2021 Predictions for Consumer, Occupier and Investment Markets

Knight Frank

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The Show Must Go On

Retail Property Market Outlook 2021

THE SHOW MUST GO ON

KEY MESSAGES

Less, but better floorspace. Fewer, but fitter operators. Retail structural change accelerated by Covid-19 will continue to play out in 2021. Considerable but necessary short-term pain for a stable and sustainable retail market going forward.

◆

Against a more benign backdrop generally, occupier markets will stage a slow recovery as the year unfolds. Levels of retail trade are likely to have returned to something like "normalised" levels by the end of 2021.

◆

In defiance of all economic logic to the contrary, the UK consumer will spend relatively freely in 2021. Free from the constraint of lockdowns and with considerable pent up demand, retail sales are forecast to grow by ca. 5% in 2021.

◆

2021 will be The Year of the Arrear – an estimated 50% of retail rents from this year remain unpaid going into the New Year. Resolution of this will be painful, with landlords either aggressively chasing what is due to them, or formally taking the pain themselves on their balance sheet.

◆

Occupier markets face a potential meteorite crash at the end of March, with a risk of the moratorium on forfeiture and the business rates holiday being lifted almost simultaneously (exacerbated by Q1 rent day). A major pinchpoint with inevitable fall-out.

◆

CVAs will sadly continue, particularly in the fashion sector which has been crippled by a toxic scenario of over-supply (too many operators, too many stores) and exceedingly soft consumer demand during 2020 (clothing sales down ca. -25%-30%).

Some CVA protagonists will graduate to full liquidation and the high street is likely to lose some well-established brands in 2021. But a "new breed" of operator will emerge to replace them over time as part of an evolutionary "changing of the guard".

◆

Flexibility and affordability will be the two defining forces of occupier markets in 2021. Manifestations of this will be shorter leases and a continued push towards turnover rents. But these need to be a two-way street to be effective, with retailers and landlords being transparent and collaborating.

◆

Retail floorspace – increased separation between the wheat and the chaff in 2021 will drive both the investment market and potential development into alternative uses. Retail remains an investible property class, albeit one that now requires far greater discrimination than in the past.

◆

Investors will continue to favour foodstores (-25bps to sub 4.00%) and retail warehousing (-50bps to 6.00%) and volumes will reflect that in 2021. OOT's accessibility, flexibility and simplicity, plus perceived incubation from online, will continue to attract both institutional and PE investors.

◆

Expect a flurry of retail repurposing exploration in 2021, although actual activity will not match the level of narrative as it is a more complicated play than many currently appreciate. Retail stock will be circled by a whole host of alternative uses, both commercial and residential, mainstream and specialist.

◆

Many potential retail repurposings will not cross the "Four Great Divides" we identify, with value alignment invariably the most challenging. Those that do will largely be within Greater London and certain towns in the South East. Only in select locations will the stars fully align to make repurposing financially viable.

THE SHOW MUST GO ON – RETAIL PROPERTY MARKET OUTLOOK 2021

INTRODUCTION

No time for self-pity. The embattled retail sector has to come out fighting in 2021. And there is good cause to believe it will.

STEPHEN SPRINGHAM
PARTNER – HEAD OF RETAIL RESEARCH

Covid-19: the ultimate stress-test that nobody wanted. Those that hitherto celebrated disruption and disruptors as forces for good must surely have reviewed their stance in the face of what this looks like in reality. The retail sector was already firmly in the throes of structural change and entered the pandemic with serious pre-existing conditions, rendering it highly vulnerable to everything that has ensued. Any lingering weakness in the retail industry has been cruelly exposed.

Irrespective of success of any vaccination programme, 2021 will be a far better year than the "annus horribilis" of 2020. But it won't be a "Bobby Ewing in the Shower" scenario whereby we just erase what has happened under the pretext of it just being a bad dream. Beware the inevitable "return to pre-pandemic levels" headlines that will increasing come to the fore as the year unfolds. If we were destined to just go back to where we were before, it would take several years. But the reality is that we are actually on a different trajectory, a "new norm" to use popular parlance.

What is the "new norm" for retail? Flexibility and affordability are the two key watchwords for retail occupiers and, by extension, the two challenges for retail landlords. In practical terms, this will mean shorter leases and a push towards turnover rents, but both will require proactive collaboration and both sides have to play ball if this is to prove a workable and sustainable solution.

What is the "new norm" for retail? Flexibility and affordability are the two key watchwords for retail occupiers and, by extension, the two challenges for retail landlords.

2021 will not be without further pain. CVAs will still occur and could actually accelerate in Q2 unless the potential meteor collision of the business rate holiday and moratorium on forfeiture ending at the same time is averted. A number of former CVA candidates will sadly graduate to full liquidation and the high street will inevitably lose some well-established names. Harsh as it may sound, this is the natural order of retailing and is nothing new. Retail remains the survival of the fittest and some operators are tangibly fitter than others.

In retail, consumer is king. And the consumer is likely to play his/her part in 2021. Contrary to every economic indicator, we expect the UK consumer to spend freely in 2021. Retail sales have been wildly erratic during 2020, slumping to unprecedented monthly lows during Lockdown 1, staging something of a recovery as stores reopened, only for this to be derailed by Lockdown 2 in November.

For many, optimism may be tempered by employment concerns. Conversely, many others may find that constraint and restraint this year has left them with a significant cash surplus and pent-up demand going into 2021 is considerable. And there is comfort that in past recessions and times of hardship, the UK consumer has usually defied gravity and continued to spend.

"The high street is dead. Long live alternative use". The narrative on retail's demise has amplified over the past year. But this narrative remains as premature as it is simplistic. The UK retail industry is still worth £390bn a year and is not simply going to disappear. Change and evolve, yes, vanish into the ether, no. Reducing overall retail footprint is a fundamental part of this evolutionary process, a necessary factor to address the key structural flaw of oversupply. But only a limited proportion of retail floorspace actually lends itself to viable repurposing to alternative uses and it is a far more complex play than many appreciate. It is a bespoke rather than turn-key process – and, needless to say, one that Knight Frank is uniquely positioned to advise on.

A consumer willing to spend, a changing of the guard amongst occupiers, the emergence of a new breed to take the market forward, fewer but fitter operators, less but better floorspace, a renewed sense of purpose within town centres that have been re-engineered to reflect the future rather than the past. Positive counterpoints to all the pain the retail sector has had to endure in recent years and a blueprint for retail's future.

Retail in 2021. The Show Must Go On. Maybe not as rehearsed, unscripted to a point, and largely improvised. But Go On it shall.

We would be delighted to discuss any issues raised in this body of work with you.

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CHARLIE BARKE

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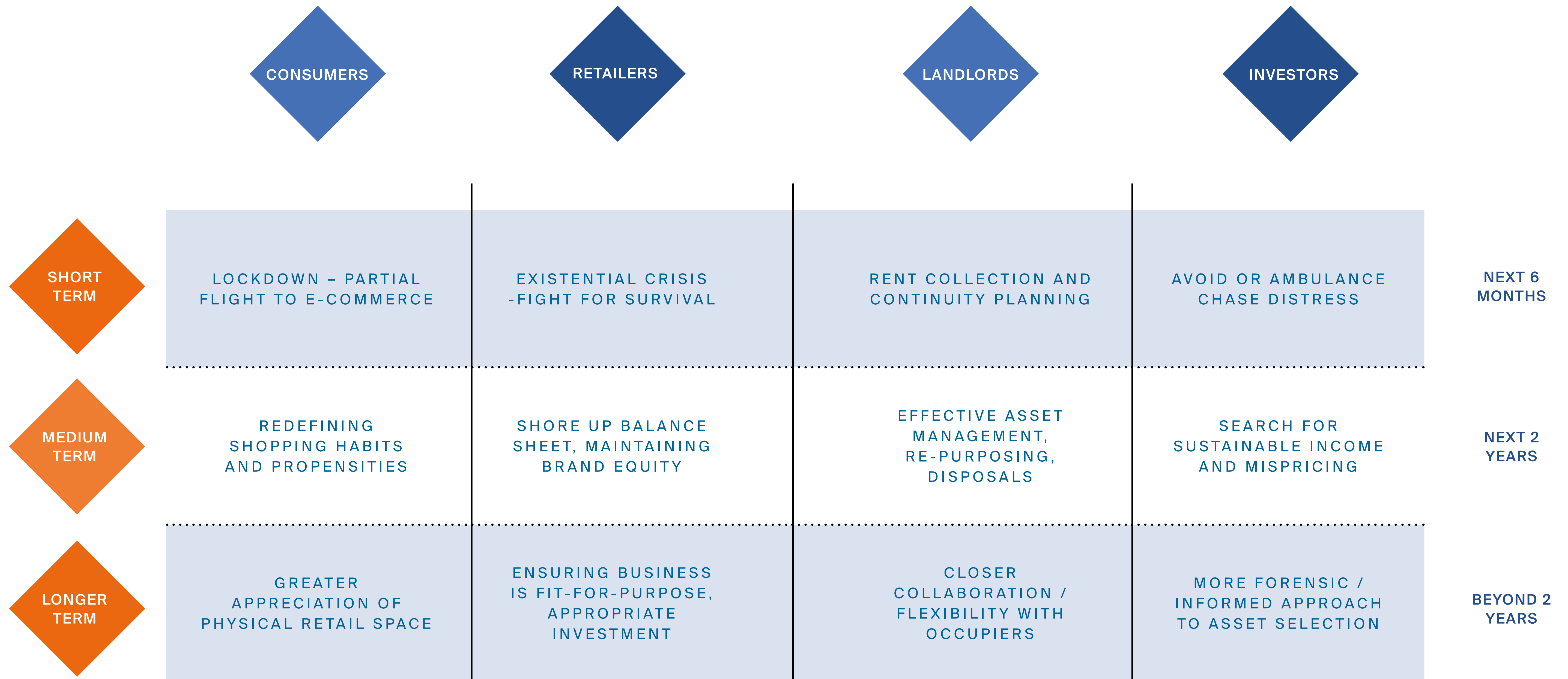
RETAIL STAKEHOLDERS MOTIVATION MATRIX

Key Stakeholders - Short, Medium, Long-Term Agendas



	CONSUMERS	RETAILERS	LANDLORDS	INVESTORS	
SHORT TERM	LOCKDOWN – PARTIAL FLIGHT TO E-COMMERCE	EXISTENTIAL CRISIS -FIGHT FOR SURVIVAL	RENT COLLECTION AND CONTINUITY PLANNING	AVOID OR AMBULANCE CHASE DISTRESS	NEXT 6 MONTHS
MEDIUM TERM	REDEFINING SHOPPING HABITS AND PROPENSITIES	SHORE UP BALANCE SHEET, MAINTAINING BRAND EQUITY	EFFECTIVE ASSET MANAGEMENT, RE-PURPOSING, DISPOSALS	SEARCH FOR SUSTAINABLE INCOME AND MISPRICING	NEXT 2 YEARS
LONGER TERM	GREATER APPRECIATION OF PHYSICAL RETAIL SPACE	ENSURING BUSINESS IS FIT-FOR-PURPOSE, APPROPRIATE INVESTMENT	CLOSER COLLABORATION / FLEXIBILITY WITH OCCUPIERS	MORE FORENSIC / INFORMED APPROACH TO ASSET SELECTION	BEYOND 2 YEARS

THE SHOW MUST GO ON – RETAIL PROPERTY MARKET OUTLOOK 2021

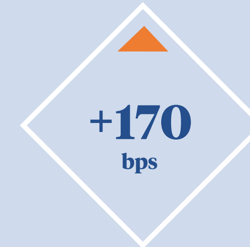
THE SHOW MUST GO ON
DASHBOARD

THE CONSUMER: RIPPING UP THE RULEBOOK

FORECAST RETAIL SALES VALUE GROWTH IN 2021

PROJECTED FY 2020 RETAIL SALES GROWTH, DESPITE COVID-19

PROJECTED DECLINE IN FY 2020 GDP GROWTH



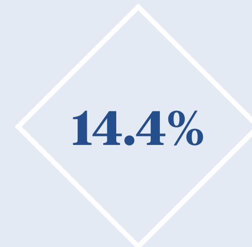
RETAIL SALES AVERAGE ANNUAL OUTPERFORMANCE OF GDP OVER LAST 30 YEARS

FORECAST RATE OF UNEMPLOYMENT IN 2021

CHANGING OF THE OCCUPIER GUARD

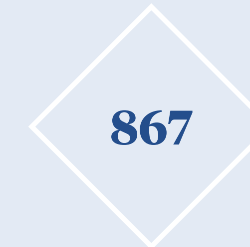
ESTIMATED PROPORTION OF RETAIL RENT STILL OWED GOING INTO 2021

NUMBER OF RETAILER FAILURES DURING 2020



RETAIL VACANCY RATE @ SEPTEMBER 2020

NEW HIGH STREET OPENINGS DURING H1 2020



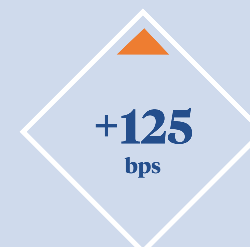
TOTAL NUMBER OF NEW BARBERS, BEAUTY AND NAIL SALONS OPENED H1 2020

INVESTMENT: BETTING ON A RECOVERY

PROJECTED TOTAL RETAIL INVESTMENT VOLUMES IN 2020

2020 VOLUMES VERSUS HISTORIC 10 YEAR AVERAGES

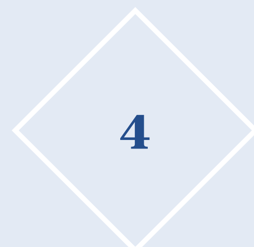
PROPORTION OF 2020 RETAIL INVESTMENT VOLUMES ACCOUNTED FOR BY FOODSTORES



YIELD MOVEMENT ON REGIONAL SHOPPING CENTRES DURING 2020

FOODSTORE YIELDS IN Q4 2020 AND PROJECTED VALUE FOR 2021

RETAIL REPURPOSING: LESS IS MORE?



