H2 2022

Retail Investment Update

A game of two halves

knightfrank.com/research

RETAIL INVESTMENT AT A GLANCE...

Retail Warehousing

- By far the best performing of any of the traditional real estate sectors with total return of 11% forecast for 2022 (MSCI), driven by excellent capital growth and robust income return.
- Appetite remains strong but buyer/seller pricing aspirations have momentarily diverged, with yields moving out by 100bps to 5.75% for the best quality stock.

Foodstores

- A swift correction, partially as a result of demand driving yields to record lows last year, is underway as pricing moves out to compensate for a higher interest rate environment.
- Uncharacteristically low deal volumes in Q4 of just £50m has left investors questioning where to price this subsector. We expect yields to settle at 5.00% in the short term.

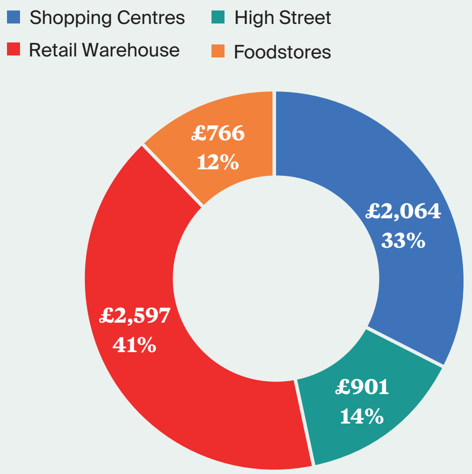
Shopping Centres

- A buoyant start to the year, with equity investors returning to the market and prime yields coming in to 7.50%, has since given way to another slowdown.
- Demand continues to remain regionally diverse and the absence of accretive debt financing is holding back demand for larger assets.

High Street

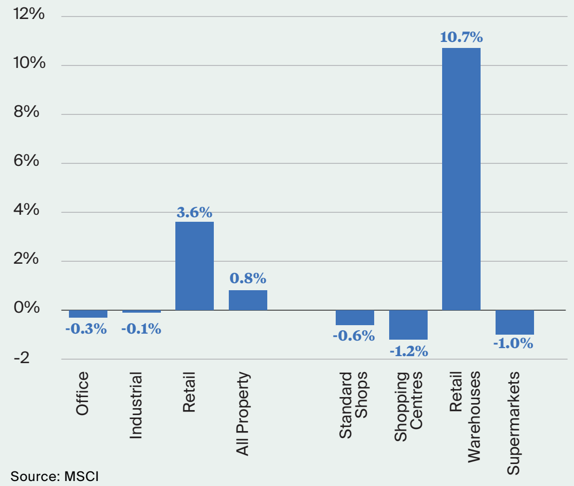
- Institutions continue to dominate the sales lists with a move to further down weight the retail components of their portfolios.
- Demand, principally originating from Prop Co's and UK/overseas Private investors, remains focussed on smaller opportunities in better quality South East centres, and some regional cities.

Transaction Volumes FY 2022 (projected) (£m)



Source: Knight Frank

Commercial Property Total Returns 2022f



Source: MSCI

2022 was a game of two halves. Strong appetite propelled deal volumes to £3.58BN for H1 (up 11% on the same period for 2021), but economic headwinds proved too strong in H2, suppressing deal volumes to £2.75BN (down 33% on 2021). Despite this, Total Returns for all Retail sectors are set to be the highest of any of the traditional commercial sectors (albeit driven largely by the Retail Warehouse market).

Key Transactions - 2022

Property	Sector	Purchaser	Vendor	Price	NIY %
The Zebra Portfolio	Retail Warehousing	Realty Income Corporation	Frasers Group	£205.0m	6.25%
The Bullring, Birmingham (33%)	Shopping Centres	CPPIB	Nuveen	£155.0m	7.50%
Willow Brook Centre, Bradley Stoke	Retail Warehousing/ Foodstore	Supermarket Income REIT	CBRE Investment Management	£84.0m	5.60%
Tesco, Trostre Road, Llanelli	Foodstore	Supermarket Income REIT	M&G Real Estate	£66.4m	5.30%
The Mall, Blackburn	Shopping Centres	Adhan Group	Capital & Regional*	£40.0m	11.50%
Corn Exchange, Manchester	Leisure	Private Investor	Aviva Investors	£38.0m	8.20%
80 George Street, Richmond	High Street	Sheen Lane Developments	Private Investor	£28.0m	£350 psf
Broadbridge Health Retail Park Horsham	Retail Warehousing	Knight Frank Investment Management	Delancey	£27.9m	4.70%
86-92 George Street, Edinburgh	High Street	Broadland Properties Limited	CBRE Investment Management*	£15.3m	6.21%
Central Exchange, Newcastle	High Street	Motcomb Estates	Royal London	£12.7m	7.10%

