H1 2024

Knight Frank

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Retail Investment Update

Competition Heating Up

RETAIL INVESTMENT AT A GLANCE

Retail Warehousing

- Strong demand across the board but particularly robust for prime assets. Most UK institutions have had active requirements since the turn of the year and pricing is now under pressure.
- Low availability of stock is holding back deal volumes and competition is hot for prime assets.

Foodstores

- Broad demand but some of the greatest price variance ever witnessed between covenants.
- Investment volumes have normalised (following the bumper year of sale and leasebacks in 2023) and are in line with the 10 year average at £680m.

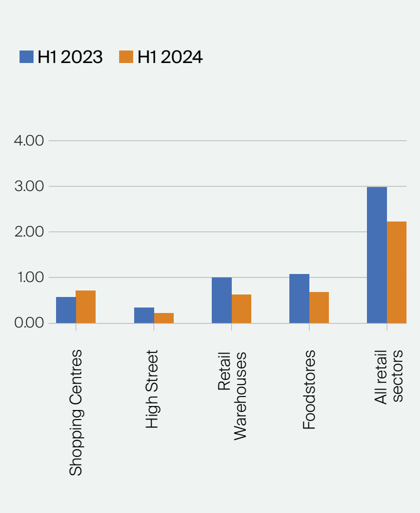
Shopping Centres

- Pool of buyers is the deepest and liquidity approaching the best it has been for the past five years with a handful of REITs and institutions back in the prime arena.
- Mainstream finance (selectively) available once more with NatWest and Lloyds providing new loans on prime assets.

High Street

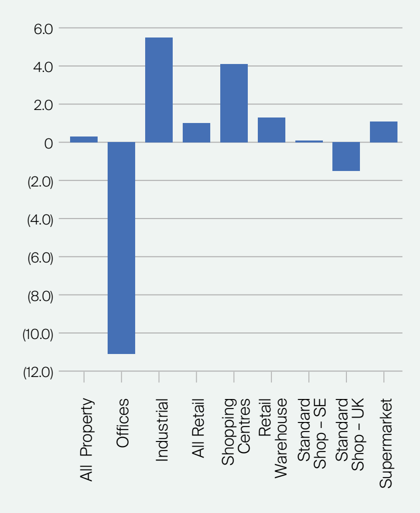
- Prime yields have stabilised at 7.00% and we are seeing signs of downwards pressure with competitive bids processes driving pricing.
- Investment volumes underwhelm at £230m, 60% below the 10 year average, principally driven by low availability of bigger lots.

H1 2023 vs H1 2024 Transaction Volumes (£bn)



H1 2024 Transaction Volumes (£m)

Total Returns, by sector 12 months to April 2024



The Retail Investment market has had a slow start to 2024, with deal volumes totalling £2.23bn, down from £2.89bn at the same point last year and the 10 year average of £3.65bn. Whilst these transaction volumes are disappointing, the tide is turning and, for the first time in a long time, this is driven by a lack of stock rather than a lack of buyers.

Key Transactions - 2024

Property	Sector	Purchaser	Vendor	Price	NIY %
The Phoenix Centre, Corby	Retail Warehousing	Columbia Threadneedle	Peel L&P*	£26,000,000	7.49%
Birstall Shopping Park, Leeds	Retail Warehousing	Realty	L&G	£60,000,000	8.40%
Southampton Road Retail Park, Salisbury	Retail Warehousing	British Land	Lothbury	£22,770,000	7.70%
Tesco, Bromley by Bow, London	Foodstore	Newcore Capital	British Land	£30,000,000	4.50%
Morrisons, Aldershot	Foodstore	Private Overseas	British Steel	£22,250,000	9.60%
Tesco, Yarrow Road, Poole	Foodstore	L&G	Natwest Pensions Trustees Ltd (abrdn)	£46,100,000	7.75%
118/121 High Street, Winchester	High Street	CBRE IM	Private PropCo	£8,250,000	7.80%
41/43 St Peters Street, St Albans	High Street	CBRE IM	Private Investor	£1,650,000	6.85%
34-36 & 50-56 Buchanan Street, Glasgow	High Street	London & Cambridge	Lothian Pension Fund	£20,600,000	6.12%
Meadowhall, Sheffield (50%) - Exchanged	Shopping Centre	Norges	British Land	£363,000,000	8.00%
Union Square, Aberdeen	Shopping Centre	Hammerson	Lonestar	£111,000,000	12.70%
West 12, Shepherds Bush, London	Shopping Centre	Landsec*	Private Investor	£58,500,000	6.50%

