H2 2024

Knight Frank

Retail Investment Update & 2025 Outlook

knightfrank.com/research

Retail Resurgence: Back in the Game

RETAIL INVESTMENT AT A GLANCE

Occupational

- Retailer distress less than half the pre-pandemic average, a reduction in store closures and stalwart brands reinvest in their physical store estate throughout the year.
- Prospect of rental growth in all Retail subsectors – whilst this is old news in the Retail Warehousing sector, it marks a turning of the tide for the Shopping Centre and High Street markets.

Retail Warehousing

- Stellar performance again with total returns forecast at 12.4% for 2024 – rental growth and yield compression are already playing out in prime markets.
- Deep pools of institutional capital continue to drive the market, with more expected to come next year.

Foodstores

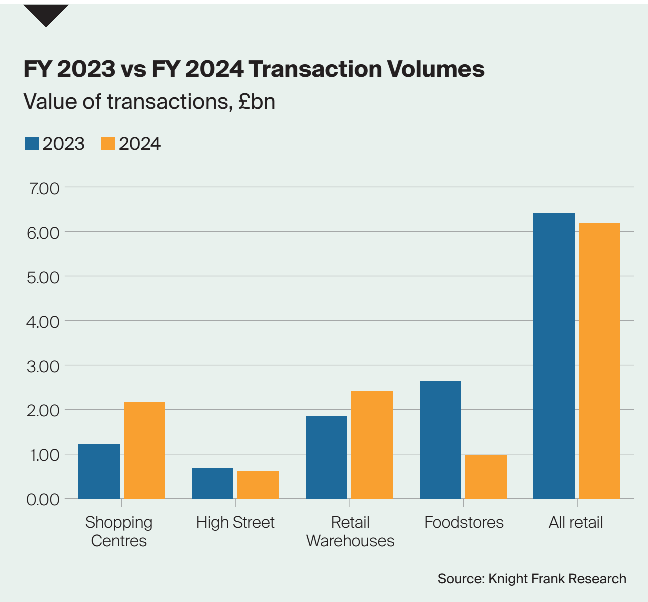
- Investment volumes have fallen away as stock dries up and inflationary suspicions return.
- Despite narrowing yield arbitrage to Base Rates, specialist buyers continue to trawl the market for new opportunities.

High Street

- Private investors remain the principal source of demand although the market is the subject of selective institutional interest once again.
- Demand remains focussed on core high streets in Greater London, the South East and key Regional markets though large rent rolls remain under scrutiny.

