Retail Renaissance 2025

Lesson #2: An end to complacency and underinvestment

2025

The second of six papers exploring what other real estate sectors can learn from Retail's fall and unlikely rise again

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Lesson #2: An end to complacency and underinvestment

The Perils of Neglect.

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3 KEY LESSONS:

- Real estate markets are complex. Structural change can challenge steadfast notions around cyclicity and the need for aggressive development pipelines.
- Retail – especially, but not exclusively – is a capital-intensive property asset class. Effective capex deployment is a prerequisite.
- Complacency has no place in real estate – ultimately this will always come home to roost.

Complacency and underinvestment. Two of retail's most criminal structural failings, as identified in our *'Price of Change'* research report. The hardest to actually quantify and the least measurable, but arguably the most damaging. And the very first shortcomings that needed to be addressed in Retail's Renaissance.

Complacency and underinvestment mean different things to key retail stakeholders: retail occupiers, landlords, developers, investors, local authorities, central governments. It would be churlish to point the finger of blame at any single party, all were complicit in their own way of taking retail for granted. Collectively, they all neglected the hand that fed them and were left scratching their heads when the wheels came off.

RETAILERS – MISINVESTMENT?

As will be explored in **Paper 4**, many retailers were as guilty as those around them in becoming complacent. Key manifestations of this were over-expansion, compounded by a failure to address and weed out underperforming existing outlets. As the macro-economic market tightened from the late 2000s onwards, most were in the parlous situation of having too many stores, many of which were losing money. Cue massive retrenchment, a collapse in rents and significant occupier fall-out for much of the 2010s, exacerbated by COVID from 2020.

It would be inaccurate to suggest that retailers did not invest at all over this period, but the destination of that spend was not necessarily where it was needed most – the core portfolio. The chase for space meant that a disproportionate amount of investment was channelled into new stores. Simultaneously, there was a chase for 'online space', resulting in massive investment in the supposed holy grail of e-commerce. Online was very much in its infancy and was something of a great unknown – but it had to be embraced and therefore accounted for a vast proportion of most retailers' investment budgets. Investment in online and new stores completely diverted cash away from the bread and butter of the business, the existing store base.

Private equity (PE) undoubtedly had a lot to answer for. Few retailers benefited from the short termism of PE ownership and the typical investment model that came with it. Limited to no investment in the core business, but ramping up expansion to give a veneer of good health. Behind-the-scenes asset stripping. And then exit before any nasties surfaced on the balance sheet. PE was not solely to blame for upheaval in retail occupier markets, but some could certainly be left at its door.

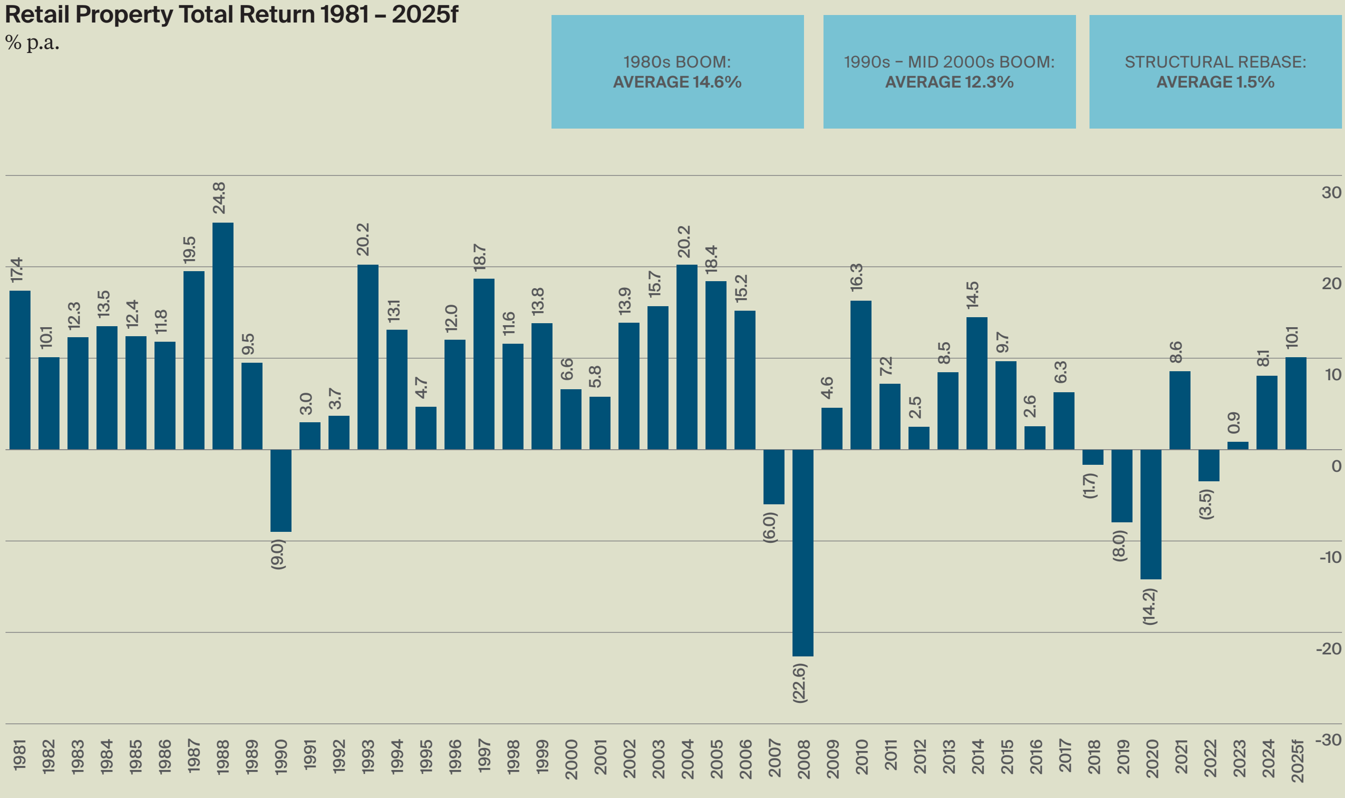
> "As the macro-economic market tightened from the late 2000s onwards, most retailers were in the parlous situation of having too many stores, many of which were losing money."