*Advised by Knight Frank

REVIEW OF THE YEAR

Occupational

- After a protracted period of rent rebasing and portfolio rightsizing, retail occupier markets have achieved a state of relative stabilisation. Indeed, many retailers are back on the expansion trail, but on a highly measured and selective basis. Accordingly, retail vacancy rates are trending downwards, albeit at a very slow rate (15.3% at H1 2024).
- An apparent uptick in occupier distress belies this general stability. According to the Centre for Retail Research, the number of operators and stores affected by CVA/administration last year was at its lowest level since 2015 (61 and 971 respectively). In 2024 YTD, the corresponding figures are 12 and 318, these figures inflated by distress at retailers such The Body Shop, Ted Baker and Lloyds Pharmacy.
- Knight Frank's proprietary Retailer Watchlist has now been fully reviewed and updated. Of the Top 300 UK retailers covered (ranked by turnover), 198 (66%) are classified as posing 'No Immediate Apparent Risk'. Some 58 (19%) are classified as 'Major Risk: severe underperformance or CVA/ administration rumoured'. But of these, 27 (9%) are online pure-players, as opposed to store-based or multi-channel operators. Time is now catching up with many loss-making online 'disruptors'.
- These metrics show considerable improvement on the 2022 iteration. In 2022, our Watchlist also identified 58 'Major Risk' operators, some of which have since come to pass e.g. Wilko's, Mackays. But the number of 'No Immediate Apparent Risk' operators was lower then at 64% vs 66% now. This reflects both 'self help' measures bearing fruit, together with general improvement in occupier market conditions.

Investment

- The consistent theme across all subsectors is a shortage of quality stock, with improving occupational dynamics and the hope of an imminent hardening in pricing encouraging owners to hold. This undersupply has generated competitive bids processes on the lion's share of our recent sales, across all the main Retail subsectors. The writing is on the wall with yield compression over H1 in the out-of-town market soon to be replicated in the in-town sectors in the second half of the year.
- MSCI Total Return forecasts for the year are appealing at 8.0% for Retail. This elevated return (compared to All Property at 5.8%, Offices at 0.7% and Industrial at 8.4%) is attracting a diverse range of investors into the Retail sector. Whilst total deal volumes for H1 are disappointing, for the first time in five years, this is driven by a lack of stock rather than a lack of buyers and we are tracking more live Retail requirements than at any point since the start of the pandemic.

Retail Warehousing

- The Retail Warehousing subsector's occupational dynamics are driving investor demand, with rents having been slashed during the pandemic, limited new stock being built and changing tenant preferences. Total vacancy across all markets is now <4% and with more occupiers seeking out-of-town formats, there is genuine upwards pressure on rents.

- Deal volumes for H1 2024 are a modest £620m, down some -38% on H1 2023 and -54% down on the 10 year average (£2.70bn – full year) at the half year point. A lack of sellers, rather than a shortage of buyers, is the reason for the drop in transactions. This dearth of stock is heightening competitive tension and putting downwards pressure on yields. We have witnessed 25bps inward yield shift over H1 and we expect further improvement as the year progresses and the weight of money grows.

- It is hard to find an institutional investor who does not have a Retail Warehousing requirement. However, these groups are typically focussed on similar core product in London, the South East and select prime centres and availability of such stock is low. The recent sale of Tandem Centre, Colliers Wood (q. £56.1m / 6.50% NIY – Knight Frank advised the purchaser, Abrdn) and marketing of Lombardy Shopping Park, Hayes (q. £54m / 6.00% NIY) are understood to have generated significant institutional interest.