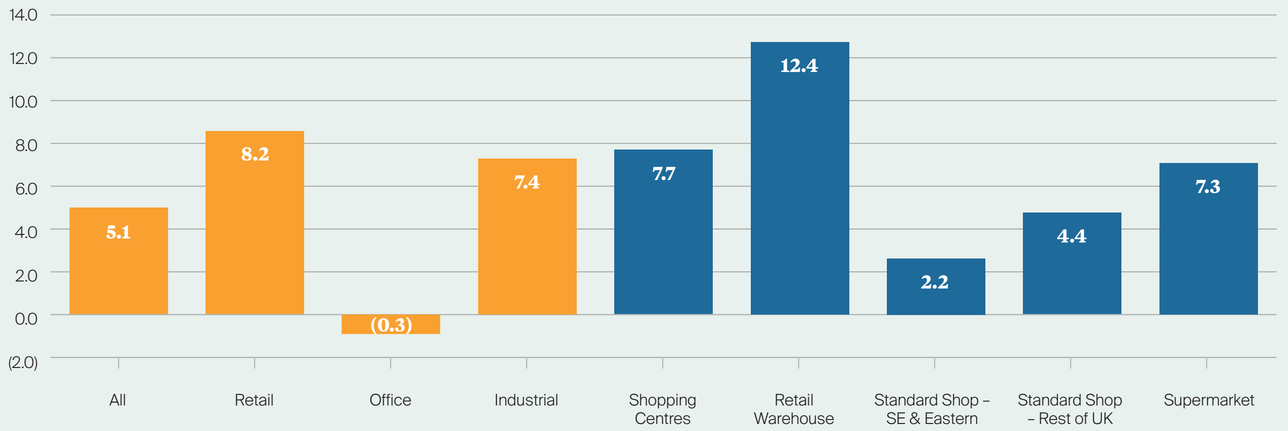
Shopping Centres

- Deal volumes approaching the 10 year average at £2.17 billion for 2024 but still some way behind historic peaks of £3-5 billion.
- Average lot sizes increase but largely driven by part-owners upsizing in their existing investments as buyers acknowledge strong risk-adjusted returns in prime centres.



Attitudes towards the Retail sector are the most positive they have been for 10 years. Institutional capital is now active in all of the Retail subsectors and liquidity has returned to even those subsectors previously thought to be too challenged to consider. Total deal volumes at £6.18 billion fall short of 10 year averages at £6.87 billion, but with an element of stability returning to the investment markets next year, we expect a profitable year for Retail investors in 2025.

Total Returns – Annual Forecast
2024 (f)



Source: Realfore

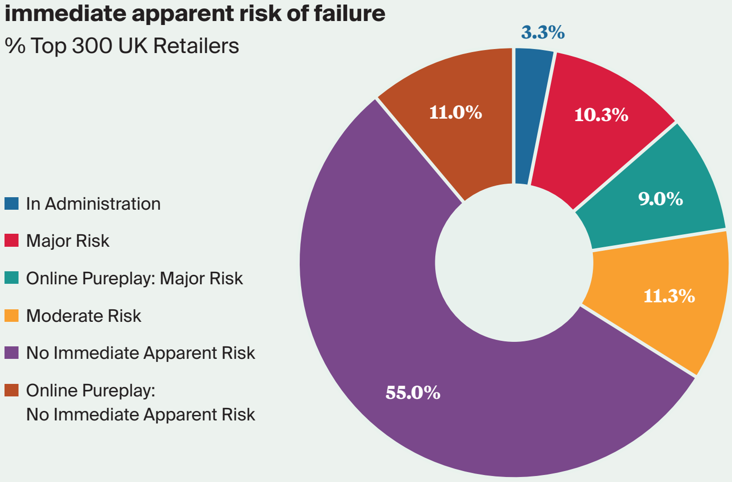
REVIEW OF THE YEAR

Occupational Markets

- Retailer distress is at historic lows, vacancy rates are broadly stable, and while a few big names have stumbled – Ted Baker, The Body Shop, Carpetright and Homebase – 2024 has been relatively uneventful for closures. That alone feels like progress after the upheaval of the pandemic years.

- Compared to the rollercoaster of the last five years, only 886 physical stores have been caught up in CVA or administration activity – less than half the pre-pandemic annual average of 2,462 stores (2019-2021). The casualty list has been lighter, with no major shockwaves, suggesting a much steadier occupational market overall.

KF Watchlist shows 66% of retailers at no immediate apparent risk of failure
% Top 300 UK Retailers



Source: Mintel, Knight Frank Research

- Knight Frank's Retailer Watchlist suggests this calm may hold. Two-thirds of the Top 300 UK retailers are rated "low risk" with no immediate danger of failure. Only 19% are identified as a "major risk" and many of those potentially teetering on the brink are digital-first players (9%) rather than bricks-and-mortar/multi-channel staples. Analysis weighted to turnover reduces the proportion of physical and multi-channel retailers at "major risk" to just 2%.

- The balance of store openings and closures settled into a more predictable rhythm in 2024 for a third consecutive year. While there was a net store decline of 2,284 in H1 2024, this marked a dramatic improvement on the pandemic-era low of 6,001 net closures in H1 2020. Meanwhile, opening activity gained momentum, with 4,661 new units launched in H1 2024 – up from 4,427 in H1 2023, representing a healthy 25 retail openings per day.