NUMBER OF 'GREAT RETAIL REPURPOSING DIVIDES'

NO. OF RETAIL UNITS (LIVE + VACANT) CONVERTED TO OTHER USES H1 2020

RETAIL FLOORSPACE PRODUCTIVITY: OXFORD VS RUNCORN

RENTAL PERFORMANCE 2010-20: BRIXTON VS FALKIRK

INVESTMENT DEALS IN MAIDENHEAD / ORPINGTON BY ARELI AS PART OF REPURPOSING PLAYS

Sources: Knight Frank, ONS, Oxford Economics, Centre for Retail Research, Property Data, CACI, PMA, LDC.

THE CONSUMER: RIPPING UP THE RULE BOOK

Why we expect the UK consumer to defy economic logic and spend freely in 2021, with the retail sector a key beneficiary

STEPHEN SPRINGHAM – HEAD OF RETAIL RESEARCH
EMMA BARNSTABLE – RETAIL RESEARCH ANALYST

The UK consumer tends to have scant regard for such logic and 2021 is likely to be far stronger for retail sales growth than these metrics suggest.

The UK consumer moves in mysterious ways – to second-guess these movements is often a fool's errand. Macro conditions supposedly dictate that the consumer reacts and behaves in a certain way, yet she/he regularly goes off at an unexpected tangent. That has been the lesson from both history and past recessions and is likely to be the case as we enter 2021. A Covid-19 pandemic is most certainly uncharted territory, but there is enough past evidence to support this view.

UK retail sales in 2021 are likely to confound a significant proportion of the economist community, certainly those wholly-wedded to their text books. The text book narrative is relatively simple: amidst unprecedented levels of political, economic and social uncertainty, consumer confidence is exceptionally low, unemployment is rising and inflation will outstrip wage growth. QED, consumers will be cash-strapped and will rein in spending. But the UK consumer tends to have scant regard for such logic and 2021 is likely to be far stronger for retail sales growth than these metrics suggest.

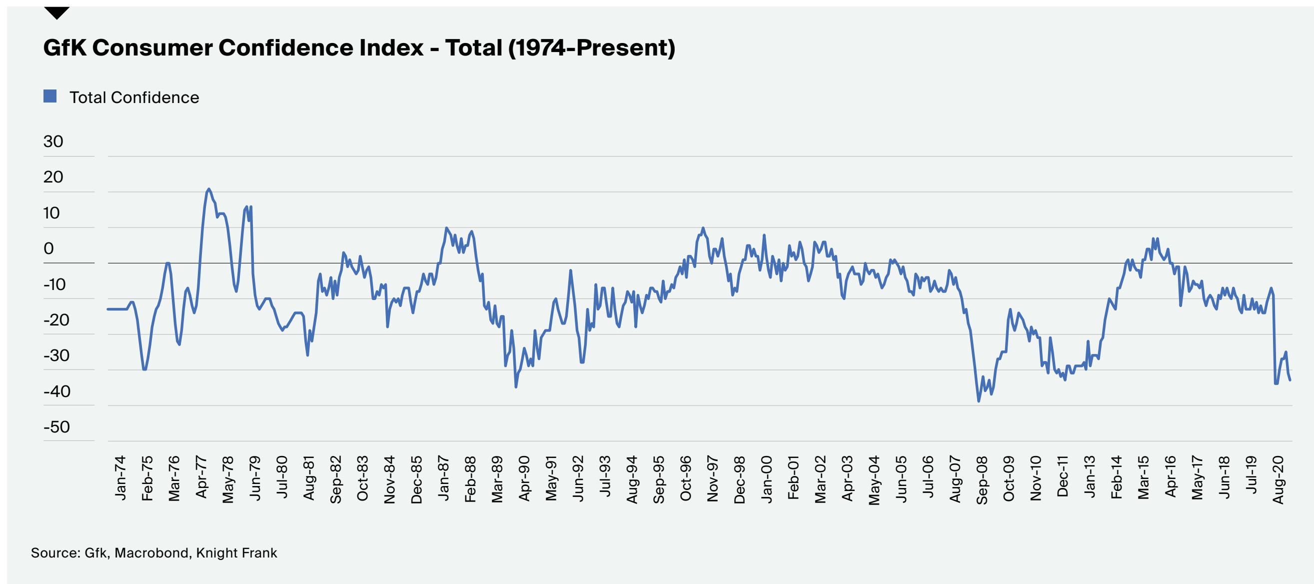
Consumer Confidence – a weak barometer of actual consumer behaviour

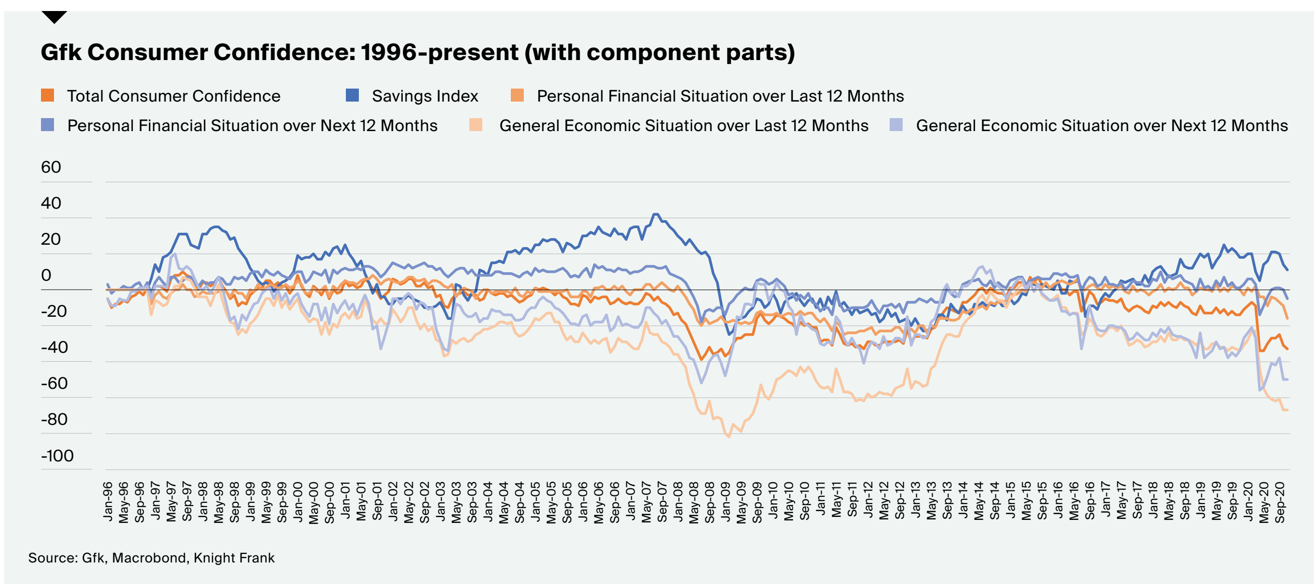
Consumer confidence is not necessarily the water-tight barometer of retail spending it purports to be.

What a consumer feels and the way they behave are not wholly one and the same. Low confidence may not equate to low spending, it may actually prompt the converse, "retail therapy" (to use popular parlance) actually being an outlet for deeper disquiet.

Reference to low consumer confidence can be something of a lazy catch-all or a throwaway comment, but it can also be a quantified measure.

For example, Gfk has been producing an Consumer Confidence Index since 1974, disaggregating a 'Total' figure into finer confidence indicators for 'General Economic Situation' and 'Personal Financial Situation' since 1996.





How does Covid-19 compare with the annals of time? After a relatively stable period from 2017, Gfk's Total Consumer Confidence Index plummeted to -34 in April 2020 as the full scale of the pandemic became apparent and the UK went into total lockdown. But this has been surpassed in history. During the Global Financial Crisis, the Index hit a low of -39 in July 2008 and during the early 1990s recession it was broadly comparable to this year, at -35. Covid-19 may be unprecedented, but confidence is not plumbing new depths.

The component parts of the Index are perhaps more revealing still as to consumers' actual behaviours. In April 2020, the 'Personal Financial Situation' indicator declined to -14 (versus a monthly average of ca. +3 the preceding 12 months), but this was a shallow fall relative to 'General Economic Situation' (-56 versus -31 previously). In general, consumers are far more confident in their own personal finance situation than they are in wider economy. And from a retail perspective this is crucial as their purse strings are far more attached to the former than they are the latter.

Retail sales tend to outperform the wider economy. In the 30 year historic timeseries produced by the ONS, annual retail sales have grown faster than comparable GDP on no less than 23 occasions.

Brexit is both a recent and classic case in point. In the wake of the Referendum vote in June 2016, overall Consumer Confidence slipped (to -12) and virtually every economist and commentator in the land predicted that retail sales would slump in sympathy. They patently didn't, growing by +3.1% in 2016 and +4.5% in 2017, largely because the main downward movement in confidence related to the general economic situation (-33) rather than their own personal one (-1). That Brexit destabilised retail sales remains, at best, a red herring, at worst a factual inaccuracy. Consumers felt that their personal finances were insulated from movements in the macro-economy and retail sales held up accordingly.

Retail sales vs GDP – previous recessions/crises

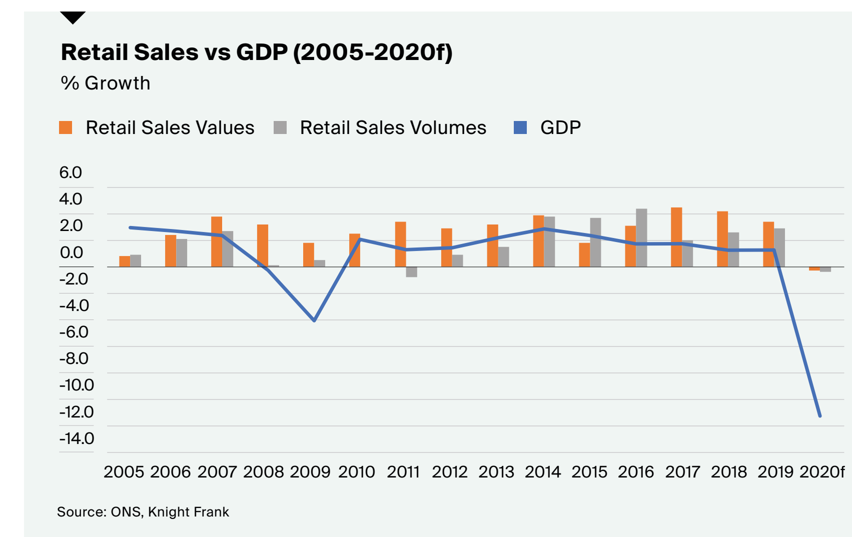
Consumer confidence is only a very loose indicator of retail sales. History has also proved that it is similarly wrong to simply assume that retail sales religiously track wider GDP performance.

