H2 2023

Retail Investment Update

Defrosting the Retail Deep Freeze

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RETAIL INVESTMENT AT A GLANCE

Retail Warehousing

- There is no shortage of demand for this high-performing subsector but the “bid-ask” spread has widened given the disparity between vendor valuations and market pricing. Deal volumes have been subdued as a result and will remain so until one or both sides move.
- A small handful of UK funds and international investors continue to invest through this period, notably Realty Income Corporation who have added to their already significant Retail Warehouse portfolio.

Foodstores

- Record deal volumes are skewed by a handful of portfolio deals, including large sales of Asda, Morrisons, Sainsbury’s and Waitrose investments (primarily through sale & leasebacks).
- Outside of these larger deals, there remains strong interest from institutional and specialist investors but the rising cost of capital for most of these groups means most need to see yields of 6.00%+.
- The subsector remains extremely popular and there continues to be a sense of scarcity of stock, outside of these large sale & leaseback packages.

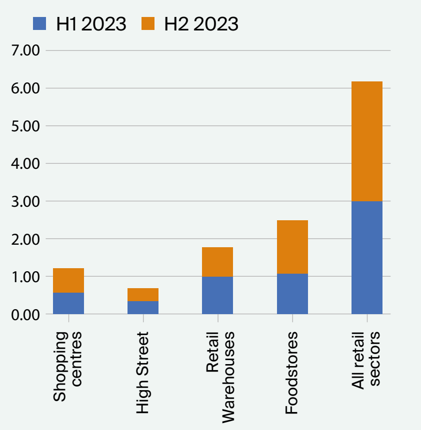
Shopping Centres

- Larger, destinational assets are outperforming the market, soaking up occupier demand and consumer spend mostly at the expense of weaker, non-dominant schemes.
- Demand is limited to a handful of experienced investors targeting prime, regional assets and a number of opportunists seeking smaller local, convenience centres.
- The elevated cost of finance has frozen out most private equity investors and most transactions are taking place “all cash”, limiting ticket sizes and therefore overall deal volumes.

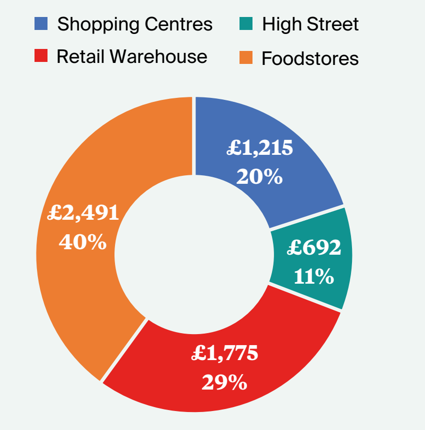
High Street

- Demand is strongest in the London “villages” as well as Oxford, Cambridge and a handful of major cities where strong supply/demand dynamics and rebased rents are driving yields into the 6.00%s.
- Where assets are multi-let, or exposed to weaker covenants, there remains a sizeable discount from these better let investments.
- Buyers are typically opportunistic private investors or smaller prop co’s, both domestic and overseas.

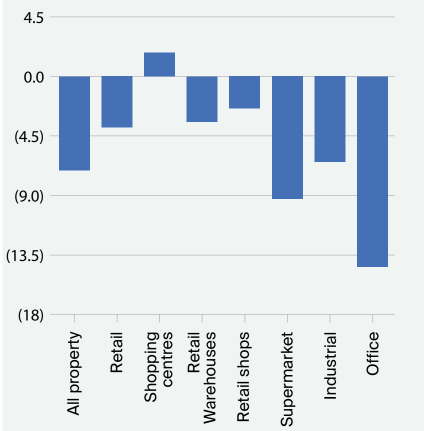
H1 2023 vs H2 2023 Transaction Volumes



H1 2023 Transaction Volumes (£m)



Total Returns 12 months to October 2023



This has been a challenging year for real estate with commercial investment volumes forecast to be down around 50%. However, with Retail volumes totaling £6.17 billion, the sector is an outperformer with investment activity only 2% below FY 2022 and MSCI Total Returns of -4.3% vs All Property at -7.9%, Industrial at -7.2% and Offices at -16.0%.