Key Transactions - 2024

Property	Sector	Purchaser	Vendor	Price	NIY %
Brookfield Retail Warehouse Portfolio	Retail Warehouse	British Land	Brookfield	£600,000,000	7.15%
Arnison Retail Park, Durham	Retail Warehouse	Realty Corp	CBRE IM	£110,000,000	7.00%
Longwell Green Retail Park, Bristol	Retail Warehouse	CBRE IM	Sterling Ventures / Letter One*	£22,590,000	5.60%
Sainsbury's, Southgate, Huddersfield	Foodstore	Supermarket REIT	M&G Real Estate	£49,700,000	7.60%
Tesco, Linkway, St Helens	Foodstore	Private Overseas	Aviva Investors	£53,820,000	7.00%
Project Jade Foodstore Portfolio	Foodstore	PIMCO	M&G Real Estate / Gingko Tree	£200,000,000	7.85%
Exchange Buildings, Birmingham	High Street	Corum XL	Orchard Street IM*	£23,400,000	8.75%
7-8 Queen Street, Oxford	High Street	Private Investor	Private Investor	£3,780,000	5.90%
185-205 Old Street, London	High Street	Meadow Partners	Private Investor	£40,000,000	6.90%
Centre MK, Milton Keynes (50%)	Shopping Centre	Royal London*	Australian Super	£142,000,000	9.25%
Liverpool 1, Liverpool (93%) - Under Offer	Shopping Centre	ADIA/Grosvenor	LandSec	£500,000,000	7.00%
Westquay, Southampton (50%)	Shopping Centre	Hammerson	GIC	£135,000,000	9.00%

*Advised by Knight Frank

- However, not all retail sub-sectors are benefitting equally. Out-of-town formats are leading the way, with Retail Parks achieving a rare net gain of +0.4% net openings, while the High Street (-1.5%) and Shopping Centres (-1.0%) remain under more pressure.

- Vacancy rates reflect these challenges. Retail Parks have seen vacancies slashed to a lean 6.8% but Shopping Centres saw a more modest -20 bps improvement to 17.7%, whilst the High Street has been static at 14.0%. Overall, retail and leisure unit vacancies have held steady at 14.0% for five consecutive quarters. Vacancy in the prime markets is much lower in all cases as the gap between the best and the rest continues to widen.

Rental Growth & Renewed Confidence

- Demand for physical Retail remained robust in 2024, with several major retailers reinforcing their commitment to bricks-and-mortar stores. Industry leaders such as M&S, Aldi, Next and Primark not only expanded their portfolios but also prioritised significant investments in store upgrades and modernisation, highlighting a renewed emphasis on enhancing the in-person shopping experience to stay ahead in an increasingly competitive landscape.

- Newer entrants have also contributed to the sector's momentum, with brands like Sephora, Sostrene Grene and Miniso moving to establish or expand their UK physical presence. Their activities signal growing confidence in the long-term viability of physical retail, even as the sector navigates mounting budgetary pressures.

- One clear area of progress is rental growth. Retail rents are forecast to rise by +1.3% in 2024, marking a positive shift across all sub-sectors. Retail Warehousing leads the way with a robust +1.9%, while Shopping Centres are finally returning to positive territory with +1.2%. High Streets, too, are holding their ground, with a respectable +1.6%, enough to support a cautiously optimistic outlook for the market.

- If there was a cloud on the horizon, it was the new Labour Government's Autumn Budget. Delivering a "triple whammy" of rising costs (employer National Insurance contributions, minimum wage hikes and business rate increases) which threaten to squeeze operators' margins. A bitter pill to swallow, but unlikely to trigger a sector-wide crisis. Some will double down on efficiency and automation to weather the storm. Others may scale back expansion plans, reconsider their store portfolios or raise prices for consumers to make the numbers add up.