*Advised by Knight Frank

REVIEW OF THE YEAR

- It feels difficult now to remember the buoyancy we witnessed through the first half of 2022, where deal volumes and pricing in all of the retail subsectors were improving for the first time since 2013. A weight of capital was finding its way into the real estate markets, investors were attracted to the relative discount on offer in retail compared against other sectors and appetite for Foodstores and Retail Warehousing was red hot.
- With the arrival of summer, the markets began to cool with concerns over the gradual unwinding of the huge government economic support through the covid pandemic and rising cost of energy, fuelled by the war in Ukraine. Base Rate increases and rising Gilt yields began to impact the cost of debt, with swap rates moving out from a previously stable 1% and pricing softening to account for this.
- What followed was anything but gradual, with a surprise budget sprung by the Truss Government unwinding all of this positivity and value recovery in one fell swoop and creating turmoil across all of the investment markets. No sector was left unscathed, with those achieving the keenest pricing (namely Logistics, Foodstores, Long Income alternatives and Retail Warehousing) feeling the greatest effect, and a contagion spreading through the rest of the market.
- Occupationally, the predicted (and much reported) "consumer squeeze" has begun to bite into some of the retail sectors, but its impact has been slower to take hold than anticipated. Indeed, the consumer appeared resilient and keen to continue spending until Q4 but it is clear now that monthly sales volumes are receding from 2021 levels (-6.4% in September and -6.4% in October) and value growth is being driven by inflationary pressures.
- Occupier fall out is inevitable (notably Joules and McColls to date) and we expect most tenants will look to restructure portfolios with more vigour than expected earlier in the year. Most new lettings are being heavily scrutinised once again and renewals are being conducted with even greater emphasis on cost reduction.
- Pure-play, online retailing will not be left unscathed, with the recent acquisition of Made.com out of administration by Next (for just £3.4M, only a year after it was floated for £775M) and profit warnings from Boohoo, Asos, AO.com and Ocado, amongst others, a sign of things to come.
- The Retail Warehousing sector is perhaps the only Retail subsector continuing to show robust underlying occupational tension in most geographies. This, coupled with its excellent performance through the year (by far the strongest of any real estate sector) and relative simplicity/ flexibility, means that any cooling of demand will be short-lived. Having said that, scale continues to deter investors evidenced by the withdrawn Boxplus (£300M) and Peacock (£260M) portfolios, which both fell away over the summer. Whilst unlikely to return to pricing at <5% NIY in the first half

of the year, we expect institutional buyers to return to this popular sector early in the New Year, reversing the outward movement in yields that we have momentarily experienced. Early signs suggest this process is already underway with Purley Cross Retail Park, Croydon believed to be under offer to a UK Fund at c.£56M / 5.75% NIY.

- Shopping Centres have been discounted yet again, following significant rebasing of rents and values since the GFC, EU Referendum, Brexit, covid and again at the hands of the “Mini Budget” (with very little value recovery in the meantime). There must now be an argument that well-located, fit-for-purpose investments (namely true convenience or destinational, “day-out” assets) at appropriate yields make an attractive investment case. We witnessed the return of quasi-institutional, equity buyers to the market during the first half of the year, and multiple competitive sales processes, but the recent economic turmoil suggests that they are unlikely to return in early 2023. The continued absence of accretive debt financing will restrict most sales to <£30M and also limit the return of leveraged Private Equity buyers to the market for now. Demand remains regionally diverse with a host of UK and overseas Prop Co’s making countercyclical plays by targeting sellers in distress and properties showing deep discounts to long term value.