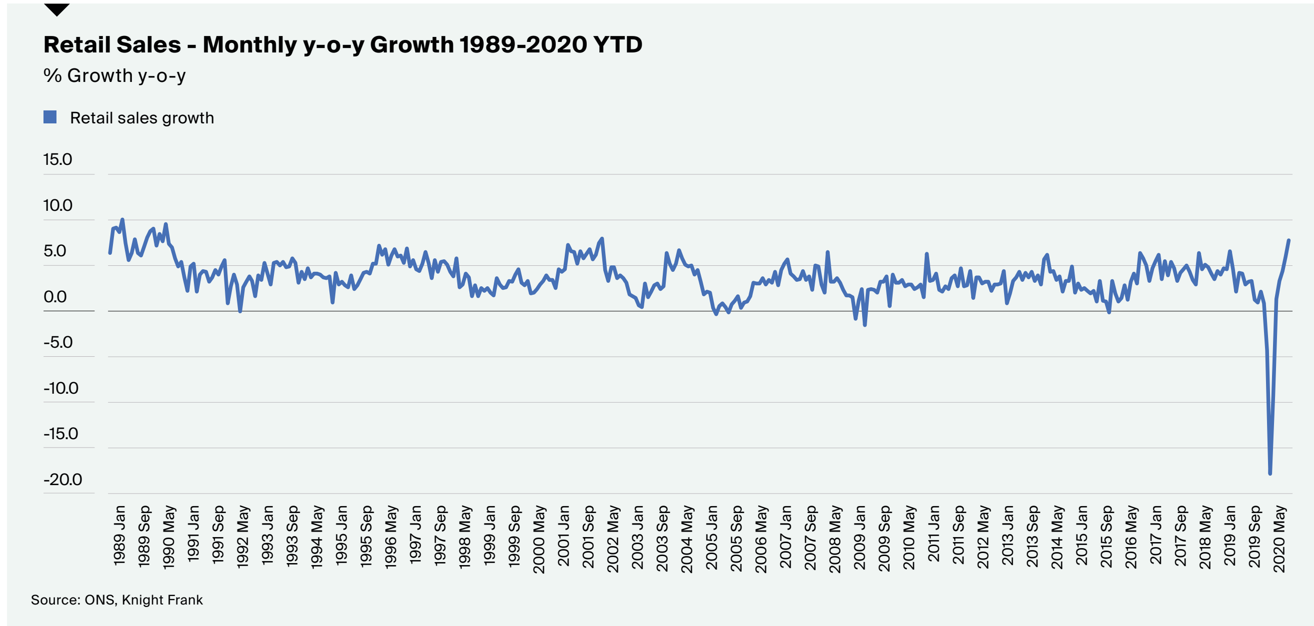
If anything, retail sales tend to outperform the wider economy. In the 30 year historic timeseries produced by the ONS, annual retail sales have grown faster than comparable GDP on no less than 23 occasions. GDP growth has surpassed retail sales growth on just six occasions. Only once (in 1998) over the last 30 have they broadly aligned (within 10bps either way), probably less a close correlation, much more a case of a broken clock telling the right time twice a day.

Since 1989, average annual retail sales growth has been +3.7%, compared to +2.0% for GDP. A key factor here is the relative performance during times of recession or crisis (financial or otherwise). During these periods of hardship, retail sales have a track record of significantly out-performing the wider economy.

The last two recessions (GFC and early 1990s) certainly bear this out, as does the Dot Com crash in the early 2000s to a certain degree. In 1990, retail sales grew by +7.3% compared to GDP growth of just +0.7%. The following year, the gap narrowed (+3.7% versus -1.1%) but was still significant. Retail rode on the consumer boom of the late 1980s longer than other industries but did ultimately succumb, albeit to a lesser degree than the wider economy.

A similar story during the GFC. High profile retail failures such as Woolworths, MFI and Comet (amongst many more) are the enduring public perception of the retail sector in the wake of the collapse of Lehman Brothers and there is no denying that GFC marked a period of major pain and wider fall-out for the UK high street. But the actual retail sales figures paint a slightly more nuanced picture. Retail sales in both 2008 (+3.2%) and 2009 (+1.8%) eclipsed GDP growth (-0.3% and -4.2%). A backdrop of wider retail distress





Source: ONS, Knight Frank

In times of past hardship, the consumer has time and time again defied gravity and retail sales have usually outperformed the wider economy. It is not unreasonable to surmise that 2021 will follow a similar pattern.

(the first manifestations of structural retail change that is still ongoing to this day) overshadowed a consumer who, despite everything, continued to spend.

In times of past hardship, the consumer has time and time again defied gravity and retail sales have usually outperformed the wider economy. It is not unreasonable to surmise that 2021 will follow a similar pattern.

2020 – how bad was it?

Fast forward to the here and now. How have retail sales responded to Covid-19 and government-imposed restrictions throughout the year? We will not receive the official 2020 outturn figures from the ONS until mid-January, but we are in a position to analyse the vacillations in monthly trends over the course of the year, plus put forward our projections for Christmas and FY 2020 outturn.

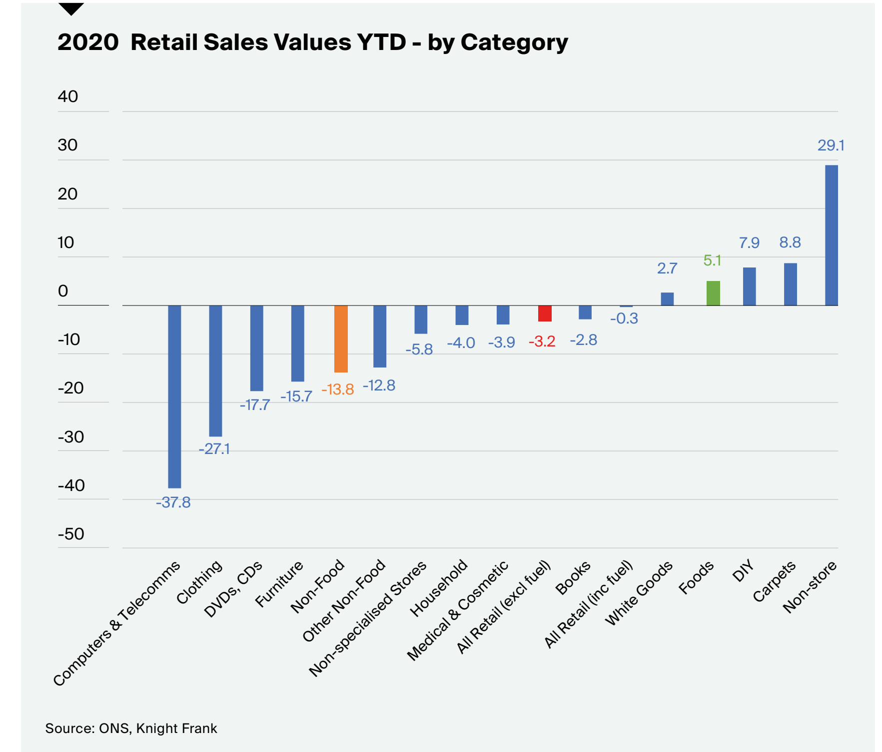
Beyond any doubt, this has been the most challenging year for the retail sector, arguably since World War 2. This is only partially reflected in the actual retail sales numbers. The 1st national lockdown came into force from 23 March and was only lifted from 15 June. Retail sales inevitably fell off a cliff over this period. In March they were down by -4.5% y-o-y, reaching a nadir in April (-18.2%) and remaining heavily in negative territory in May (-9.5%). These were unequivocally the three worst monthly performances since data records began in the late 1980s and probably any time since the late 1940s (if that data existed). For context, the previous worst month on record was May 2009, when year-on-year retail sales were down by comparatively mild -1.7%.

Retail sales 2020 YTD

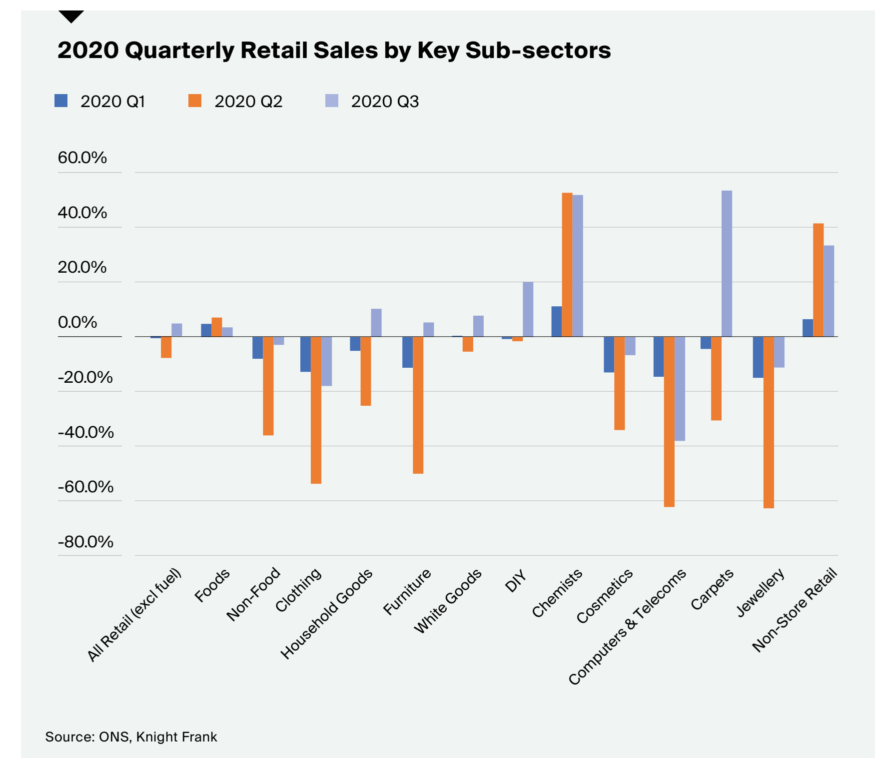
These headline figures do not even tell the full story, nor reflect the actual scale of the pain on the high street. "Essential retailers" (including supermarkets) were able to trade during the 1st lockdown and actually saw an acceleration of growth (March +10.4%, April +6.5%, May +7.9%). Stripping these figures from total retail sales paints a very bleak picture for the rest of the retail market. Non-food retail sales slumped by -21.4% in March, -53.3% in April and -42.3% in May. Non-food only returned to positive growth in September (+0.4%), but with monthly average declines of -21% in the intervening period. Of all the non-food sub-sectors, fashion has definitely been the hardest hit, recording average monthly declines of -37% between March and September and still in double digit negative growth with the end of year in sight.

Retail sales staged something of a rally between the 1st and 2nd lockdowns. Y-o-y retail sales growth averaged +5.3% between July and October, peaking at +7.7% before we entered 2nd lockdown on 5 November. This recovery confounded many economists, again exposing their tenuous grasp of the vagaries of consumer behaviour and that propensity to spend trumps all other considerations. At the same time, widespread narrative of retail sales "returning to pre-pandemic levels" is both tenuous and disingenuous and gives a false sense of recovery. Retail sales in September may have been higher than February in absolute terms, but seasonally, February is the low point for retail sales in any "normal" calendar year and therefore a weak base for comparison. Higher sales values in September versus February also glosses over the huge volumes of trade that disappeared in between.

The 2nd lockdown destabilised what fragile recovery we were seeing. On the plus side, the second lockdown was shorter



Source: ONS, Knight Frank



Source: ONS, Knight Frank

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than the first and having been there before, retailers were better-equipped to deal with some of the challenges that inevitably arose. But on the negative side, the timing could scarcely be worst, November being a key month in the build up to Christmas. Despite a smokescreen of "skyrocketing" online growth, the harsh reality is that overall retail sales again returned to negative territory in November.

At time of writing, Christmas 2020 is still playing out. With the 2nd lockdown lifted from 2 December, we expect retail sales to benefit from considerable pent up demand. Again, this is very hard to quantify at this stage, but we would tentatively estimate that y-o-y retail sales growth could comfortably surpass +5% in December.

Our projections for FY 2020 are as tentative as the shifting landscape allows. Assuming a lull in demand in November, followed by a frantic December as pent up demand is released, overall retail sales could grow by +5% to +6% in Q4. This would suggest a broadly neutral FY outturn figure of between -1% and +1% (with -0.5% and +0.5% a more likely range). But with a big polarity between food (FY 2020 retail sales growth projection +5% to +7%) and non-food (FY 2020 retail sales growth projection -4% to -8%).