Key Transactions - 2023

Property	Sector	Purchaser	Vendor	Price	NIY %
Bath Road Retail Park, Slough	Retail Warehousing	Segro*	RLAM	£120,000,000	-
Craigleith Retail Park, Edinburgh	Retail Warehousing	Realty Income Corporation	Nuveen	£65,000,000	7.50%
Purley Cross Retail Park, Croydon	Retail Warehousing	DTZ Investors	Oval	£59,000,000	5.50%
Westwood & Westwood Gateway Retail Parks, Thanet	Retail Warehousing	British Land*	Receivers	£54,500,000	8.20%
Asda Sale & Leaseback Portfolio	Foodstore	Realty Income Corporation	Asda	£650,000,000	c.7.00%
4M Portfolio (Morrisons)	Foodstore	PIMCO	M&G	£118,400,000	6.25%
Sainsbury's, 31-41 Liverpool Rd, Islington	Foodstore	DTZ Investors*	Lothbury	£56,250,000	4.45%
Tesco, Mill Wood Drive, Worcester	Foodstore	Supermarket Income REIT	British Steel	£38,300,000	6.00%
16-18 Market Street & 7-11 Rose Crescent, Cambridge	High Street	Gonville & Caius College	CBREIM	£20,700,000	6.10%
7-19 Amhurst Road, Hackney	High Street	Brydell Partners*	Oval	£12,200,000	6.85%
38-46 Church Street, Liverpool	High Street	Private Overseas Investor	NFU Mutual*	£8,800,000	8.00%
60-62 & 64 Buchanan Street, Glasgow	High Street	Greenridge*	LaSalle Investment Management	£7,900,000	7.85%
Churchill Square, Brighton	Shopping Centre	Ingka	Abrdn*	£143,000,000	9.00%
St David's, Cardiff (50%)	Shopping Centre	Landsec	Lenders to intu	£113,000,000	9.70%
The Mall, Luton	Shopping Centre	Frasers	Capital & Regional*	£58,000,000	12.00%
Bentalls Shopping Centre, Kingston Upon Thames (50%)	Shopping Centre	Aviva	Gingko Tree	£57,500,000	8.00%

*Advised by Knight Frank

REVIEW OF THE YEAR

Occupational

- Investor confidence in the retail occupational outlook is returning to pre-pandemic levels. General consensus suggests that rents have bottomed out given the extensive rebasing exercise of the preceding three years and most are now buying into a stable income position (if not with the prospect of growth) for the foreseeable future.
- Overall sales values growth at +5.5% this year suggests that most retailers continue to trade well, setting a solid foundation for an improvement in the investment markets. Negative sales volume growth of -3.2% is manageable and there remains a group of high-performing occupiers in both the in-town and out of town sectors with particular resilience in the more discretionary footwear (+21% sales value growth / +15% sales volume growth), cosmetics (+11% / +3%) and furniture (+7% / +3%) categories.
- Whilst trading conditions for retailers remain more difficult than usual, we are not anticipating further widespread distress to take hold. The Wilko administration process took some by surprise and was against the run of play. Many of the affected stores were swiftly acquired by competing retailers in signs of a more resilient occupational market. Better capitalised groups such as Poundland, B&M, Dunelm and Home Bargains have taken up stores to limit the overall net loss. We provide a detailed assessment of the ongoing occupier evolution in our recently published report - Retail Renaissance 2023, The Price of Change 2.0.

Investment

- The appeal of an elevated income return is attracting a diverse range of investors into the Retail sector. Total deal volumes at £6.17 billion are only 2% below FY 2022 (although well-supported by a record year for the Foodstore subsector) but well below the 10-year average of £7.33 billion. The Retail sector is also outperforming on a total return basis (-4.3% for Retail vs -7.9% for All Property, -7.2% for Industrial and -16% for Offices, MSCI), evidencing its relative resilience.