Investment Markets

- A steady recovery through 2024, that was beginning to gather momentum in the second half of the year, was slowed during Q4 by the double blow of the Autumn Budget in October along with the US Election in November. Primary concerns relate to inflationary measures reversing the rapid reduction in core inflation, along with increasing pressure on low margin retailers needing to fund employer National Insurance contributions (not to mention the impact on Private Investors considering inheritance tax liabilities).

- A slowing of the reduction in the Bank of England Base Rate (and an expectation now that the trajectory through 2025 will be shallower than expected), coupled with outward movement in SONIA swap rates to around 3.85% (5 years) at the time of writing, is likely to take until the new year to unwind. Notwithstanding this momentary pause, most investors are approaching the Retail sectors with greater positivity than in any year since 2018.

- All Retail is forecast to return 8.2% on the MSCI Index in 2024 and remains one of the most appealing high-return sectors in the UK investment markets (MSCI forecasts for All Property at 5.1%, Industrial at 7.4% and Offices at -0.3%). Retail Warehousing is due to deliver a remarkable return of 12.4% in 2024 and will be a significant outperformer. However, all of the Retail sectors now offer appealing risk adjusted returns which is attracting a deepening pool of investors to the Retail markets.

Retail Warehousing

- Retail Warehousing continues its stellar performance with deal volumes of £2.4 billion, up 30% on 2023. Demand continues to originate from numerous sources, all attracted by robust occupational dynamics, with next to no vacancy in prime markets coupled with limited future development. Rental growth seems a surety and is already evidenced in some retail parks, along with inward yield shift (75 bps through 2024 to date) – it is easy to see why so many buyers have these on their requirement lists.

- Larger lot sizes (often Shopping Parks) principally appeal to REIT investors (namely British Land), overseas buyers (US Realty) and select UK funds (Columbia Threadneedle). These conviction buyers typically seek yields in excess of 7.00% NIY in return for transacting at a larger scale, typified by British Land's acquisitions of the Brookfield retail warehousing portfolio in two stages – firstly acquiring parks in Didcot and Merthyr Tydfil for £159m / 7.10% NIY followed by parks in Middlesbrough, Telford, Falkirk, Nottingham, Rugby, Waterlooville and St Helens for £441m / 7.20% NIY.

- Institutional demand for retail warehousing investments continues unabated. Most of this originates from local authority pension mandates managed by the likes of CBRE IM, abrdn, DTZ IM and Knight Frank IM. The only deterrent to these investors appears to be lot size and environmental concerns, principally relating to flooding.

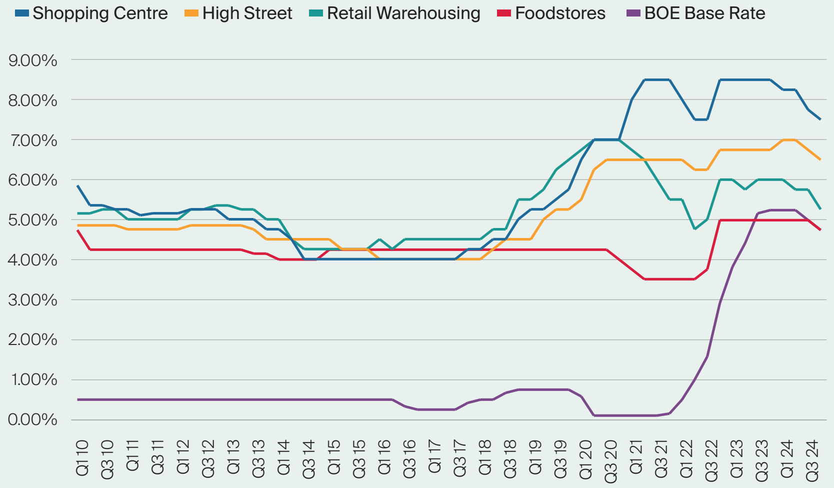
- Within target ranges of £15-40m, most sales processes have attracted numerous fund bidders with sales at Longwell Green, Bristol to CBRE IM at £22.59m / 5.60% NIY (Knight Frank advised the vendor), along with Anchor Retail Park, Mile End and Ivybridge Retail Park, Twickenham both thought to be under offer to mainstream funds ahead of quoting pricing of £30m / 5.50% NIY. Indeed, even some investments with environmental concerns, such as Plough Lane, Wimbledon (selling to M&G at £33m / 5.75% NIY) tick enough boxes for compromises to be accepted in return for a pricing discount.