A FY neutral outturn (-1% to +1%) is not exactly a triumph, but may actually be a decent return given the lows earlier in the year and the scale of the challenge Covid-19 has presented. One thing is certain – retail sales will again "out-perform" the wider economy this year, with consensus forecasts (in November 2020) suggesting that UK GDP will fall by ca. -10% to -11% this year.

But in many respects, it is less about the minutiae of the numbers, it is far more around the bigger picture. And the bigger picture here is of a consumer that is still willing to spend, as and when the high street is not subject to enforced closure.

Prospects for 2021

With so many moving parts both politically and socially and almost hourly newsflow on the nature of further restrictions and the prospects of vaccinations (not to mention the final outcome of Brexit), making concrete forecasts for 2021 is nigh on impossible. That said, we are confident that retail sales will stage a relatively strong recovery next year, the only major caveat being no further lockdowns nor disruptions on a major scale. Successful roll-out of a Covid-19 vaccine will undoubtedly have a huge economic impact, but its influence on retail sales can only be on the upside.

A FY neutral outturn (-1% to +1%) is not exactly a triumph, but may actually be a decent return given the lows earlier in the year and the scale of the challenge Covid-19 has presented.

The history of past recessions is likely to repeat in 2021, with retail sales outperforming both GDP (as already discussed) and wider consumer spending. Again, there is a tendency to confuse retail sales with consumer spending, or rather, to assume that the two are one and the same. In reality, there is surprisingly little correlation between the two. Retail sales actually represent only around one third of overall consumer spending, a pot that includes housing, transport, health, education, recreation, culture and communications, amongst many other categories.

In times of economic and social hardship, there is usually a flight to retail within consumer spending. In other words, consumers tend to redefine their spending priorities and money that would have been spent on other categories is actually spent in retail channels. Rather than buy a new car or go on an expensive holiday, some or all of that cash will be actually find a more immediate outlet in retail. To a degree, we have already seen this in 2020. Oxford Economics (OeF) are forecasting (at November 2020) that overall consumer spending for FY 2020 will be down -14.8%. Compare this with our own FY 2020 retail sales prediction of -1% to +1%.

Deciphering underlying performance as the year unfolds will be extremely difficult on account of a wildly fluctuating comp base. Basic mathematics will detract from what may be happening on the ground / on the high street. The monthly figures from March onwards will inevitably show huge demand spikes as they lap such weak comps in 2020. Taking the year as a whole, we would project that retail sales in 2021 are likely to grow in the order of +5% to +6%. Although in line with 2021 forecasts for consumer spending (e.g. OeF at +5.2%), retail sales growth will be leveraged off a more demanding base. And by the end of the year, we should be some way towards clawing back the trade that was lost in 2020 at the height of the pandemic.

Some perspective

Retail sales are the lifeblood of the high street, but the arteries to its vital organs are manifold. While strong retail sales are a prerequisite for a healthy retail industry, they cannot necessarily sustain a healthy market on their own. Sadly, strong retail sales do not necessarily percolate to a healthy high street if the latter has pre-existing conditions. Many of the UK retail sector's issues are structural and will not simply be washed away by a tide of positive consumer demand.

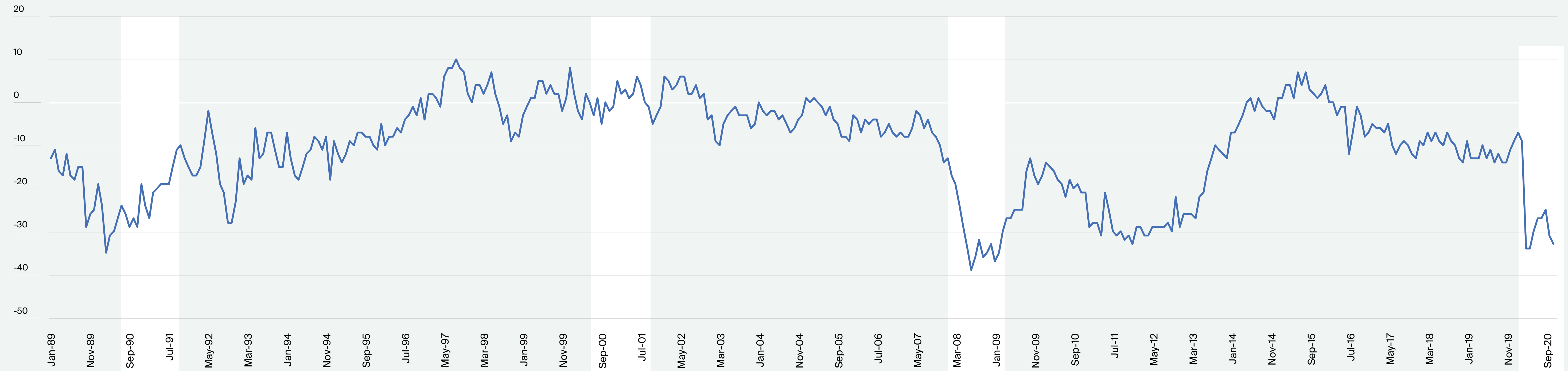
If not full salvation, strong retail sales at least provide a platform upon which to build. Retailers still face a multitude of challenges and many remain ensconced in a battle for survival. But the likelihood of this being achieved and necessary rebasing / restructuring being implemented is infinitely higher if consumers continue to spend. As many aspects of the retail industry battle on, they can do so in the relative comfort of knowing that the UK consumer is likely to play their part, whatever the economic text book may say.

By the end of the year, we should be some way towards clawing back the trade that was lost in 2020 at the height of the pandemic.

COVID-19 VS PAST RECESSIONS AND CRISES

GfK Consumer Confidence Index

Total (1989-Present)



Early 1990s Recession

Y-o-Y Growth (%)

	1990	1991
GDP	+0.7%	-1.1%
Retail Sales Values	+7.3%	+3.7%
Retail Sales Volumes	+1.4%	-1.8%
CPI	+7.0%	+7.5%
Unemployment	5.5%	7.6%
Retail Capital Values	-15.5%	-4.8%
Retail Rental Values	+4.9%	-1.9%

Dotcom Crash

Y-o-Y Growth (%)

	2000	2001
GDP	+3.5%	+2.7%
Retail Sales Values	+3.0%	+5.5%
Retail Sales Volumes	+3.7%	+10.8%
CPI	+0.8%	+1.2%
Unemployment	3.5%	3.1%
Retail Capital Values	+0.8%	-0.4%
Retail Rental Values	+4.9%	+3.3%

Source: ONS, MSCI, IPD, Realfor, Oxford Economics

GFC

Y-o-Y Growth (%)

	2008	2009
GDP	-0.3%	-4.1%
Retail Sales Values	+3.2%	+1.8%
Retail Sales Volumes	+0.1%	+0.5%
CPI	+3.6%	+2.2%
Unemployment	2.7%	4.6%
Retail Capital Values	-26.6%	-2.8%
Retail Rental Values	+0.1%	-5.4%

Covid-19 Pandemic

Y-o-Y Growth (%)

	2020p	2021f
GDP	-11.3%	+5.2%
Retail Sales Values	-0.3%	+5.0%
Retail Sales Volumes	-0.4%	+4.0%
CPI	+0.9%	+1.4%
Unemployment	6.3%	8.0%
Retail Capital Values	-18.2%	-6.6%
Retail Rental Values	-10.0%	-5.5%

THE OCCUPIER: CHANGING OF THE GUARD

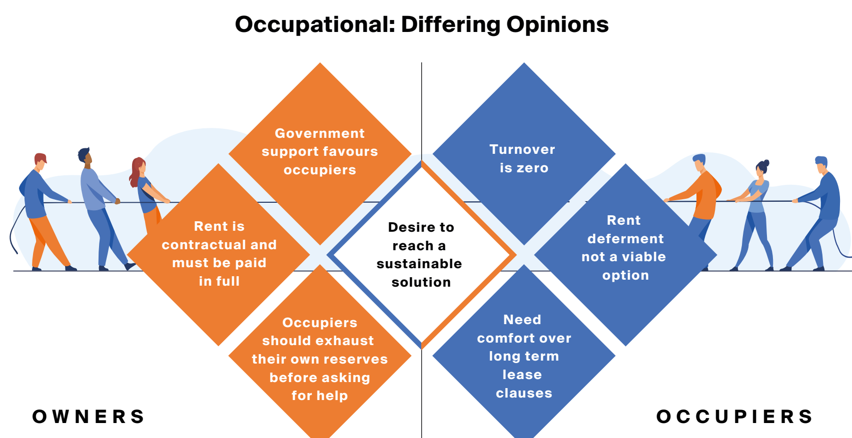
Retail Darwinism at its most intense – 2021 will again be survival of the fittest amongst retailers. Goodbye to some of the old guard, hello to a new breed.

STEPHEN SPRINGHAM – HEAD OF RETAIL RESEARCH
DAVID LEGAT – PARTNER, RETAIL AGENCY

Covid-19 has accelerated and accentuated many trends we were already seeing in the retail market and turbo-boosted painful but necessary structural change. A popular (if slightly lazy) summation is that we have witnessed 5 years of change in as many months. That may be true up to point, but the impact of Covid-19 has not been progressive on all counts.

Two aspects of retail have sadly regressed considerably over the past year, with little prospect of this changing in 2021 – retailer and landlord relations and narrative over online. Market conditions have brought tenants and landlords onto a collision course, the much vaunted "spirit of collaboration" of recent years often seeming little more than a myth. Similarly, a harsh dividing line has been reinstated between online and physical retail, a major setback in the journey towards understanding the multi-channel mechanics of modern-day retailing and reacting to what is an evolutionary process. On both these key issues, we have gone backwards rather than forwards.

Occupational: Differing Opinions



Year of the arrear

Quarterly rent days can be a pinch-point at the best of times. 2020 was clearly not the best of times and there were considerable stand-offs between landlords and occupiers, many of which are still ongoing.

The UK first went into lockdown on 23 March, a couple of days before quarterly rent day. A number of retailers (those that were able to stop standing orders from going through) withheld payment. With lockdown lasting almost until Q2 rent day, retailers were in a far worse cash position in June, having had zero trade through their stores and only compromised sales through their online divisions. Less than 20% of all retailers paid on time and in full in June, with a similar trend repeating in September.

As a very general rule, all the major grocers paid in full, but hardly any hospitality operators paid anything. Non-food retailers were somewhere in-between these two extremes. Most controversial were non-food "essential" operators that were able to open during lockdown, yet still did not meet their quarterly rent obligations. Essentially, all operators fell into four broad camps – "the payers", "the can't pays", "the won't pays" and those that proactively sought to secure landlord concessions. With negotiations still ongoing, some rents were collected post quarterly payment days in some shape or form e.g. staggered monthly or at a reduced rate.

But there is still a cloud of unpaid rent hanging over the sector, with little indication as to how this will be resolved. In broad terms, Knight Frank estimates that around 50% of retail rent owed is still outstanding going into 2021 and with many retailers still trading below historic volumes (by as much as -50%), the prospects of it being repaid anytime soon are bleak, particularly all the time the moratorium on forfeiture remains in place.

2021 will be the Year of the Arrear. What is going to happen to the money that is owed? Are landlords merely going to write it off, or aggressively try to recoup as and when they are able, or are mutually-beneficial compromises going to be struck? Compromise solutions include staggered repayments over a predetermined timeframe or possibly re-gearing the lease. But the latter solution is only viable on three conditions.

1. The landlord has faith in an occupier's covenant
2. The unexpired term permits
3. The owner can afford short-term income loss.

Similarly, staggered repayments only work if the tenant

1. Stays in occupation
2. Doesn't fold corporately.

In many cases, none of these issues are certainties and many landlords have lost faith in occupiers' longevity.

Two aspects of retail have sadly regressed considerably over the past year, with little prospect of this changing in 2021 – retailer and landlord relations and narrative over online.

We believe the moratorium on forfeiture will be extended until March. This will buy further breathing space for occupiers, but will not resolve the issue of unpaid rent. But ultimately, if landlords are to write-off rent owed, then at some point they will be obliged to do so formally, actually recognising it on their balance sheets, rather than just notionally "somewhere in the ether", as is currently the case. The stagnation we are currently seeing in rent arrears cannot carry on indefinitely and is a ticking time bomb.

Pinch points – end of the moratorium and business rate holiday

The detonation of this time bomb is likely to occur when the moratorium on forfeiture is lifted. In all likelihood, the moratorium is likely to be extended to March. Beyond that, it is impossible to speculate at time of writing (December 2020).