Retail Warehousing

- Certainly, this attraction remains the case in the highly popular Retail Warehousing and Foodstore sectors where occupational dynamics (not least a shortage of new supply given build cost inflation) are stronger and an established pool of retailers have begun to expand their portfolios. A small number of active domestic and overseas institutional investors have dominated both of these markets throughout the year. Realty Income Corporation has soaked up an enormous amount of Retail Warehousing space, totalling 43% of the market, the most of any investor by far this year. Others including British Land (which, advised by Knight Frank, acquired Westwood Gateway Retail Park in Thanet at £54.5 million / 8.50% NIY), DTZ Investors and CBRE IM have made selective acquisitions and elsewhere, M&G have upscaled in Two Rivers, Staines buying the 50% share that they already own for £77.5 million / 7.25% NIY.

- Demand for Retail Warehousing investments remains strong but deal volumes, totalling £1.78 billion, have been held back this year by the gap between vendor aspirations and market pricing. There is no shortage of active investment requirements for the sector but until valuations correct to a level reflecting the new capital environment, we expect many deals to be held up.

Foodstores

- Foodstore deal volumes total a record £2.49 billion this year, largely driven by sizeable portfolios of Asda (£650 million sale & leaseback, acquired by Realty Income Corporation), Morrisons (£115 million, acquired by PIMCO), Sainsbury's (reversion portfolio at £430 million, acquired by Sainsbury's) and Waitrose (rumoured to be under offer at £130 million to M&G) superstores. Outside of these big tickets, there is still keen interest from a range of institutional and specialist investors but volumes have been held back by the rising cost of capital meaning yields need to be 6.00%+ for most investors to get comfortable.

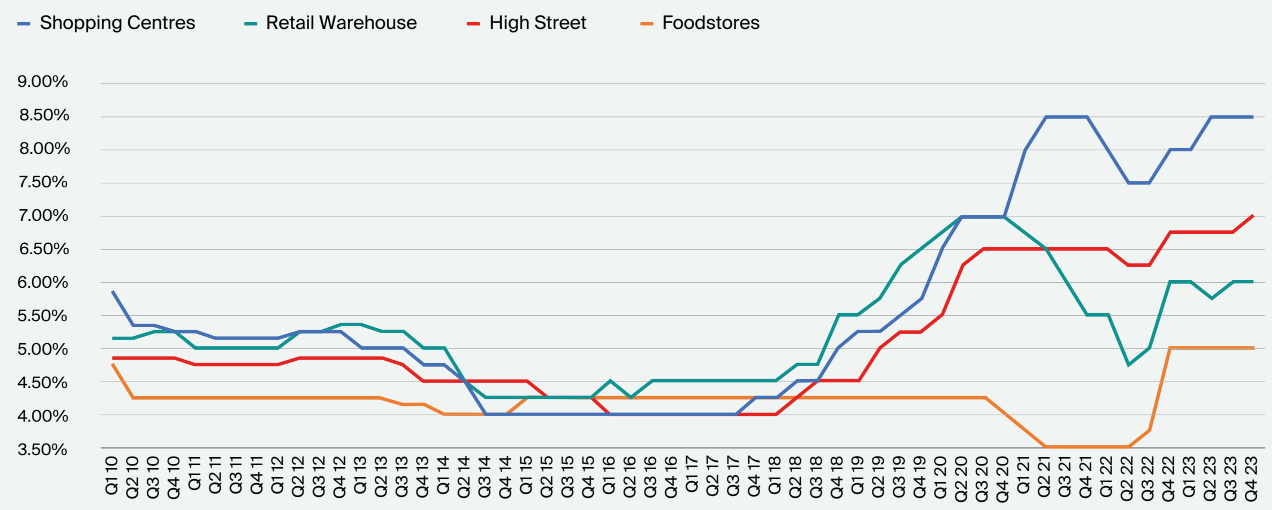
- The small number of highly successful supermarket operators in the UK creates a sense of rarity around their investments, and this, coupled with long leases, inelastic consumer demand and their lower propensity to close stores makes this a highly popular asset class. We expect funds and specialist investors to continue to stock up on Foodstore investments when these become available, as we outline in our recent report – Foodstores: a Feeding Frenzy.