- With deep pools of new institutional capital from the likes of Border to Coast, ACCESS and LGPS Central looking for deployment in the coming years, we see no change to this level of demand and with potentially tens of billions to spend, we expect some will filter into the in-town retail sectors as well as out of town settings.

Foodstores

- Despite the Foodstore market remaining one of the most popular investment sectors, transaction volumes have are relatively subdued at £985m for the year (down 63% on the exceptional volumes for 2023). A continued scarcity of stock

Prime Retail Yields & UK Base Rate 2010-2024



Source: Knight Frank Research

(with most owners choosing to hold these popular investments rather than sell) is the root cause, although the narrowing arbitrage between Base Rates and the keen yields that were being paid for longer leases secured to Foodstore operators has dampened activity in this space to an extent.

- This has not been helped by concerns over the impact of the new Labour Government's Autumn Budget on the larger, "Big Four" operators such as Sainsbury's and Tesco. Given the fine trading margins on which they operate they will surely attempt to insulate the shopper from the inflationary impact of these measures, but it is perhaps inevitable that some price rises will find their way into stores and onto shelves.

- Specialist buyers and Institutions continue to trawl the market for opportunities and owners/buyers of such covenants should still be comforted that they remain among the best businesses around, and longer term prospects of rental and capital performance remain sound. These operators' continued willingness to take up pre-emption options to acquire stores they occupy indicates their healthy cash positions and commitment to their store infrastructure.

High Street

- The High Street investment market remains the domain of the Private Investor, with the vast majority of transactions taking place involving private capital. It is easy to understand why, with now-stable covenants paying rebased rents in often fashionable locations and digestible lot sizes, making these investments an obvious target for these groups. Only 1 in 4 transactions take place with repeat buyers so predicting which buyer is likely to acquire is very challenging.

- High Streets in Greater London, along with affluent towns in the South East, remain the most favourable markets, largely due to stronger consumer spending dynamics and higher alternative use values (despite a greater acceptance now that physical retail is here to stay). Investments in affluent London suburbs such as 107-143 Muswell Hill Broadway (under offer at £16m / 6.55% NIY) and Crescent Arcade, Greenwich (sold at £25m / 7.25% NIY) are prime examples. Larger rent rolls on traditional prime pitches in major UK cities (Buchanan Street, Glasgow; Market Street, Manchester; New Street, Birmingham; Briggate, Leeds) have exposed these investments to greater scrutiny and so fewer have traded throughout the year.

- The relative discount in yields at 6.50% against other more keenly priced sectors (e.g. Industrial prime yields at 5.00% and Retail Warehousing at 5.50%) is sufficient compensation for the additional perceived risk of investing in the High Street space. We expect traditional investor types to see the appeal of this space in the short term, with the opportunity to aggregate portfolios of high quality stock. French SCPI Property funds including Corum, Sofidy and Iroko Zen are among the first institutional movers, owning similar investments on the continent and now targeting the UK for sustainable high yields.

REIT Share Price Tracker

	Landsec	British Land	Hammerson	NewRiver	Supermarket Income REIT	London Metric
Latest Share Price (p)	596.50	372.20	29.50	80.40	71.10	189.53
2024 Movement	-16%	-6%	+6%	-4%	-18%	-0.25%
EPRA NTA per share (p)*	859.00	567.00	38.00	115.00	87.00	195.70
Premium to NTA	-31%	-34%	-22%	-30%	-18%	-3%

*Latest available published NAV per share

Shopping Centres

- Interest in the Shopping Centre space is the strongest it has been for 5 years. A growing acceptance of their relevance, along with limited opportunities to acquire assets of scale at such discounted yields are driving major investors to consider the sector once again. However, what was expected to be a flurry of sales activity did not materialise in the second half of the year. A number of larger sales originating from owners seeking to exit since (and in some cases before) covid were anticipated to reach the market. Instead, open market sales processes tended to originate from administrative or receivership situations which has been typical in the Shopping Centre market for the last few years.