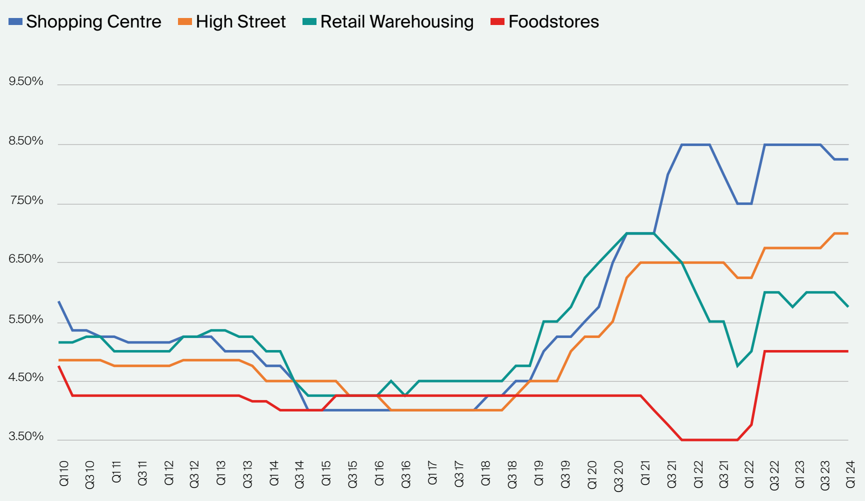
- Transaction volumes are principally held up by activity in the mid-market, which continues to be dominated by Realty Income Corporation, British Land and Columbia Threadneedle, with each completing a sizeable deal in the first half, as noted in the adjoining transactions schedule. The secondary market remains the hunting ground of UK property companies seeking slightly higher yields.

Foodstores

- It was inevitable that Foodstore investment volumes would not keep pace with their record performance in 2023, given the extensive, big-ticket portfolio activity we saw last year. Volumes for H1 2024 at £680m are comparable with the 10 year average (£1.39bn – full year) at the half year point, with 23 deals completing, but down -37% on H1 2023. Hardly surprising when in H1 2023 portfolios alone totalled £737m and H1 2024 portfolio activity was just £200m.

- Demand for Foodstores is broad and liquidity high, with very few assets "unsold" over H1. However, we are witnessing some of the greatest price variance for covenants seen for some time. Private equity acquisitions of ASDA and Morrisons (and a subsequent upscaling of TDR Capital's ownership in the case of ASDA) have softened investor's pricing requirements for their income and, in certain circumstances, weaker trading stores in oversupplied towns, the yields on offer can almost reach double digits.

Prime Retail Yields



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High Street

- Whilst prime High Street yields are currently 7.00% NIY, we have seen this bettered on fully rebased, small lot size assets in top tier centres. 41/43 St Peters Street, St Albans traded at £1.65m / 6.85% NIY and 3-4 Market Hill, Cambridge is understood to be under offer better than the asking price of £2.82m / 6.50% NIY. Both sales attracted competitive bidding multiple bids received. The tide is undoubtedly turning and prime yields are forecast to tighten by yearend.

- There are few investors buying "the market" and repeat purchasers are rare. Buyers are typically well capitalised private investors and property companies, often with a geographical bias, and often hard to unearth without a full marketing campaign. As a result, it is hard to advocate an "off market" disposal unless a material price premium is offered.

REIT Share Price Tracker

	Landsec	British Land	Hammerson	NewRiver	Capital & Regional	Supermarket Income REIT	London Metric
Latest Share Price (p)	622.50	411.60	28.30	74.10	61.00	72.30	194.90
H1 2024 Movement	-12%	+4%	+1%	-6%	+5%	-16%	+3%
EPRA NTA per share (p)*	859.00	562.00	51.00	115.00	88.00	88.00	191.70
Premium to NTA	-28%	-27%	-45%	-36%	-31%	-18%	2%

*Latest available published NAV per share

- Whilst High Street shop buyers remain predominantly private capital backed, select institutions have active requirements for large, prime blocks, as evidenced by Lothian Pension Fund's acquisition of 34-36 & 50-56 Buchanan Street, Glasgow for £20.6m / 6.12% NIY and the Institutional demand witnessed during our marketing of Exchange Buildings, Birmingham (q. £25.65m / 8.00% NIY). Provided blocks of sufficient scale and quality are marketed, we expect to see more institutional activity in the remainder of the year, as the appeal of higher income return prevails.