High Street

- Where rents have been rebased, there remains a strong investment case for the in-town retail sectors (which are also seeing a resurgence of demand) especially given their appealing entry yields. High Street units let to robust covenants continue to receive strong interest and most processes result in multiple offers, especially those in top tier "Cathedral Cities" such as Oxford and Cambridge and the London "villages". Outside of this narrow group of towns and cities, and for more multi-let investments, yields soften as demand originates from a much smaller group of opportunist investors.

- High Street liquidity is greatest for smaller lots. A greater pool of buyers in the sub £3 million lot size arena is generating premium prices and is dominated by UK private investors, prop co's and overseas investors targeting higher returns.

Prime Retail Yields



Source: Knight Frank

REIT Share Price Tracker

	Landsec	British Land	Hammerson	NewRiver	Capital & Regional	Supermarket Income REIT	London Metric
Latest Share Price (p)	665.00	390.00	27.04	81.40	58.00	79.80	191.00
FY 2023 Movement	+4%	+13%	+11%	+3%	+%	-22%	+9%
NAV per share (p)*	893.00	565.00	52.00	122.00	106.00	93.00	229.00
Premium to NAV	-26%	-31%	-48%	-33%	-45%	-14%	-17%

*Latest available published NAV per share

Shopping Centres & Outlets

- Shopping Centre performance remains intensely polarised between larger, destinational assets and right-sized convenience centres and, at the other end of the scale, centres that are proving to be no longer fit for purpose. There is growing evidence to support this outperformance with footfall, retailer sales and leasing data showing a migration of shoppers and occupiers to bigger, better assets. With this, we have seen a number of vendors begin to test the market with larger sales. Bear in mind that yields for even the best stock in this market are now 8.00-10.00%, signalled by the completion of Abrdn's bellweather sale at Churchill Square, Brighton at £143 million / 9.00% NIY (Knight Frank advised the vendor). This relative discount against more keenly-priced sectors is the principal driver of demand in the sub sector.

- Sales at Centre:MK, Milton Keynes (50%, £150 million), Liverpool One (£350 million), Union Square, Aberdeen (£120 million) and Meadowhall, Sheffield (£850 million but with a £500 million securitisation attached to the asset so really an equity cheque of £250 million) would drastically increase the total deal volume and average lot size for 2024 if these sales are concluded. We understand there are a handful of buyers engaged in each of these processes in hopeful news for the sector.

- Aside from these larger sales, there remains an adequate market for local, convenience centres and a number of investors have taken advantage of the quieter markets to each pick up a handful of these centres. M Core (which includes LCP and Evolve Estates) has amassed a sizeable portfolio of local and district centres and other investors such as the Gluck Group, Martin Property Group and Midos have also acquired a handful of assets.

- The specialist Designer Outlet market continues to attract investor attention, with five separate transactions totalling £140.5 million this year (included within our Shopping Centre deal volume total) and two others totalling £160 million under negotiation or in the market. The top handful are all within institutional / long term ownership and are unlikely to trade in the near future. The middle section transact infrequently, creating a sense of rarity, and appeal to investors such as Patron Capital, Ares and Frasers PLC who have all made acquisitions in this space. We expect these assets to continue to appeal with further sales to come next year, albeit with the need for a discount to longer term, fixed income given the flexible nature of their occupancy

- We expect shopping centre deal volumes, totalling £1.22 billion for 2023, to remain subdued for the foreseeable future. The heightened cost of finance has proven to be prohibitive, even in the higher yielding in-town retail subsectors where there is more headroom for debt. With margins of 300-400bps over SONIA (5 year swaps currently 4.20% at the time of writing), markets that are reliant on the range of US-based private equity investors have largely ground to a halt.