- This has not dampened deal volumes though, with £2.17 billion of transactions approaching the 10 year average of £2.26 billion excluding Covid (but still some way behind historic peaks of £3-5 billion). One third of the transactions have involved existing owners upsizing in their prime assets. As a result, the average deal size has increased this year, which is a trend we expect to continue. The likes of M&G (50% of Cribbs Causeway, Bristol at £110m / 8.25% NIY), Hammerson (50% of West Quay, Southampton at £135m / 9.00% NIY) and Norges (50% of Meadowhall, Sheffield at £363m / 8.00% NIY) have all upsized in their existing assets this year. Royal London, advised by Knight Frank, recently added a 50% interest in Centre:MK, Milton Keynes (£140m / 9.00% NIY) in another share sale example.

- Principally, these owners are buying into the opportunity for strong, risk-adjusted returns from the prime sectors and yields here look increasingly favourable at 7.50%. Equally, they are purchasing shares of assets they already own at historic discounts with good prospects of value recovery. Occupational demand has improved to the extent that better centres now have relatively few vacant units remaining, and with next to no future development, these prime, super-regional shopping centres have become something of a rare commodity. There is now the genuine potential for forward-looking rental growth which, coupled with a stable investment market, should see the sector outperform through 2025.

- Outside of these prime centres, the sub regional markets are still reliant on largely the same pool of experienced buyers. Frasers now own in excess of £250m of shopping centres with recent acquisitions including Fremlin Walk, Maidstone (£25m / 10% NIY) and Princesshay, Exeter (£55m / 10% NIY). M Core (owners of Evolve, Sheet Anchor and LCP property companies) is one of the largest owners of shopping centres in the UK, having recently added The Bridges, Sunderland (£24m / 15% NIY) and Washington Square, Workington (£9.15m / 14% NIY) to their portfolio to name but a few. Both buyers are expected to continue to build their portfolios through 2025, along with a group of Prop Co, private equity and private investors.

Leisure

- Leisure-anchored investments remain a challenge, with stubborn concerns over cinemas and the squeezed restaurant sector hampering liquidity in this sector. Despite Cineworld's ongoing Chapter 11 bankruptcy and subsequent restructuring process providing some certainty to leisure owners, there remains a fear of contagion as other heavily leveraged operators such as Odeon and Vue seek to reduce their liabilities. Knight Frank's sale of Medway Leisure Park, Rochester (Q: £25m / 9.64% NIY) will be a bellwether test of the market and a positive outcome could pave the way for further leisure sales in this space.