LANDLORDS – KILLING THE GOOSE THAT LAYS THE GOLDEN EGGS?

Historically, retail nearly always delivered the goods for landlords. Between 1981 and 2006 it was by far the best performing real estate asset class, delivering annual average total returns of 12.3%. The market did have its up and downs, but these were largely cyclical and could be computed and reasoned with general real estate trends.

If retail was already delivering, there was limited impetus for landlords to invest significantly. Their priorities were invariably to drive rental growth to maximise property values. The need for significant investment in the upkeep of their assets, particularly shopping centres, largely flew under the radar and slowly but surely, retail stock became very dated.

Retail Property Total Return 1981 – 2025f
% p.a.



Source: MSCI, Knight Frank Insight

Developers were of a similarly complacent mindset. If retail was delivering the goods, build more of it. An extremely aggressive retail development pipeline ensued from the 1980s onwards, the tap only abruptly switched off with the onset of the GFC. But, as explored in **Paper 3**, there was no process of obsolescence management, first and second generation schemes effectively staying in the market, but facing a downward spiral of decay. We sleepwalked into a situation of having a vastly over-supplied market – which we are still grappling with to this day.

Retail delivered for landlords and developers for a long period of time. Until there came a time when it didn't anymore. And rather than a cyclical downturn, the catalyst for change was structural. Years of complacency, neglect, overdevelopment and underinvestment came back to haunt virtually overnight. Many fingers were burnt and some of the scars are still in evidence to this day.

> "Challenging as COVID undoubtedly was, it nevertheless had some positive, if unintended, consequences. It actually served to underline the retail sector's resilience, when previously it had become renown more for its fragility."

INVESTORS – CAPITAL STACK CONSTRAINTS

Capital markets effectively mirrored these retail market dynamics. When retail was delivering, capital unsurprisingly flowed into the sector from all sources – institutions, REITs, private equity and private investors alike. When structural change engulfed the market and capital values plummeted, investors took flight. The funds in particular looked to massively rebalance their capital allocations away from retail.

The retail-focussed REITs saw dramatic falls in their respective share prices. The most extreme case saw the demise of INTU, but Hammerson also had to significantly retrench and sell off a whole host of assets. The likes of British Land and Landsec either pivoted away from retail, or gravitated to those retail sub-sectors deemed more resilient e.g. retail warehouses.

Whatever the movements in overall volumes and capital flows, there was a fundamental shift in sentiment away from retail. For some, this has proved a case of 'once bitten, twice shy'. Even those investors that have returned now recognise that retail is a highly complex asset class.