Leisure

- The leisure sector is yet to get going in earnest, having been one of the most severely affected sectors during the pandemic. There remains meaningful concern in investors' minds over the future of the cinema market in the UK, especially with the Hollywood writers' and actors' strike likely to delay important profitable new releases. There are however some brighter signs in the market. Cineworld have actioned a corporate restructuring which should improve the covenant position of the business going forwards. We understand that their better performing cinemas have been moved into the UK parent Cine-UK Ltd with others being subject to rent reductions or lease variations. New equity at the corporate level has also allayed fears of imminent distress. Nuveen's sale of Omni, Edinburgh is rumoured to be under offer ahead of asking terms (£65 million / 8.00% NIY) suggesting that there are investors targeting these assets where the story is strong enough.

KNIGHT FRANK OUTLOOK

2024 Macro-economics

Improving headline macro-economics, particularly around consumer metrics (declining inflation, higher wage growth, rising confidence), but lagging effects of fiscal policy will impact spending.

- The UK economy will avoid recession but forecast growth in GDP in 2024 (+0.4%) is still expected to be slightly lower than in 2023 (+0.6%). We expect RPI inflation to ease significantly to 3.1% on an annualised basis (vs 7.4% in FY 2023). However, reductions in Base Rates are unlikely before H2 2024 at the earliest and we are anticipating rates to be elevated at around 4.75% at 2024 year-end.
- Macro and retail economies will continue to be maintained by tight employment markets – we expect to see an increase in the working population of +0.4% and labour supply rising by +0.3%, despite a moderate rise in the unemployment rate to 4.6%. Average earnings growth of +4.4% will be higher than inflation. However, the cashflow effect of tighter monetary policy will continue to build, with a further 1.5 million mortgagors due to refinance before the end of 2024.
- Declining inflation will have a pivotal effect on retail sales, rather than prompt a straight rebound. Retail sales value growth will decelerate to +3.5% in 2024 from c.+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 will return to positive but marginal growth (+0.5% vs -2.5% in 2023), spearheaded by food (Q1 2024). Non-food is unlikely to return to positive volume growth before H2 2024.

2024 Property Prospects

Positive total returns across all Retail sub-sectors in 2024 – plus a modicum of rental growth across some.

- All Retail forecast to achieve total returns of 6.5% in 2024, a significant improvement on the 2023 outturn of just 2.2%. Negative total returns in Central London shops and foodstores will be reversed in 2024 (5.7% and 5.5% respectively), with standard shops (5.6%), retail warehouses (8.8%) and shopping centres (5.9%) likewise all achieving improved returns on 2023.
- Improved total returns will be driven more by income return (+5.5%) than capital growth (+1.0%). The capital value growth picture is mixed across the retail sub-sectors, with retail warehouses at one extreme (+2.5%) and shopping centres at the other (-0.6%). The latter should see a return to positive capital growth from 2025 with yield correction possible from Q4 2024.

Longer Term Prospects

Retail to continue delivering the highest income returns of all the mainstream CRE sectors.

- Annual average total returns between 2024 and 2027 are forecast to be 7.0%, with 4 year annual average capital increases of +1.5%. Retail's annual total returns over the four year period will be higher than Offices (6.5%) and only marginally lower than Industrial (7.5%).
- Underlying rental growth will continue but will remain modest (+0.8% per annum 2024 – 2027). Central London retail will be the main outlier to this (+2.3%), with retail warehousing also outperforming the wider retail market (+1.1%).
- Income remains one of Retail's main selling points as an asset class. Annual average income returns between 2024 and 2027 are forecast to be 5.4%, higher than Offices (5.3%) and Industrial (4.5%).