KNIGHT FRANK OUTLOOK

2025 Macro-economics – counting the cost of clarity and certainty

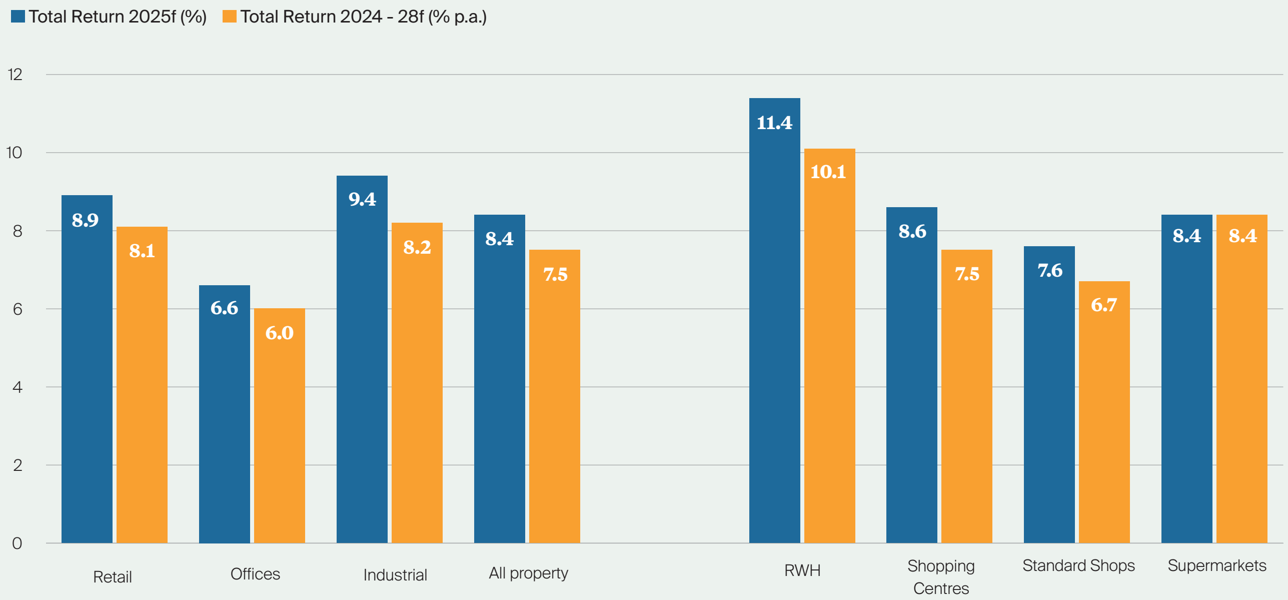
A more stable geopolitical backcloth with less uncertainty – but tightening fiscal policy, decelerating economic growth and Retail at the sharpest end of tax hikes.

- Slowing economic growth in H2 2024 is likely to restrict GDP growth to +1.5% in 2025 (vs. +1.0% in 2024). The positive reduction in RPI inflation witnessed throughout 2024 will bottom out and many of the new government's fiscal policies may prove inflationary. CPI is forecast to increase to 2.5% by 2025 year-end (vs. 2.3% at 2024 year-end).
- Sticky inflation will not necessarily stand in the way of further interest rate cuts. A staggered round of reductions is likely to see 100 bps of cuts in 2025, leaving the year-end rate at 3.75% (vs. 4.75% at the end of 2024). The longer-term forecast is 2.00% by the end of 2027. Faster rate cuts are possible if government fiscal policy dampens wider economic growth.
- Macro and retail economies will be maintained by tight employment markets – the unemployment rate is forecast to remain stable at just 4.3% in 2025 and average earnings growth of +3.4% will be higher than inflation. However, consumer markets will remain fragile, with private consumption forecast to grow by just +1.9% in 2025.
- After a period of heavy inflation and consumer squeeze, retail sales are likely to remain fairly subdued. Retail sales value growth is forecast to be decelerate to +2.5% in 2025, below both long term (30 year) and 10 year averages of +3.5%. Retail sales volume growth is likely to be in the same order (+2.5%), with grocery inflation offsetting marginal deflation in non-food.

2025 Property Prospects – retail comfortable wearing the crown

Spearheaded by Retail Warehousing, Retail will retain its crown as the top performing commercial real estate asset class including positive metrics across all Retail sub-classes.

Retail's Renaissance – Total Return Forecasts – Total Return (%)



Source: REFL, Knight Frank Research

- All Retail is forecast to achieve total returns of 8.9% in 2025 (vs 8.4% for All Property), further improvement on the 2024 outturn of 8.2% (vs 5.1% for All Property). Retail Warehousing to again achieve double-digit total returns (11.4%) and maintain its status as the top performing commercial asset class. Strong total returns will also be available in High Street shops (7.6%), Shopping Centres (8.6%) and Foodstores (8.4%).

- Tellingly, this improvement in total returns will be driven not just by high income return (+5.8%) as was the case in the past, but also by positive capital growth (+2.9%). Capital value growth will be strongest in Retail Warehouses (+4.5%) but will not be insignificant in either Shopping Centres (+1.7%) or High Street shops (+2.9%).