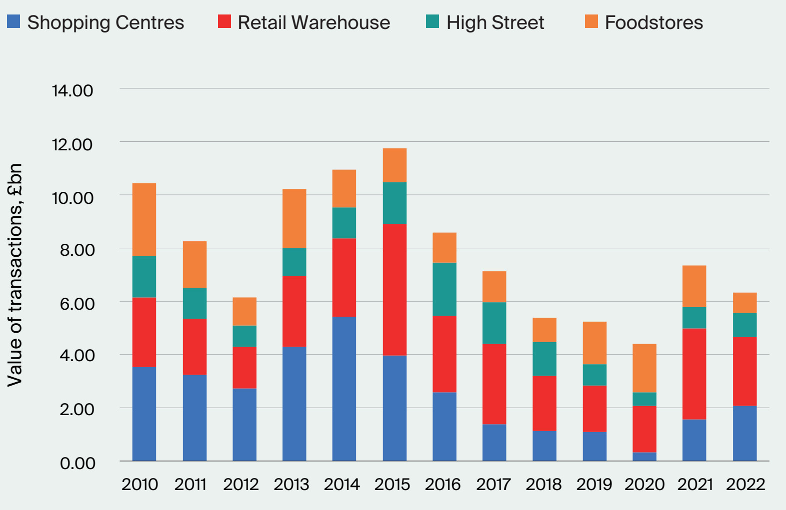
- One bright spot remains the Outlet market, which has seen quite reasonable demand from lower cost of capital domestic and overseas buyers this year. The sale of Cheshire Oaks and Swindon to LaSalle at £600M / 6.00% NIY evidenced this and LandSec’s disposal of J32, Castleford (quoting £55M / 8.00% NIY) will test this market again, potentially signalling further sales in this space. Leases affording transparency of trade and the ability to cultivate an appropriate tenant mix continue to appeal to these buyers, especially in the face of potential occupational uncertainty in the short term.

- Single and multi-let properties on the High Street remain on the sales list for most institutions (as evidenced by the floating of the Argon portfolio from the Shell Pension Fund at £68M / 8.60% NIY) but their principal appeals should not be overlooked. Their relative simplicity, low management and now elevated yields mean that a host of Private and Prop Co investors are scouring the market seeking these opportunities. We expect this space to appeal to investors seeking to tentatively increase their Retail weightings next year, increasing the share of High Street retail investment from £900M, just 14% of total retail deal volumes this year.

- Demand for Leisure assets, particularly those anchored by cinemas, has cooled due to meaningful covenant concerns over large parts of the market, particularly in light of the “consumer squeeze”. The ongoing Chapter 11 process at the Cineworld parent company has sparked fears of the financial viability of other debt-laden cinema chains. Having said that, we do expect better located and well-let Leisure investments to continue to appeal (such as Corn Exchange, Manchester, sold at £38M / 8.20% NIY) but others may fall out of fashion if new concepts fail to bed in. Their relative scarcity means that deal volumes, which had been low already, will remain suppressed whilst this occupational uncertainty persists.

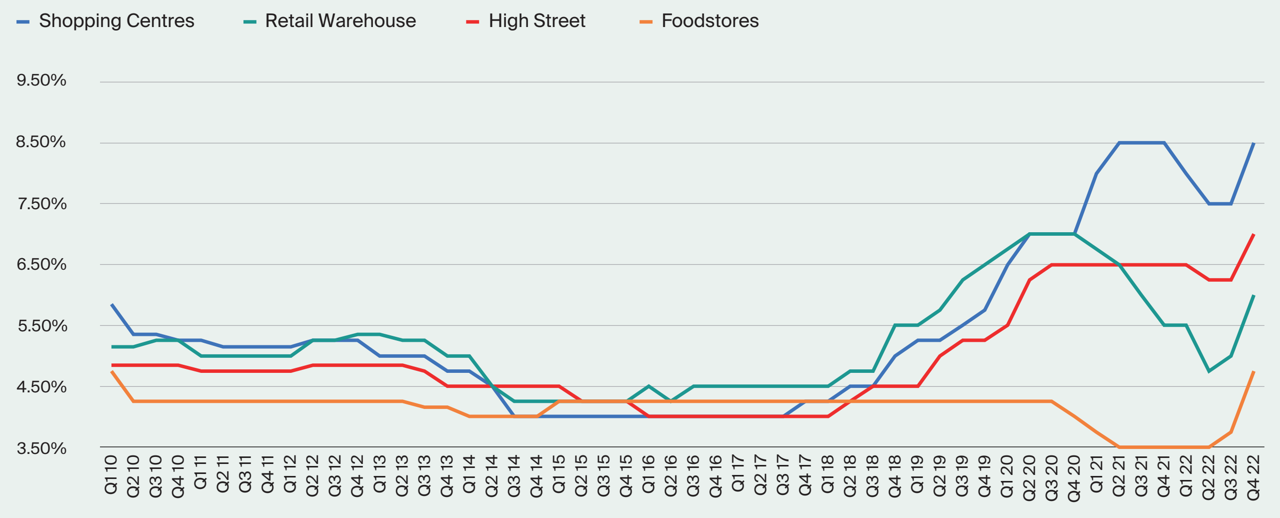
- A global repricing of real estate assets is now underway, to which all sectors will need to adjust. Those where conviction is strongest and macro-economic trends are most supportive will recalibrate quickly. Others, where there are greater underlying concerns, will take more time to stabilise. With deal volumes for the second half of the year estimated to total £2.75BN (down 33% on H2 2021) we expect the close to the year to be more akin to the end of 2020, where a few cautious investors push deals over the line, but most sit on the side lines waiting for better clarity over what is to come in 2023.