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

RETAIL INVESTMENT UPDATE

Capital Markets – Knight Frank forward-looking overview

	2022 Yield	2023 Yield	2024p Yield	2022 Volumes	2023p Volumes	2024p Volumes vs 2023	2024p Volumes vs 10 Yr Averages	Key Buyers	Key Sellers	2024 Trends
High Street	6.00%	7.00%	6.50%	£0.90bn	£0.69bn	▲	▼	Private / Overseas Investors + PropCos	Institutions	Buyer pool to deepen to include retail specialists (not just opportunists)
Shopping Centre	8.00%	8.50%	8.00%	£2.06bn	£1.22bn	▲	▼	Overseas Investors, Small PropCos, PE	Any SC owner with debt + REITs and UK funds	Improving demand but very selective and reliant on debt
Retail Warehousing	5.00%	6.25%	5.75%	£2.06bn	£1.78bn	▲	▶	UK Institutions, PE Funds, REITs, PropCos, Overseas Investors	Institutions	Greater availability of stock on valuation corrections
Foodstores	3.50%	5.00%	4.75%	£2.60bn	£2.49bn	▼	▲	Specialist Funds, Institutions, Occupiers	Institutions, Occupiers	Feeding frenzy to continue and more portfolio deals possible

Source: Knight Frank

2024 Sector Predictions

A more stable economic picture will support the appeal of most Retail subsectors' relative discount to the rest of the market. Deal volumes will recover signalling the start of the next recovery period.

- **Retail Warehousing** – the popularity of this sector will prevail as institutions and specialists continue their acquisition sprees. An improvement in pricing in this market could see some existing owners move to "profit taking" and supply should increase through the year.
- **Foodstores** – the feeding frenzy will continue in one of the strongest sectors in the market. We expect to see more portfolio deals as the leveraged owners of Morrisons and Asda seek to release capital from their owned estates. These will be readily soaked up by institutions and specialists keen to add to their portfolios.
- **Shopping Centres** – larger deals are waiting in the wings so deal volumes will surely increase from this year's very low base. Confidence in a steady reduction in Base Rates should attract leveraged investors back to the market but yield recovery is likely to wait until Q4 2024.
- **High Street** – pricing for better assets will continue to stabilise and the buyer pool will evolve to move away from opportunists to more committed investors buying into the longevity of well-let investments. Properties reliant on leisure income will be more affected in another challenging year for this sector.

KNIGHT FRANK DEALS

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

Westwood & Westwood Gateway Retail Parks, Thanet

Tenure: Freehold
Client: British Land
Price: £54,500,000
NIY: 8.5%

Dicken's Yard, Ealing

Tenure: Long Leasehold
Client: St George
Price: £20,000,000+
NIY: Confidential

Churchill Square, Brighton

Tenure: Freehold
Client: Abrdn
Price: £143,000,000
NIY: 9.00%

Sainsbury's, 31-41 Liverpool Road, Islington

Tenure: Freehold
Client: DTZ Investors
Price: £56,250,000
NIY: 4.44%

The Mall, Luton

Tenure: Long Leasehold
Client: Capital & Regional
Price: £58,000,000
NIY: 12.50%

Pavilions, Uxbridge

Tenure: Long Leasehold
Client: AEW
Quoting: £34,440,000
NIY: 8.50%

Bath Road Retail Park, Slough

Tenure: Freehold
Client: SEGRO
Price: £120,000,000
NIY: -

Decathlon, 18-20 Church Street, Liverpool

Tenure: Long Leasehold
Client: Redevco
Price: £7,800,000
NIY: 7.60%

Morrisons, Prince Charles Road, Exeter

Tenure: Freehold
Client: DTZ Investors
Price: Confidential
NIY: Confidential

Lush, 38-46 Church Street, Liverpool

Tenure: Freehold
Client: NFU Mutual
Price: £8,800,000
NIY: 8.00%

Morrisons, 40 Black Fan Road, Welwyn Garden City

Tenure: Freehold
Client: Abrdn
Price: Confidential
NIY: Confidential

"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

Alex Jimenez
alex.jimenez@knightfrank.com

Ross Needham
ross.needham@knightfrank.com

Josh Roberts
josh.roberts@knightfrank.com

Hollie Barden
hollie.barden@knightfrank.com

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