- A clean sweep of rental growth – All Retail is forecast to achieve rental growth of +1.2% in 2025. Although still fairly modest, this is significant in that all retail sub-sectors are forecast to achieve positive rental growth to some degree, a feat achieved only once since 2007 (in 2014). Within Retail, Central London shops (+2.3%) and out-of-town Shopping Centres (i.e. regional malls) (+2.2%) are forecast to register the strongest rental growth in 2025.

Longer Term Prospects – shaken by Autumn Budget pressures, but not stirred

Measures and tax hikes announced in the 2024 Autumn Budget deeply unhelpful for Retail but are only likely to stymie rather than destabilise long-term growth.

- A “triple whammy” of 1. employer NI contribution rises; 2. increases to national minimum wage and; 3. “new” business rates multipliers has added considerable cost pressures to Retail occupiers, which are likely to moderate demand and rental growth in the short term. Once understood and absorbed appropriately, the sustained Retail recovery will continue longer term.

- Retail’s annual average total returns between 2024 and 2028 are forecast to be 8.1%, with 5 year annual average capital increases of +2.2%. Retail’s annual total returns over this five year period will be higher than Offices (6.0%) and only marginally lower than Industrial (8.2%).

- Although positive, underlying rental growth will remain modest (+1.5% p.a. 2024 – 2028). Central London retail will be the main positive outlier to this (+2.5% per annum), with Retail Warehousing (+1.9% per annum) and regional Shopping Centres (+1.9% per annum) also outperforming the wider retail market.

- Retail’s status as the highest income return commercial asset class remains undiminished - annual average income returns between 2024 and 2028 are forecast to be 5.8%, higher than Offices (5.3%) and Industrial (4.6%).

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 this year.

Centre:MK, Milton Keynes (50%)

Tenure: Freehold
Client: Royal London
Price: £140,000,000
NIY: 9.00%

Leamington Shopping Park, Leamington Spa

Tenure: Freehold
Client: CBRE IM
Price: £57,550,000
NIY: 6.35%

Exchange Buildings, New Street, Birmingham

Tenure: Long Leasehold
Client: Orchard Street
Price: £23,450,000
NIY: 8.75%

Fremlin Walk, Maidstone

Tenure: Freehold
Client: M&G
Price: £25,000,000
NIY: 10.00%

Waitrose, 145 Morningside Road Edinburgh

Tenure: Freehold
Client: DTZ Investors
Price: £18,725,000
NIY: 5.35%

Longwell Green Retail Park, Bristol

Tenure: Freehold
Client: Sterling Ventures / Letter One
Price: £22,590,000
NIY: 5.60%

Princesshay, Exeter (50%)

Tenure: Long Leasehold
Client: Crown Estate
Price: Confidential
NIY: Confidential

Sainsbury's, 33 Priory Road, Dartford

Tenure: Freehold
Client: Northdale Asset Management / Magnetar
Price: £21,300,000
NIY: 7.95%

Swan Walk, Horsham

Tenure: Long Leasehold
Client: Knight Frank Receivers
Price: £13,750,000
NIY: 11.85%

26-30 Cambridge Street & 15-19 Oxford Street, Harrogate

Tenure: Freehold
Client: Private Overseas Investor
Price: £4,325,000
NIY: 8.35%

86-90 Promenade, Cheltenham

Tenure: Freehold
Client: Private Overseas Investor
Price: £4,600,000
NIY: 10.85%

"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

Volkan Denli
volkan.denli@knightfrank.com

Agatha Eyston
agatha.eyston@knightfrank.com

David Legat
david.legat@knightfrank.com

Mike Bumford
mike.bumford@knightfrank.com

Stephen Springham
stephen.springham@knightfrank.com

Emma Barnstable
emma.barnstable@knightfrank.com

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

Knight Frank

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.

Confidential Considered Advice