By the same token, and for a host of reasons, investment into actual retail infrastructure has been severely lacking. Firstly, if the capital isn't flowing into the sector in terms of volumes, there is little impetus for actual investment in the upkeep and refurbishment of physical stock. Secondly, with share prices squeezed, the REITs were hamstrung in their ability to deploy capex. Thirdly, capital stacks, while a key vehicle in facilitating retail deals, remain far less conducive for proactive investment.

> "But all stakeholders in retail now recognise that the market is tough, there are few quick wins and any low-hanging fruit has long been devoured."

In essence, retail was starved of investment from all sides – and capital markets certainly didn't provide much by way of respite.

THE LONG ROAD TO REDEMPTION

A *Retail Renaissance*. A grim picture that has slowly improved on the back of a painful voyage of self-help. The first stage of this journey was to understand the implications of structural change and acknowledge the retail market's structural failings (see **Paper 1**). Denial was not an option.

An acceptance of the gravity of the situation was a first step away from historic complacency. And any last vestiges of complacency were then swept away in the maelstrom of COVID, an existential crisis focussing the mind in way that nothing else could.

Challenging as COVID undoubtedly was, it nevertheless had some positive, if unintended, consequences. It actually served to underline the retail sector's resilience, when previously it had become renown more for its fragility. Retail's ability to weather the biggest storm imaginable and come out of the other side saw a discernible improvement in investor sentiment, initially more towards out-of-town channels (foodstores and retail warehouses) but since cascading to in-town sub-sectors too.

But all stakeholders in retail now recognise that the market is tough, there are few quick wins and any low-hanging fruit has long been devoured. But it is a market that can perform and deliver decent returns. Above all else, no one takes anything for granted in retail any more.

INVESTMENT – FROM A TRICKLE TO A FLOW?

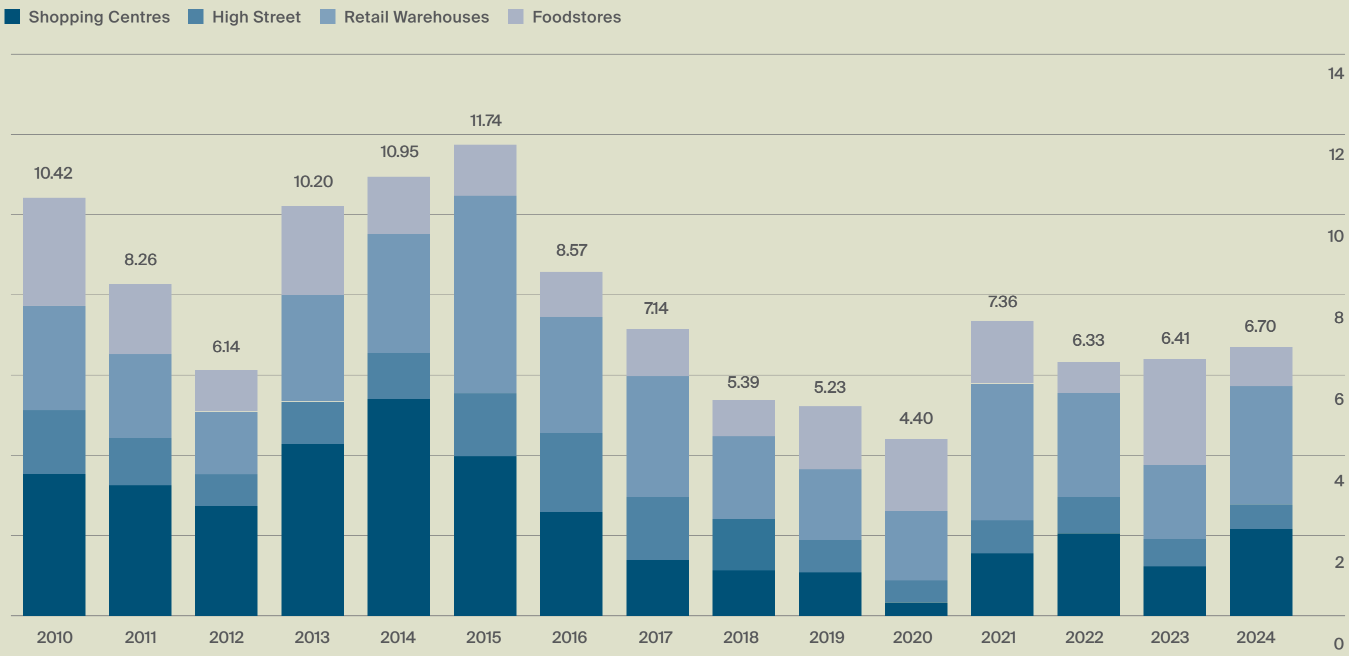
There is also a growing recognition of the need for capital investment from across the stakeholder spectrum.