The other elephant in the room is the business rate holiday, which, as things stand is also scheduled to end in March. The holiday has undoubtedly temporarily removed one major cost pressure for retailers. For the very largest retailers, rates relief was substantial (e.g. Tesco £585m, Sainsbury's £498m, Asda £297m, Morrison's £279m Note: all since repaid), but even for a small retailer or independent operator, it could be the difference between survival and failure.

Few outside Central and Local government would argue that the current business rate system is equitable in today's retail market (regardless of Covid-19). The fact that it is about the only thing that landlords and retailers wholeheartedly agree on speaks volumes. The introduction of the holiday last year raised hope of overdue reform but as yet, any detail or direction on this is not forthcoming. But simply lapsing back into the old regime would be not so much a missed opportunity as a disaster.

But how much appetite is there within Central Government to radically overhaul one of its largest and most stable tax streams? And one that is so efficient, in that it is both easy to administer and to collect? And, more obviously, how high up the agenda is it as Covid-19 still rages and Brexit nears the end-game? Re-balancing the nation's tax books will dominate the political and economic landscape well beyond 2021 and business rates risks being a secondary consideration to much more profound financial restructuring.

But business rates remain a very real issue and burden for the retail sector.

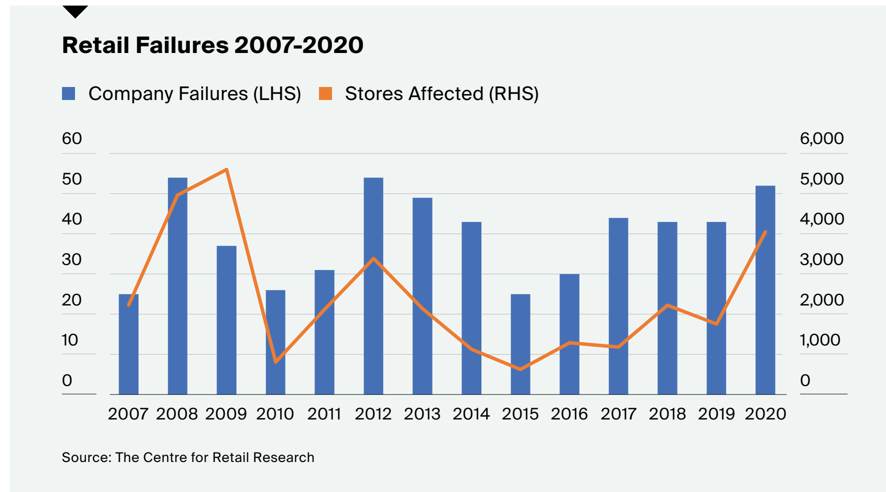
THE SHOW MUST GO ON – RETAIL PROPERTY MARKET OUTLOOK 2021

What would perfect reform look like? How long will it take to come up with a new business rates system – and what is the interim solution? Aside from the bluest-of-blue sky scenarios of business rates being scrapped completely and the current holiday made permanent, the most equitable solution would still appear to lie in levelling the playing field between online and physical. On the one hand, ensuring that large pure-play online retailers pay 1. Their fair share of corporation tax. 2. A levy on online orders.

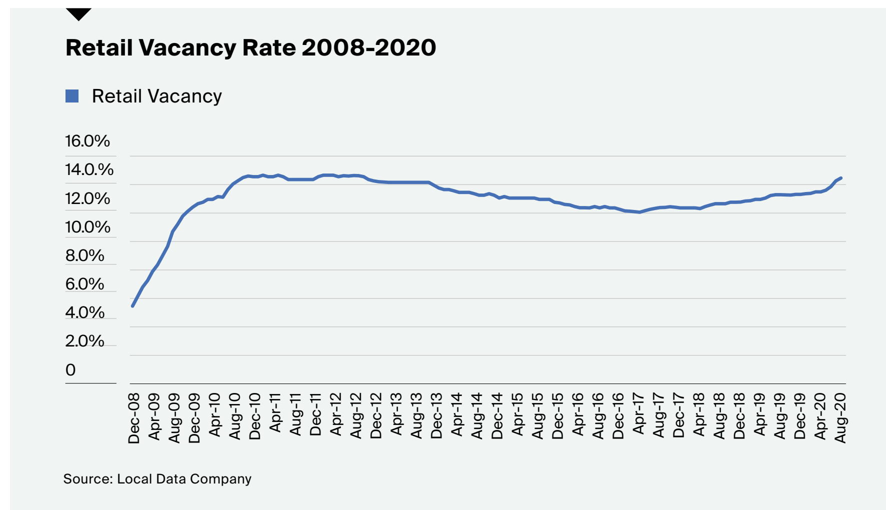
Ensuring all large multi-national businesses (not just retailers) pay a fair share of corporation tax is surely a quick win. And, if appropriate, align taxation with turnover, not profits, which can so easily be downplayed or re-distributed across geographies, jurisdictions and subsidiaries. With ESG supposedly so high on the agenda, it is staggering that this practice is still being so widely abused.

A levy on online orders would be more complex. A straight "online" tax would not necessarily level the playing field in that it would equally impinge upon those it is designed to help – multi-channel operators with both a physical and online presence (although it may prompt them to recognise store-based sales as such, rather than include large proportions in online sales as they currently do). Some sort of green tax around online deliveries may be a more appropriate avenue for exploration.

Doing nothing on business rates is not an option. And if the holiday is lifted at the same time as the moratorium on forfeiture in March, April/May could be an absolute bloodbath for retail operators...



Source: The Centre for Retail Research



Source: Local Data Company

A fresh wave of CVAs and administrations

CVAs will inevitably continue in 2021. A fresh trickle is likely in the New Year, with the further pinch point of another quarterly rent day in December exacerbated by possible pressure from banks and lenders. Giving way to a more of a flow as current relief packages (furlough schemes, moratorium on forfeiture, business rate holidays) unwind or expire as the year unfolds.

The CVA process will remain a source of unresolved controversy. Our views remain the same. We want retailers to succeed and viable operators to be given the necessary short-term support to not only survive, but to thrive in the longer term. But the CVA system should not be open to abuse, a mechanism for retailers to renege on legally-binding rent and lease obligations. Nor is the current voting process sufficiently transparent or equitable, with landlords bearing a disproportionate burden of potential income loss relative to their share of the vote. In an ideal world, a much tighter and more transparent Code of Practice needs to be drawn up and enforced to prevent further abuse of the system. But despite all the controversy and simmering resentment, this has yet to happen.

The list of potential CVA candidates has undoubtedly broadened over the course of the pandemic. Some now consider every retail operator to be a CVA risk, but this is slightly extreme as some retailers are far more immune than others and some remain extremely well-capitalised. Our generic CVA watchlist is still determined by three key considerations:

1. A track record of past CVA/administration/failure – history suggests that operators that have failed before are more than likely to do so again.
2. Private Equity ownership, current or historic – PE-owned businesses have often been asset-stripped, under-invested, with high levels of debt and lack the balance sheet strength to withstand pressure.
3. Exposure to the fashion sector – clothing is by far the most over-supplied retail sub-sector (too many stores, too many players) and consumer demand was soft even prior to Covid-19. Sales during the pandemic have been down by a monthly average of -37%.

A cross in any one of these boxes presents a risk. A cross in all three (e.g. Debenhams, House of Fraser, New Look, EWM) a much heightened one.

The "New Norm"

Flexibility and affordability – these are the two factors that will define the retail occupier landscape in 2021. And for many years to come, for that matter. The phrase "new normal" is vastly overused generally, but in a retail context, flexibility and affordability will be the predominant forces, in many respects, often going hand-in-hand.

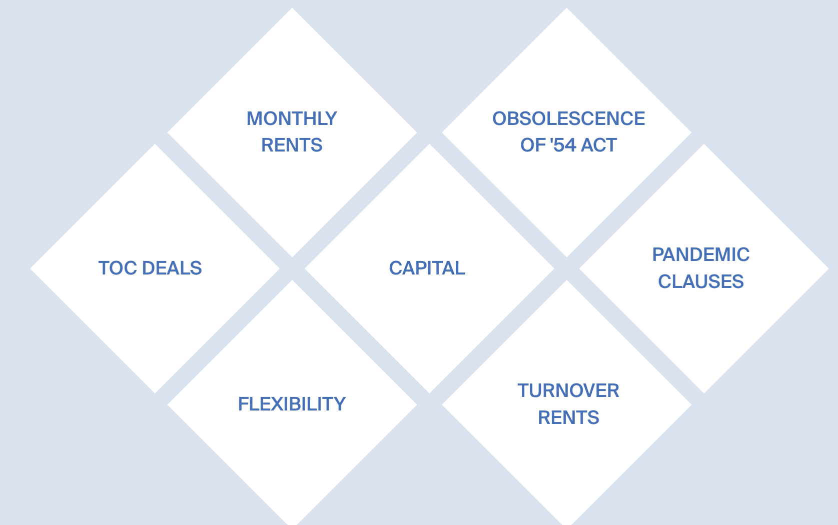
The word "flexibility" recurs in retailer narrative with noticeable frequency. It encompasses a number of facets, including lease lengths, the type/nature/terms of leases and rent payable. But it also places "the new norm" in sharp conflict with many of the founding principles of retail real estate – long fixed terms and security of income. One of the fault lines running through the whole retail industry is a misalignment of agendas between a number of its key stakeholders. Ultimately, it will always be the consumer that defines any retail market. The consumer is evolving at a rate of knots and becoming ever more sophisticating and demanding in terms of what they expect. Retailers are frantically trying keep pace with this consumer change, some succeeding far better than others. By all accounts, the property market is the laggard in all this, failing to keep pace with a world that is shifting both constantly and rapidly.

CURRENT DEALS, THE NEW NORM

Affordability and flexibility are key

Occupiers are keen to cut or control costs as far as possible, in many cases this equates to nil rent deals.

The general term certain occupiers are willing to agree to has reduced significantly.



THE SHOW MUST GO ON – RETAIL PROPERTY MARKET OUTLOOK 2021

Retail occupier markets will continue to become more flexible, key manifestations being shorter leases with more break clauses. But, clearly, there has to be a degree of give on both sides. Landlords need comfort that if they are to make concessions, they are not then exploited by retailers, for example, through a CVA. But this is where a leaner retail landscape will come into play – if only the fittest survive, then there is greater certainty that tenants are bone fide and have a sustainable future. For too long, there has not been enough discrimination between "good" and "bad" retailers, the line of distinction tending historically to be whether they are (high) rent-paying or not.

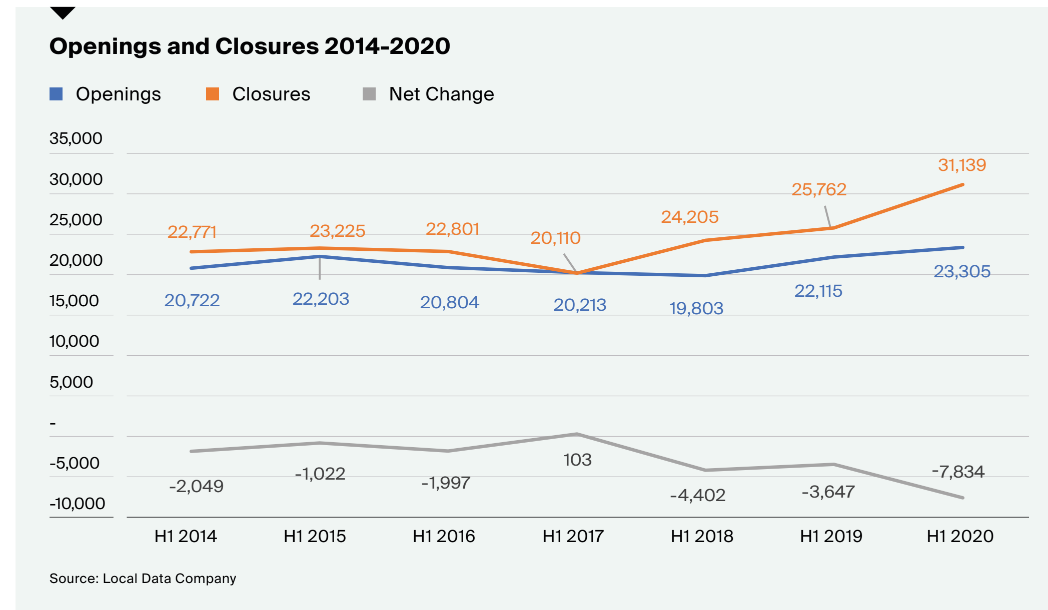
The push towards turnover rents speaks to both flexibility and affordability and will undoubtedly continue in 2021. On paper, turnover rents seem a no-brainer; in practice, they are anything but. To the uninitiated, they seem a perfectly fair and equitable solution. The occupier de-risks a trading location and pays only a proportion of turnover that an individual store generates, therefore maintaining an equilibrium of affordability. The landlord has a happy tenant who will not default, helping cover any shortfall in performance, but also benefitting from any level of out-performance. If only it were that simple.