Transaction Volumes FY 2022 (projected)



Source: Knight Frank

Prime Retail Yields



Source: Knight Frank

KNIGHT FRANK OUTLOOK...

- The after-effects of a disastrous Q4 will be felt into the early New Year, particularly as fears over a protracted recession and “consumer squeeze” play on investors’ minds.

- Winners to be separated from losers once again as discerning shoppers focus on relevant assets, be that those that are omni-channel-enabled or serving a true convenience or experiential purpose.

- Greatest distress to exhibit itself amongst the pure-play/online retailers, with further administration activity expected. Weaker physical retailers will not be immune with more consolidation or restructuring activity to come next year.

- A swifter stabilisation will occur in the Retail Warehousing and Foodstore markets, due to their stronger underlying occupational dynamics – yields in both sectors could reduce by 50bps by the end of Q1 2023.

- Further discounting in the Shopping Centre sector is likely – whilst yields appear to have moved out far enough (yet again), NOI could come under more pressure with further occupational instability.

- The appeal of higher yielding, low management High Street assets let to strong covenants will improve through the year if pricing corrects swiftly in keener sectors.

- Elevated debt costs to hold back pricing for secondary assets but availability of debt to improve for better quality assets in the short-medium term.

REIT Share Price Tracker

	Landsec	British Land	Hammerson	NewRiver	Capital & Regional	Supermarket Income REIT	London Metric
Latest Share Price (p)	616.00	393.00	24.00	79.00	49.00	104.00	178.00
H2 2022 Movement	-18%	-24%	-30%	-19%	-8%	-14%	-35%
NAV per share (p)*	1010.00	695.00	62.00	134.00	118.00	115.00	229.30
Premium to NAV	-39%	-43%	-61%	-41%	-58%	-10%	-22%

*Latest available published NAV per share

KNIGHT FRANK DEALS

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

The High Parade Streatham, London

Tenure: Freehold
Client: Acquisition on behalf of Criterion Capital
Price: £7,400,000
NIY: 8.66%

59/61 & 63/65 Northumberland Street, Newcastle

Tenure: Freehold
Client: Disposal on behalf of NFU Mutual
Price: £2,800,000
NIY: 6.44%

86-92 George St & 72-74 Rose Street North Lane, Edinburgh

Tenure: Freehold
Client: Disposal on behalf of CBRE Investment Management
Price: £15,250,000
NIY: 6.21%

Lidl, Redditch

Tenure: Freehold
Client: Acquisition on behalf of US Realty
Price: £6,400,000
NIY: 4.25%

Sainsbury's, Park Hill Road, Garstang, Preston

Tenure: Freehold
Client: Acquisition on behalf of CBRE Investment Management
Price: £10,000,000
NIY: 4.50%

The Mall, Blackburn

Tenure: Leasehold
Client: Disposal on behalf of Capital & Regional
Price: £40,000,000
NIY: 11.50%

Broad Street Mall, Reading

Tenure: Freehold
Client: Disposal on behalf of Moorgarth Group & Texton Property Fund Ltd
Price: £57,500,000
NIY: 7.10%

Clifton Moor Retail Park, York

Tenure: Freehold
Client: Acquisition on behalf of Melford Capital Partners
Price: £32,600,000
NIY: 7.61%

50% of Deepdale, Preston

Tenure: Freehold
Client: Acquisition on behalf of Melford Capital Partners
Price: £30,300,000
NIY: 9.00%

Victoria Quarter, Leeds

Tenure: Freehold
Client: Acquisition on behalf of Redical / Rivington Hark
Price: £120,000,000
NIY: 8.00%

"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."

CONTACTS

Charlie Barke
charlie.barke@knightfrank.com

Dominic Walton
dominic.walton@knightfrank.com

Alastair Bird
alastair.bird@knightfrank.com

David Willis
david.willis@knightfrank.com

Will Lund
will.lund@knightfrank.com

Daniel Serfontein
daniel.serfontein@knightfrank.com

Sam Waterworth
sam.waterworth@knightfrank.com

Freddie MacColl
freddie.maccoll@knightfrank.com

Lizzie Mason-Jones
lizzie mason-jones@knightfrank.com

Ross Needham
ross.needham@knightfrank.com

Josh Roberts
josh.roberts@knightfrank.com

Emily McInnes
emily.mcinnes@knightfrank.com

James Mohsen
james.mohsen@knightfrank.com

Marina Campbell
marina.campbell@knightfrank.com

Alex Jimenez
alex.jimenez@knightfrank.com

Confidential Considered Advice

Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.