While not necessarily awash with cash for investment, retailers have re-orientated their capex priorities. Most have right-sized their portfolios and dispensed with surplus space and under-performing outlets, a process as necessary for the wider health of the market as it was painful for any landlords affected. And the residual core portfolio is the focus for renewed investment, with a more balanced approach to online and in-store capex deployment. A 'back-to-basics' mindset generally, with the underlying aim of maintaining an attractive, fit-for-purpose store estate at its core. Any new store acquisitions now are selective rather than scattergun, any location planning strategy pragmatic rather than aggressive.

This journey has proved a wake up call for many landlords too and this has prompted wider acknowledgement of the need for rolling capital investment

> "Any new store acquisitions now are selective rather than scattergun."

Retail Property Investment Volumes 2010 – 2024
£ bn



Source: Knight Frank Insight

programmes, if their assets are going to remain attractive to both shoppers and occupiers alike. But at the same time, a highly managed process that avoids throwing good money after bad and generates an actual, measurable return, be that immediate or longer-term. And the best case scenario of all, where landlords and tenants work in unison to maximise the quality and the value of the asset.

Retail's renaissance is also filtering through to investment markets. In fairness, investor appetite is generally still strongest for retail asset classes that have lower capital requirements, notably retail warehouses and foodstores. In contrast, shopping centres remain in the 'too difficult to deal with' box for some investors. But demand is slowly returning to shopping centres too, the difference from before being a more realistic appraisal of capex requirements, short- and longer term. Rather than shy away from the thorny issue of capex, it is at least now being factored into the acquisition process. Some deals may falter on this basis, but we are seeing growing evidence to suggest that some investors can make it work.

PROOF IN THE PERFORMANCE PUDDING

Complacency gone and a far more pragmatic approach to capex and investment. Two of the key cornerstones to the *Retail Renaissance* process.

The result? Retail enjoyed total returns of 8.1% in 2024. Not only was this the best annual performance since 2015, it also made retail the top performing commercial asset class last year, surpassing both industrial (7.8%) and offices (0.7%). Crucially, this was achieved not just through income return (5.8%), but also through capital growth (+2.2%). And for the first time in a decade, there was a clean sweep of rental growth across all the retail sub-sectors. And, most positively of all, this was not a mere blip nor flash in the pan, but a portent of things to come. This level of performance is forecast to improve further over the next five years.

A coincidence, or the result of a less complacent and more investment-friendly market? Very much the latter. And achieved without the established tenets of real estate markets, such as cyclicity and an active development pipeline.

Retail may not be for the faint-hearted, nor for those without the specialist market knowledge required. But for those with this knowledge, keen to embrace the challenges of a complex market and without a reticence to invest appropriately, the rewards can be substantial.

THE AGENT VIEW

"A positive move from defence to offense"

Will Lund – Partner, Retail Capital Markets

"Hamstrung. For many owners, allocating proactive, non-essential Capex to improve assets over the past five years simply hasn't been possible. With many properties bound by restrictive structures – be they massive capital losses since acquisition, overbearing lenders sweeping surplus cash to pay down legacy loans or receivership/administration processes (or a highly toxic combination of all three!) – simply keeping "head above water" was understandably a priority.

For some, this remains the case and the physical configuration of some town centre assets particularly will mean that no amount of capital can change their fortunes (a driver of the stronger investment demand for out-of-town investments and "triple net" leases on offer in the foodstore sector). Why throw good money after bad?

Meaningful capital growth is likely to be limited to the strongest, (often but not always) largest, most well-configured prime assets. Many more dated secondary assets will be held back by hefty bills required to maintain aged infrastructure, especially where tenant demand continues to polarise.

We have, though, seen a move from defence to offense driven partly by the improving fortunes for many retail assets. With a resilient occupier market, stabilising yields and a better acknowledgement of the sector generally, many owners have seen improvements in both income and capital values. With a new wave of ownership since COVID, we are seeing profits being made from retail investments and where this is the case, capital has been more forthcoming to explore proactive asset management plans.

Occupier investment is a key catalyst – as we reference in **Paper 4** in this series, retailers are now telling landlords "if you are not enabling sales growth you are hindering it". It is hard to ignore tenants demanding physical improvements to give their shoppers the best experience.

"The occupier is king" – another refrain from our series – and their satisfaction will be the ultimate barometer to asset performance, driving further investment before they vote with their feet."

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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