For a start, there is no "one size fits all" approach. The fact that retail is increasingly multi-channel muddies the waters even further. Historically, assessing a store's turnover amounted to simply counting what went through the cash register. In a multi-channel world, the role of a store has evolved and become far broader. What actually goes through the cash register may actually have declined, but that store makes a contribution to a wider multi-channel offensive e.g. a showroom for online orders, a collection point for click & collect orders, a repository for returned purchases (from online and other stores), overall marketing support for the brand.

Quantifying all these factors to derive a meaningful and accurate figure for store contribution (upon which a turnover rent must be based) is a minefield. There is an unwelcome irony in the fact that a transparency-dependent model is rising up the agenda at the same time as transparency itself is rapidly diminishing.

But total transparency is still a prerequisite for turnover rents to work and in many cases, this is still lacking. Retailers are understandably protective of their trading data and will always seek to limit its release into the public domain over concerns of miss-use (e.g. falling into the hands of competitors or negatively influencing future deals). But without it, landlords have no transparency. Not all landlords are averse to turnover rents, but most remain sceptical. Few believe that they will benefit from retailer outperformance, noting that retailers only seem to propose switching to turnover rents in times of crisis rather than prosperity. With some justification, others may point to the fact that in the base + top up model, hardly any top ups are actually triggered.

Residual mistrust on both sides (landlords and tenants) is still a major constraint on turnover rents becoming commonplace. There needs to be more give and take on both sides. The current valuation and funding models also make turnover leases difficult to value and finance. At the same time, the retail market needs to evolve if it is to emerge from this crisis



intact and the sector needs to embrace greater flexibility. On paper, a switch to turnover rents could be a positive catalyst to necessary change, but the whole model needs fundamental review to establish full transparency, including a Code of Conduct and a formal process of external audit.

No one is saying "the new retail norm" will be easy...

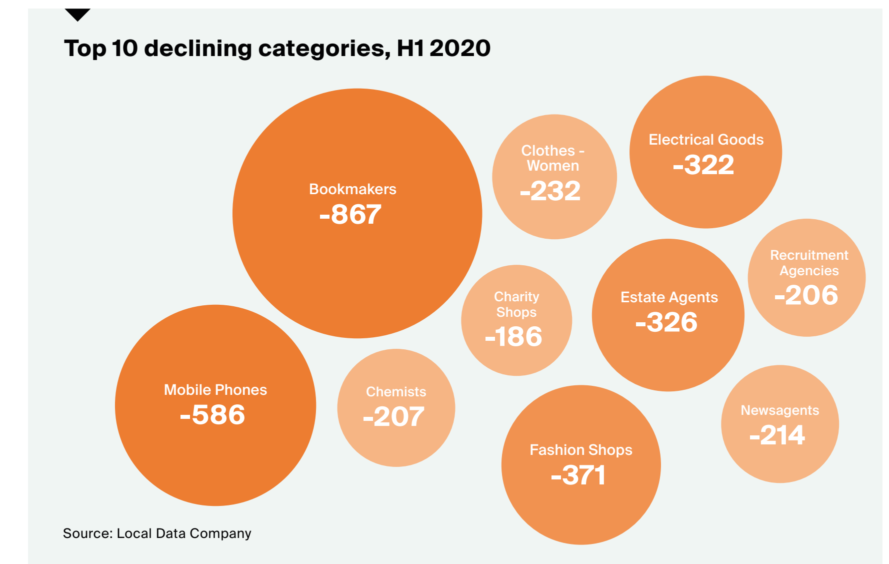
The new breed

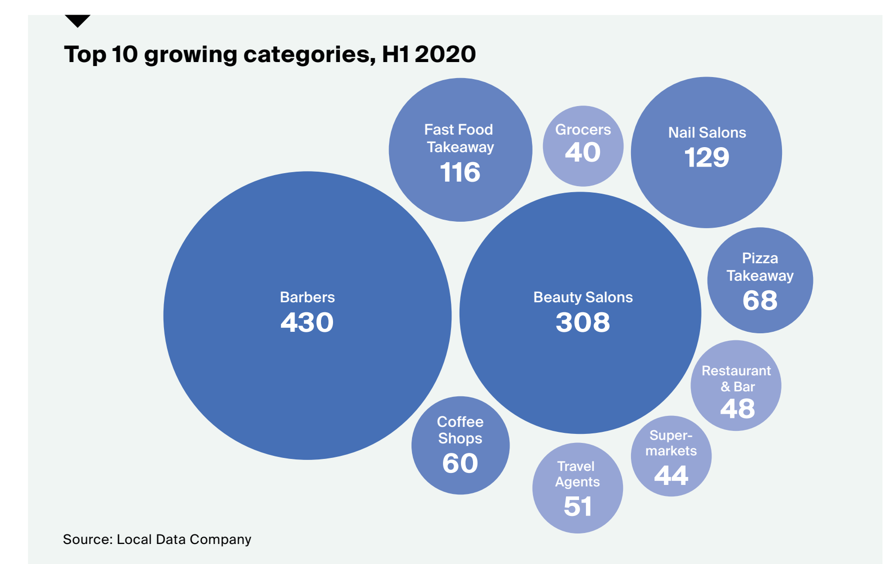
Some retailers will inevitably go further than CVA / pre-pack administration and succumb to full liquidation in 2021 – some of these may be long-established fixtures on the high street, well-known household names. Harsh as it sounds, losing high street names is all part of the evolution process. No one wants retailers to fail (with special consideration to their workforce in particular), but unsustainable businesses cannot be supported forever and the retail sector as a whole is probably better off without them.

Well-known retailers going bust and disappearing from the high street is not peculiar to Covid-19 and has been a feature of retail since time immemorial. Woolworths, Bhs, Comet, MFI, Do-It-All, Texas, Queensway, Courts, Virgin Megastore, Our Price, Freeman Hardy Willis, Dolcis, Athena, Foster Menswear, Olympus, JJB Sports, Toys R Us, Index, Staples, Etam, Allders, Tie Rack, Tandy. There's a list of more than 20 retailers that are no longer with us purely off the top of my head, I could probably come up with 100+ more if I gave it serious consideration. Discussing former high street stalwarts prompts the same sort of misty-eyed reminiscing as TV programmes of childhood, but the simple fact is that however missed and lamented these brands are, the high street has survived and evolved without them.

By way of example / case study. The clothing sector has experienced staggered fall-out from a large scale operator at regular points in recent history. There was major consternation when C&A withdrew from the UK in 2000 and all 113 stores closed. Five years later, it was the turn of Littlewoods (120 closures). In more recent memory, BHS ceased trading in 2016, resulting in the closure of ca. 160 stores. Each was a major player in the UK clothing market, with respective shares of around 2% - 4%. Their departing freed up this capacity to be distributed across other players (Primark being the main beneficiary) and eased oversupply. With oversupply still an issue going into 2021, a similar pattern may well emerge.

Much of the retail narrative is currently about retrenchment, retailers closing stores and reducing their physical footprint, or disappearing altogether. But it is not purely a one way street, a fact borne out by recent research by Local Data Company (LDC). Many of the statistics and messages from their





Changing of the Guard: Top 15 Non-Food Retailers 1990 vs 2020

	1990		2020	
Rank	Retailer	Sales (bn)	Retailer	Sales (bn)
1	Marks & Spencer	£4.4bn	Amazon	£13.9bn
2	Kingfisher	£2.7bn	John Lewis Partnership	£10.3bn
3	Boots Company	£2.2bn	Marks & Spencer	£9.4bn
4	John Lewis Partnership	£1.8bn	Ebay	£8.1bn
5	Burton Group	£1.6bn	Walgreens Boots Alliance	£7.2bn
6	Sears	£1.8bn	Kingfisher	£5.1bn
7	Great Universal Stores	£1.4bn	JD Sports	£4.7bn
8	Littlewoods Organisation	£1.4bn	Next	£4.2bn
9	House of Fraser	£1.1bn	B&M	£3.5bn
10	WH Smith	£1.1bn	Primark	£3.3bn
11	Storehouse	£1.0bn	Frasers Group	£3.3bn
12	Dixons Group	£0.9bn	TJ Morris	£2.5bn
13	Thorn EMI	£0.9bn	TK Maxx	£2.3bn
14	Gallaher	£0.7bn	Steinhoff	£2.1bn
15	Electricity Boards	£0.7bn	AS Watson	£2.0bn

Source: Mintel, Corporate Intelligence, Knight Frank

H1 Retail and Leisure Trends Report make for sobering reading. There were 31,139 closures in H1 2020, an increase of +21% on the same period the previous year. But, interestingly, there were also 23,305 new openings (+5% on H1 2019). Obviously, that leaves a net deficit of -7,834 (an inevitable by-product of Covid-19 conditions in an over-supplied market), but the number of new openings is still substantial. It proves that there is still market activity, some retailers are still acquiring new space and new operators are emerging to replace those that are falling by the wayside.

LDC's data shows which sub-sectors are gaining presence (Barbers +430, Beauty Salons +308, Nail Salons +128, Fast Food & Takeaways +116) and which are receding (Bookmakers -867, Mobile Phone Shops -586, Fashion Shops -371). More revealingly, the report also shows Independent Operators proving more resilient than Multiple Operators. In all four header categories (Comparison Goods, Convenience Goods, Leisure, Services) Independents 'outperformed' their multiple peers, in the Services sector even registering a net increase in units despite the pandemic.

A "new breed" of occupier will emerge from this market. Independent and local operators now will evolve into national (even international) multiples of the future. Even the largest, longest-established multi-national retailer started from a single store somewhere. Walmart, a single discount store in Bentonville Arkansas, Tesco a war-surplus market stall in Hackney, Sainsbury's a counter-based small grocery store on Drury Lane in London.

The "new breed" will be born of the "new norm" and will expect flexibility and affordability as standard

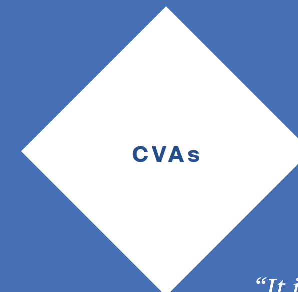
And where were some of today's trailblazers and largest non-food space occupiers some 30 years ago? Primark had 28 stores and annual turnover of just £45m (versus ca. £3.5bn and 185 in the UK alone today), H&M in the UK just 17 sites and turnover of just £23m (2020: £1.2bn, 300+ stores). B&M failed to register as one of the Top 500 retailers in the UK (2020: £3.5bn, 620+ sites). Aldi only opened its very first UK store in 1990 (ca. £12bn and ca. 1,000 stores now), Lidl, TK Maxx and Zara had yet to expand into the UK. And a number of 'home-grown' operators such as Superdry, Joules, Jack Wills, White Company and Poundland had yet to be founded.

A "new breed" will emerge over the coming years. But they will not merely backfill space vacated by the old guard, it is not a "straight substitution" and there will be a deficit in net absorption of space for many years to come. Also, the "new breed" will be born of the "new norm" and will expect flexibility and affordability as standard.

Who are the "new breed"? Any of ME+EM, Ollie Quinn, YT Mill, Specialised Concept Store, Ace and Tate, Cubitt, Aesop, Natoora, Polette, Astrid & Miyu, Knoops, Farmer J, Redemption Roasters, Japanese Knife Company, Rosa's Thai Café, Bread Ahead, ADAM Grooming, Maya Magal, Venchi, Bens, EL&N, Ever Bean Coffee, Gentleman Baristas, Black Sheep Coffee, Daisy Green, WatchHouse Coffee, Vallebona, Boom: Battle Bar, BAM Karaoke, to simply throw around 30 names out there. But there are literally hundreds more, some of which are probably still at the conception stage.

Out with the old, in with the new.