Shopping Centres

- In our recent React News articles – UK shopping centres: where did it all go wrong? and A changing of the guard – we flagged the value erosion seen in the Shopping Centre market since the GFC. Buyer profiles have evolved from principally Institutions in the 2000s, to the debt-backed private equity boom in the 2010's, and more recently councils and private investors/private property companies in the 2020's. That said, the REITs and institutions are selectively active in the prime arena, completing £470m since 2021, and approximately a further £590m is known to be under offer/exchanged. This includes Centre:MK, Milton Keynes (£150 million), Meadowhall, Sheffield (£363 million), Landsec's acquisition of a further 17.5% in Bluewater (£120m) and, perhaps most surprisingly, the Legal & General Managed Fund's acquisition of The Beacon, Eastbourne (£60m / 12.00% NIY), demonstrating demand from this group is growing.

- The pool of buyers for Shopping Centres is now the deepest it has been for the past five years. Recent sales processes in Horsham, Doncaster and Exeter all gathered multiple offers, with genuine competitive tension among the top bidders. It is too soon to say we are seeing pricing improvement but liquidity is strong and the chances of successfully disposing of challenging assets is the highest it has been for some time.

- We estimate 75% of shopping centres are held by unwilling owners (by this we mean lenders that have been forced to take possession and funds reaching end of life), yet availability of stock is low. Whilst asset specific, these groups are finding occupational improvement, NOI is stabilising/growing and, with a reduction in Base Rates anticipated, they are choosing to wait for investment market recovery.

- High Street Banks have begun to lend to the Shopping Centre sector again. Notably NatWest provided finance to Lonestar's purchase of Union Square, Aberdeen (£111m / 12.70% NIY) and Lloyds recapitalised four former intu schemes (Lakeside, Watford, Nottingham and Braehead) for £395m at 46% LTV. A reduction in margins to 300bps (alongside a corresponding movement in reference rates) could entice private equity investors back into the market sparking renewed demand for larger lot size investments.

Leisure

- Cinema-anchored leisure assets are the thorn in the side of what has otherwise been favourable selling conditions in the Retail subsectors in H1. The only notable trades were Nuveen's sale of Omni, Edinburgh to Triple B International (£64m / 8.15%) and our sale of Odeon, Brighton to a local developer (£8.5m / 1.35% NIY). Despite the high yields on offer – Odeon, Hudderfield is currently on the market quoting £5.87m / 20.00% and offering 14.5 years unexpired and annual RPI reviews (C&C 1%-5%) – investors would seemingly rather watch from the sidelines whilst the operators' restructuring options play out. Fortune may favour the brave with astute private capital starting to circle this space.

KNIGHT FRANK OUTLOOK

2024 Macro-economics – upgrades virtually all round

- Only a brave person (or a fool) revisits previous forecasts. But a nettle we are happy to grasp as we update the macro-economic predictions we made at the end of 2023. Relatively minor revisions generally, but significantly, much more on the upside than on the downside (previous predictions in parantheses).

- The UK economy generally fared better than expected in H1, prompting an upgrade to forecast growth in GDP in 2024 to +0.9% (+0.4%). Easing of inflation has been slightly slower than our expectations, with RPI down to 3.0% by May and 3.7% (3.1%) on an annualised basis. The General Election dashed hopes of any reductions in interest rates before August 2024 – two cuts are still on the cards and rates are likely to be around 4.75% (4.75%) at 2024 year-end.

- As predicted, retail sales performance has been very erratic YTD, rather than stage a straight-line recovery. We maintain our prediction that retail sales value (exc fuel) growth will decelerate to +3.5% in 2024 from ca. +5.5% in 2023. This will be in line with both long term (30 year) and 10 year averages of +3.5%. Retail sales volumes (exc fuel) will return to positive but marginal growth (+0.5% vs -2.5% in 2023). Volume growth in food achieved as expected in H1 2024, in non-food achieved earlier than expected (March), but not sustained. Consumer demand to remain highly volatile in H2 2024.