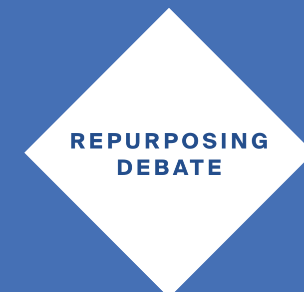
WHAT TO EXPECT IN 2021



"It is inevitable that there will be further restructuring from a large number of occupiers"

"Dipping in and out of lockdowns and tiers perpetuates uncertainty"

"The impending pinch point"



"Meat is needed on the bones to make this ideology financially stack up"

"There is no certainty over a change in the system"

"Although casualties on both sides are inevitable, there must be pursuit of common ground"

Source: Knight Frank

RETAIL INVESTMENT: BETTING ON A RECOVERY

Retail remains an investible sector, but can appear a lottery to the uninitiated. Where we think the smart money is likely to go in 2021 and beyond.

CHARLIE BARKE
HEAD OF RETAIL CAPITAL MARKETS

2020 has been a challenging year for many parts of the property market but retail has been right at the coal face.

Following on from 3-4 years of poor performance at the hands of structural change, faced with non-payment of rent and a raft of retailer failures, this year values have collapsed, with 30-50% annual decline commonplace.

Shopping centres, in particular, have seen a huge capital value reduction and this impact has not just been felt in the secondary markets. Arguably prime had some catching up to do having been more stable in the previous years. With rental movements of -30% (or more) and yield shift of +200 bps (or more), prime assets have equally suffered this year and are now often valued some way below replacement cost.

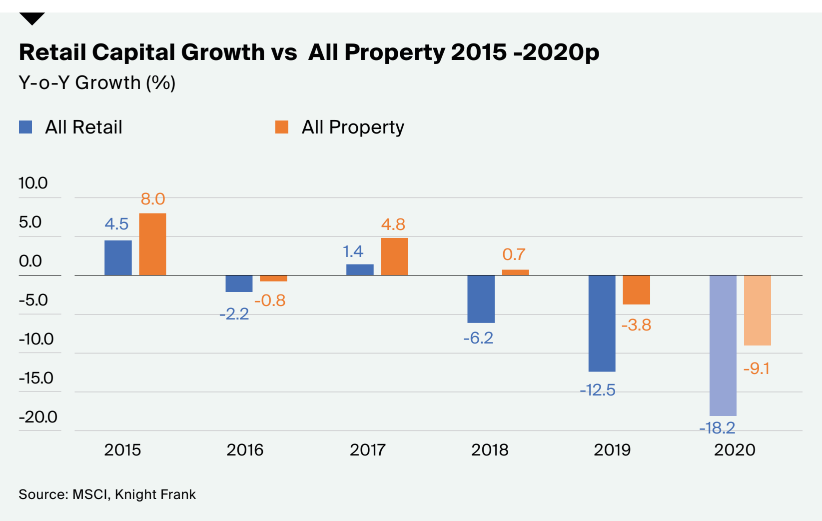
So does this stark degree of re-basing leave the sector well-priced? Is this an over-correction and will we see a 2010 style recovery that allows purchasers to make a profit of yield shift alone?

Across the retail sector generalisations remain dangerous. This is certainly true of capital values as where some assets now appear to offer recovery potential, others seem to have a less secure future.

The punters' favourite

The sub-sector that has already started to attract significant attention is retail warehousing. Considered e-commerce resistant and social-distancing compliant, these locations generally fared well post lockdown. Their accessibility, flexibility and simplicity are admired by both institutional and private equity investors. The crowds are gathering in this sector, both funds and debt-backed buyers. If the requirements from UK institutions continue to develop in early 2021, expect the PE market to be out-competed and the "bottom" in this sub-sector potentially missed by many.

For both funds and PE buyers, the preference will remain for stock in the South East of the country with some sort of alternative use under-write. Bulky goods or discount use off lower rents (<£20/sq ft) will be preferred but we even envisage some sort of recovery for fashion parks in 2021. Expect 50-100 bps of yield compression and a double-digit return from this stock in 2021 (provided the valuation is at the right starting point at year end!).

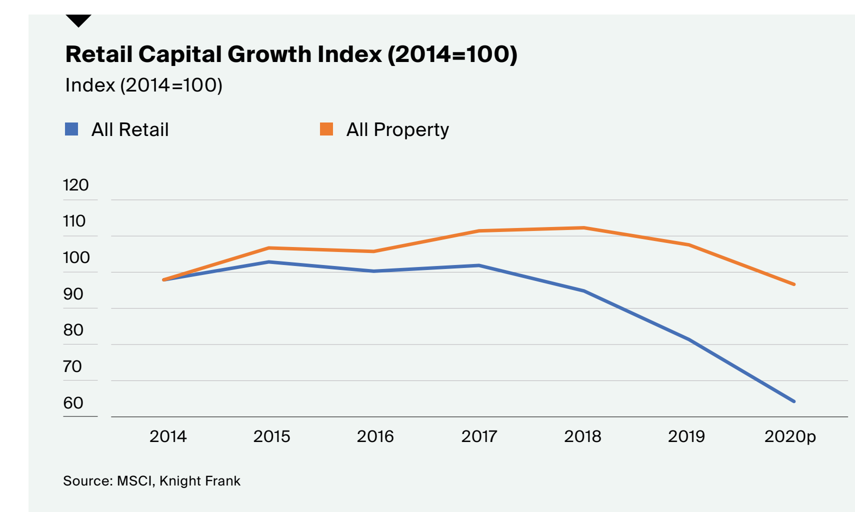


Source: MSCI, Knight Frank

Property Market Performance 2020 YTD

	Q3 2020			12 months to Sep 2020		
	Total Return (%)	Capital Value Growth (%)	Income Return (%)	Total Return (%)	Capital Value Growth (%)	Income Return (%)
All Property Types	0.10	-1.00	1.11	-3.14	-7.41	4.58
Office	0.14	-0.82	0.97	0.47	-3.36	3.96
Industrial	2.05	0.98	1.07	4.45	0.08	4.37
Retail	-1.88	-3.16	1.31	-12.86	-17.43	5.44
Shopping Centres	-5.53	-6.65	1.17	-24.97	-28.80	5.22
Retail Warehouses	-1.38	-2.96	1.61	-13.74	-19.09	6.48

Source: MSCI, Knight Frank



Source: MSCI, Knight Frank

The each way bet

The prospects for High Street investments vary hugely. The former darlings of the market, Guildford, Chichester, Winchester et al, had a torrid time in 2020, seeing rents collapse and initial yields move to 7-8%+, levels not witnessed in these locations since the early 1990s. There is likely to be a stabilisation next year but meaningful recovery in rents is not expected so yields will remain high on over-rented properties.

The continuing differential between "good" and "bad" tenants will be witnessed - as an owner of a single-let property, who would want a turnover-rent seeking fashion retailer as their tenant? Will their hard-line approach to landlord negations come back to haunt in retailers in the best locations in future years (or is that just wishful thinking?!).

Across the retail sector generalisations remain dangerous. This is certainly true of capital values as where some assets now appear to offer recovery potential, others seem to have a less secure future.

For both funds and PE buyers, the preference will remain for stock in the South East of the country with some sort of alternative use under-write.

Central London retail arguably had the greatest shock of all in 2020 and the fallout is likely to continue into 2021. We are yet to assess the extent of this damage and many landlords are yet to fully appreciate the impact on rents. This feels a market to watch from the sides for now if you can.

Is there value to be had in our regional towns? Yes, with careful stock selection over location, building, tenant and rent.

On the other hand London suburbs remain an appealing option. As workforces hopefully return to the office in 2021, we expect to still see swathes of residents in Zones 2-6 working from home 2-3 days a week. The suburbs performed well after lockdown and we expect this to be repeated in 2021. These locations have always been a good bet for click & collect and online returns. Supply is often fairly constrained here and the upper parts of buildings are often valuable. Swap Central London for suburban London exposure over the next few years where you can.

Is there value to be had in our regional towns? Yes, with careful stock selection over location, building, tenant and rent. The right high street investment still carries very low obsolescence and risk can be mitigated by treading a careful path. Yields are attractive and offer medium- as opposed to short-term recovery potential. In many instances the conversion of upper parts may still release added value.

The rank outsider

For shopping centres, the immediate outlook remains challenging. We have witnessed huge value write downs over the past five years, often to ca. 75% in total. Future occupancy remains uncertain, true rental values remain unclear and many assets will require significant capex just to stand still over the next few years, a further landlord investment that will not be justified by a Lazarus style recovery.

There are some areas where we feel more confident than others. As with high street assets, London suburbs look a good bet in both the short and medium term. Trading in these locations is typically stronger, retailers are more willing to test such locations and the investment supply of this product is finite. On top of that, the alternative use value is likely to underpin investment value and with the rise of mixed use, the ongoing development of such locations should realise value to the owner.

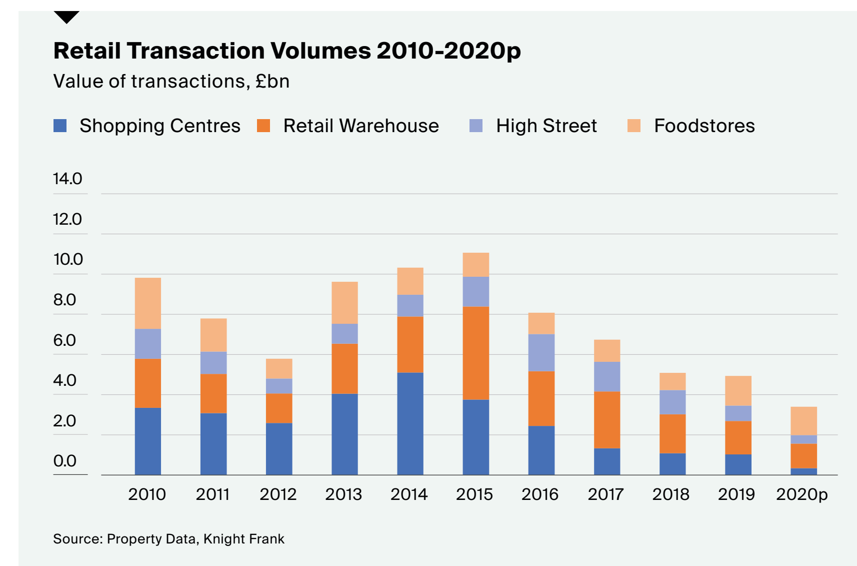
Supermarket-anchored schemes across the country remain in favour and good ones are in short supply. If institutions come back to retail in years to come we expect it to be for foodstore-anchored schemes offering an element of safely alongside an element of higher yield. In the interim, banks will continue to lend against supermarket income and so for debt-backed buyers, these schemes offer a chance of obtaining finance where otherwise it might be close to impossible to come by.

Prime centres are likely to start to stabilise but only from today's true market pricing. Many owners still believe their schemes should be valued at 7-9% NIY but the reality is today's buyers want that level of income return even in reversion. With rents coming off by 20%+, NIYs have to be double-digit for all but the very best assets. So as reality dawns and valuations catch up, the index will show further underperformance from prime schemes. Outside of that catch up process we envisage fairly stable market pricing in prime, though beware the significant supply spike that is bound to materialise in this sector. That could flood the market later in 2021/22 and, in the absence of a recovery in investment demand, an inevitable imbalance of demand and supply could cause further yield shift.

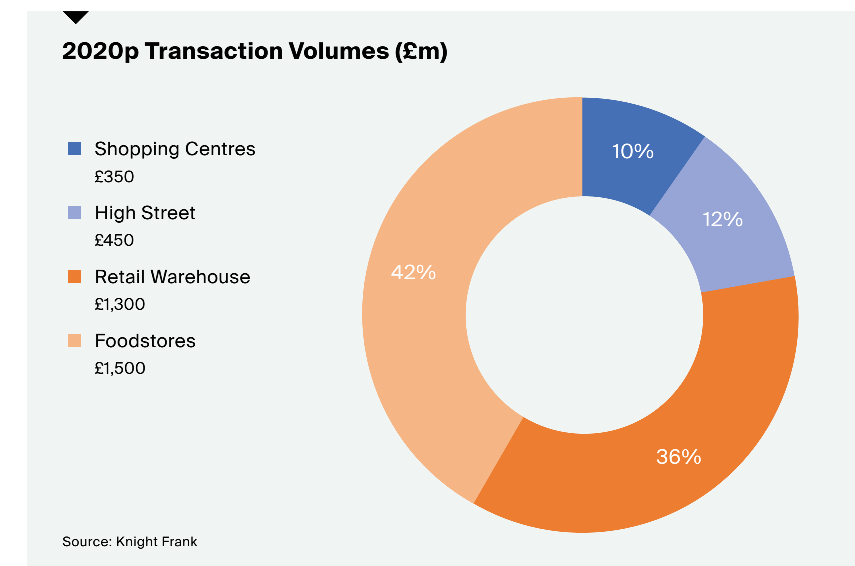
Ones to watch

Outlet malls remain a strong contender - at least the top 10-15 in the country do anyway. Again, post lockdown the trading figures in these locations looked encouraging and we expect that to be repeated in 2021. There is still something

If institutions come back to retail in years to come we expect it to be for foodstore-anchored schemes offering an element of safely alongside an element of higher yield



Source: Property Data, Knight Frank



Source: Knight Frank

quite unique about the shopping experience in these malls and if there is any sort of renaissance in physical shopping next year, which we think there will be, these locations will benefit.