2024 Property Prospects – significant upside revision

- All Retail is now forecast to achieve total returns of 8.0% (6.5%) in 2024, a significant improvement on the 2023 outturn of just 0.9%. Half-year upgrades across all retail sub-sectors – retail warehouses 9.6% (8.8%), shopping centres 7.2% (5.9%), foodstores 6.5% (5.7%) and standard shops 6.7% (5.6%). Upward revisions reflective of both an improving macro-economic backcloth and more positive sentiment towards retail generally.

- Improved total returns will be driven more by a +5.6% income return as expected (+5.5%), but with an upgrade also to capital growth projections of +2.2% (+1.0%). The capital value growth picture remains mixed across the retail sub-sectors, with retail warehouses still at one extreme of +3.2% (+2.5%), but shopping centres seeing the most dramatic revision at +0.6% (-0.6%).

- A marginal mark-up in rental growth expectations to +0.7% (+0.4%) for 2024. Slight tempering of rental growth expectations in Central London of +1.6% (+2.1%) but still outpacing standard shops generally at +1.3% (+0.7%) and there remains something of a polarity between retail warehouses at +1.3% (+1.0%) and shopping centres at -1.1% (-0.3%). As previously noted, rental growth remains patchy and restricted to certain assets.

Longer Term Prospects – still on track

- Annual average total returns between 2024 and 2028 are forecast to be 7.8% (7.0%), with four year annual average capital increases of +2.2% (+1.5%). Retail's annual total returns over the four year period will be higher than Office's 7.3% (6.5%) and on a par with Industrial's 7.8% (7.5%).

- Underlying rental growth will continue but will remain anaemic at +1.2% p.a. 2024 – 2028 (+0.8%). Central London retail will be the main outlier to this +2.2% (+2.3%), with retail warehousing also outperforming the wider retail market +1.4% (+1.1%).

- Retail's income return credentials remain undiminished. Annual average income returns between 2024 and 2028 are still forecast to be 5.4% (5.4%), higher than offices 5.2% (5.3%) and industrial 4.5% (4.5%).

- We were cautiously optimistic coming into 2023. We remain so entering H2 2024 but are generally slightly more upbeat. Investment markets will remain more sensitive to interest rate movements than the outcome of the General Election and consumer markets will be more slave to the weather than any economic metric or political movement.

Sources: Knight Frank, Oxford Economics, Experian, Real Estate Forecasting

KNIGHT FRANK DEALS

A selection of our recent transactions are shown below. Thank you to all of our clients who have worked with us.

86-90 Promenade, Cheltenham

Tenure: Freehold
Client: Private Investor
Price: £4,600,000
NIY: 10.83%

Galaxy Portfolio (4 Secondary Shopping Centres)

Tenure: Freehold / Long Leasehold
Client: AEW / Mars Pension Fund
Price: £22,700,000
NIY: 15.60%

Springvale Retail Park, Orpington

Tenure: Freehold
Client: NFU Mutual
Price: £44,800,000
NIY: 7.33%

The Phoenix Centre, Corby

Tenure: Freehold
Client: Peel L&P
Price: £26,000,000
NIY: 7.49%

ASDA, Aylesbury

Tenure: Freehold
Client: Wesleyan Assurance Society
Price: £8,075,000
NIY: 6.08%

West 12, Shepherds Bush

Tenure: Freehold
Client: Landsec
Price: £58,500,000
NIY: 6.50%

Morrisons, Brentford

Tenure: Long Leasehold
Client: Ballymore
Price: £10,100,000
NIY: 6.50%

Crowngate, Worcester

Tenure: Freehold
Client: The Crown Estate
Price: £6,500,000
NIY: 3.50%

Odeon, Brighton

Tenure: Freehold
Client: Abrdn
Price: £8,500,000
NIY: 1.35%

Tandem Centre, Colliers Wood

Tenure: Freehold
Client: Abrdn
Price: £56,100,000 (quoting)
NIY: 6.50% (quoting)

B&Q, Milton Keynes

Tenure: Freehold
Client: The Duchy of Cornwall
Price: £29,050,000
NIY: 7.10%

"Knight Frank are highly active across all of the retail sub-sectors, with specialists focused on each market.

Please do not hesitate to get in touch if we can assist with your Retail Investments."

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