And let's not forget foodstores. The outlier in 2020 in terms of performance as their values certainly did not decline and in many cases they went up. What prospect for these off what are sector-low yields? Answer: very robust. Perhaps not huge further yield compression but steady, low risk income return. We do not see occupational dislocation or risk of outward yield shift. Investment demand will remain strong, finance will remain available and so liquidity will be good. Therefore, if you want solid if unspectacular performance from retail with minimum management hassle or risk, supermarkets are the best bet.

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Prime Retail Yields 2010-2020p

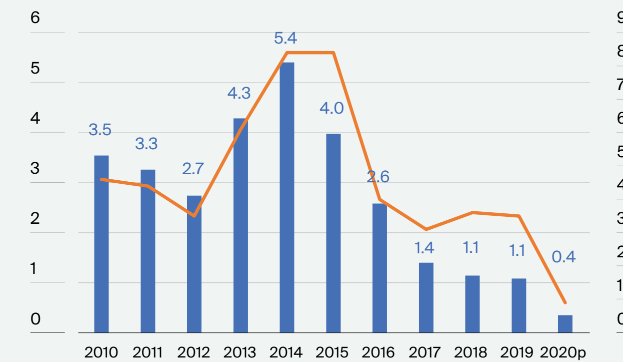
Source: Knight Frank

VOLUMES AND DEALS 2010-2020P

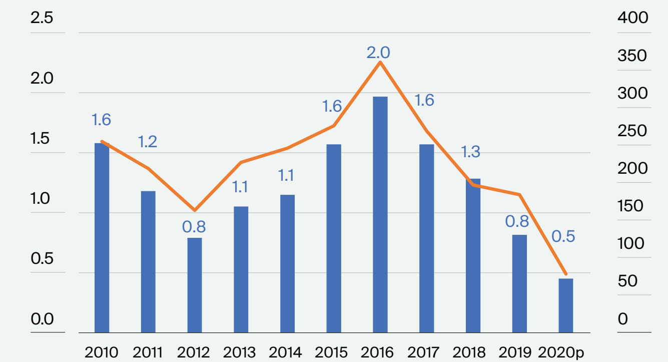
Values and Numbers of Transactions

■ Volumes (LHS), £bn ■ Number of transactions (RHS)

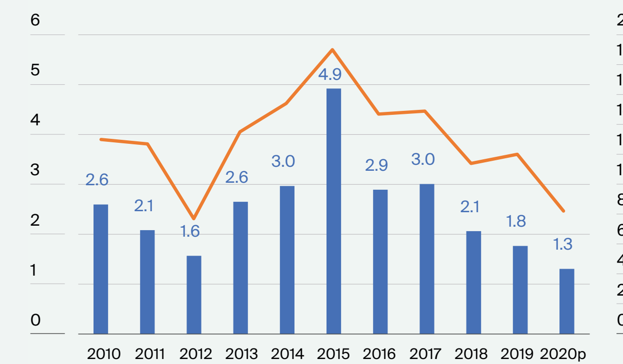
Shopping Centres



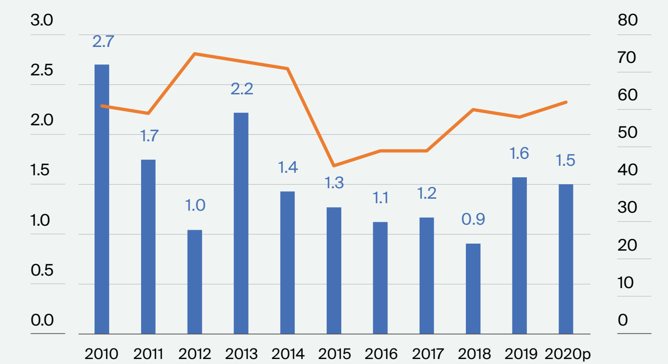
High Street



Retail Warehousing



Foodstores



Source: Property Data, Knight Frank

	2019 Yield	2020 Yield	2021p Yield	2020 Volumes	10y Ave Volumes	2021p Vols. Vs 2020	2021p Vols. Vs 10 Yr Ave	Key Buyers	Key Sellers	Trends
High Street	5.25%	6.75%	6.75%	£450m	£1,296m	▲	▼	Private Investors	Institutions	Falling values where rents re-basing
Shopping Centre	5.75%	7.25%	7.75%	£350m	£2,942m	▲	▼	Councils + Repurposing Developers	Any SC landlord + Anyone that lent money against one	Falling values / increasing over-supply
Retail Warehousing	6.00%	6.50%	6.00%	£1,300m	£2,648m	▲	▲	Institutions + Private Equity	Institutions	Improving sentiment / yield recovery
Foodstores	4.25%	4.00%	3.75%	£1,500m	£1,518m	◀▶	◀▶	Specialist Funds + Institutions	Institutions	To remain very popular with investors

RETAIL REPURPOSING: LESS IS MORE?

Converting surplus and/or redundant retail floorspace to other undersupplied property uses may seem a no-brainer on paper, but the reality is often very different

STEPHEN SPRINGHAM – HEAD OF RETAIL RESEARCH
WILL LUND – ASSOCIATE, RETAIL CAPITAL MARKETS

The high street is dead, long live alternative use. That seems to be the mantra in the media at least. There is a groundswell in thinking that virtually all retail floorspace is redundant and that the incumbent real estate would be better served by any alternative use, be that mainstream commercial (e.g. offices, industrial) or residential (e.g. houses, apartments, build-to-rent) or any host of specialist / niche classes (e.g. hotels, healthcare, senior living, student accommodation, data centres, life sciences etc etc). But evidence of retail repurposing is still relatively thin on the ground, for a very simple reason – we are only at the beginning of this journey and the process is far more complex than most give it credit for.

Understanding retail oversupply

That the UK retail market is oversupplied is beyond question. Oversupply is one of the 'Key Structural Weaknesses' of the UK retail industry we have previously identified and researched. The problem has arisen through two key shortcomings: overdevelopment in the past (including aggressive out-of-town expansion in retail warehousing and a foodstore "space-race"), coupled with a "laissez-faire" attitude to obsolescence management. Too much has been built, not enough has fallen off the bottom.

Formally quantifying the level of oversupply is impossible and, by all accounts, actually irrelevant. There is an estimated 550 million sq ft of retail floorspace in this country, but there is no "magic number" as to what optimum supply would be. The issue with quantification is that it is not a one dimensional number, retail floorspace trades at massively different levels of productivity (or sales/sq ft, to use the usual metric). Some retail floorspace may be working 100x harder than apparently similar space elsewhere, so it is impossible to derive a universal handle on appropriate quantum of space. For what it's worth, some commentators have estimated (guessed?) that the level of oversupply is ca. 40%, others closer to 20%. We would venture that the figure is closer to national vacancy rates, some 10-15%.

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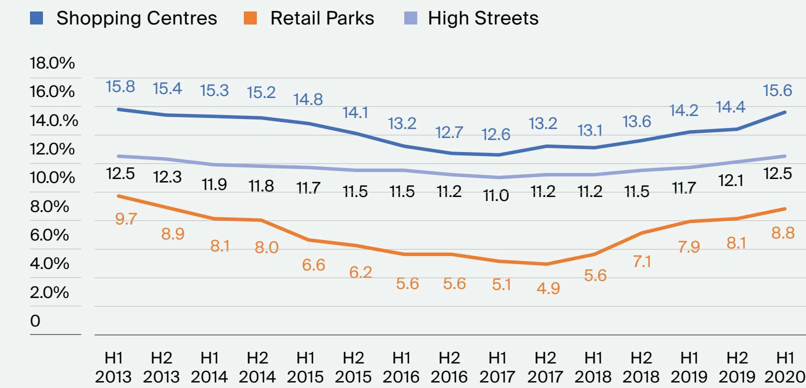

But a national oversupply figure is largely academic.

The level of oversupply is best understood at local level – even then, not on a Local Authority 'needs' basis as per the old town centre planning model (which, if it still exists, needs to be consigned to history). But much more on a town centre 'bottom up' basis – understanding that town, what makes it tick, what is failing, why is it failing, what could be done to reverse this trend? And this leads into the realm of exploring potential repurposing plays.

To understand local supply and a town's overall retail health, we typically employ three datasets / methodologies:

1. Vacancy rates
2. Rental performance (2010 – 2020)
3. Space productivity (£/sq ft)

In isolation or combination, these provide a telling overview of the state of the local retail market, as well as potential availability of retail stock for repurposing. According to LDC, the national **retail vacancy rate** at H1 2020 was 13% (14.2% retail, 10.1% leisure). Generally, towns with vacancy rates <10% may be regarded as being in relatively good health. Those with vacancy rates >20% generally display signs of distress.

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Rental performance is based upon Prime Zone A rent movements over a 10 year period (2010 – 2020). Clearly, the greater the rebasing, the higher the correlation to under-performance and potential oversupply. The 300 PMA PROMIS centres have seen Prime Zone A rents decline by an average of around -30% over the past decade, with considerable polarities between individual centres (e.g. Brixton +68%, Falkirk -68%). Rebasing of -18% or less would make a centre 'Top Quartile', -43% or worse 'Bottom Quartile'.

Space productivity is calculated by dividing modelled comparison goods spend (i.e. non-food spend) made in each centre (source: CACI) by overall retail floorspace (source: PMA). A high figure indicates healthy levels of sales density/ space productivity; a low figure poor performance and/or oversupply.
The unweighted average across the centres is £227/sq ft. Figures range from £11, £15, £32/sq ft in Runcorn, Bicester town centre and Ramsgate respectively, to £646, £647 and £686/sq ft in Guildford, Kingston and Oxford.

Not a panacea by any means, but collectively a very useful starting point for identifying and understanding retail oversupply...

Four great repurposing divides

Identifying retail oversupply and targeting potential retail stock for alternative use is one thing, actually making a repurposing play is another entirely. There are at least four divides that have to be crossed before any potential repurposing becomes in any way viable. In broad terms, these are:

1. Planning
2. Geography
3. Configuration/ownerships
4. Value alignment

Historically, Planning may have been the main stumbling block, but recent sweeping reform to Permitted Development (PD) Rights and Use Classes Order has rendered it less an obstacle than it was previously. From 1 September 2020, there is a new Use Class (E) to include all current A1 (retail & shops), A2 (financial & professional services) and A3 (food & drink) Classes, alongside B1 (offices, R&D, light industrial), D1 (clinics, health centres, creches, day nurseries) and D2 (gyms & indoor activities). Potentially meaning far greater fluidity between existing classes. As planning reform goes, this move is very far reaching and it could potentially have a profound impact on the future of high streets. In very general terms, this represents significant relaxation of a system that was previously very rigid and a major barrier to asset repurposing.

Geographies have to align and often they don't. The towns we identify in our 'Top 10s' of oversupply are not necessarily the

KEY RETAIL HEALTH METRICS

Top 10 Vacancy Rate	
Centre	**Vacancy Rate**
Richmond	5.3%
Canterbury	6.1%
Cambridge	6.9%
Leamington Spa	7.0%
Edinburgh	7.8%
Brighton	8.1%
Bromley	8.1%
Chelmsford	8.5%
York	8.8%
Bath	8.8%

Top 10 Productivity	
Centre	**Sales/sq ft (£/sq ft)**
Oxford	£686
Edinburgh	£665
Kingston-upon-Thames	£647
Guildford	£646
Milton Keynes	£628
Glasgow	£611
Brighton	£605
Leeds	£585
Manchester	£578
Bristol	£531

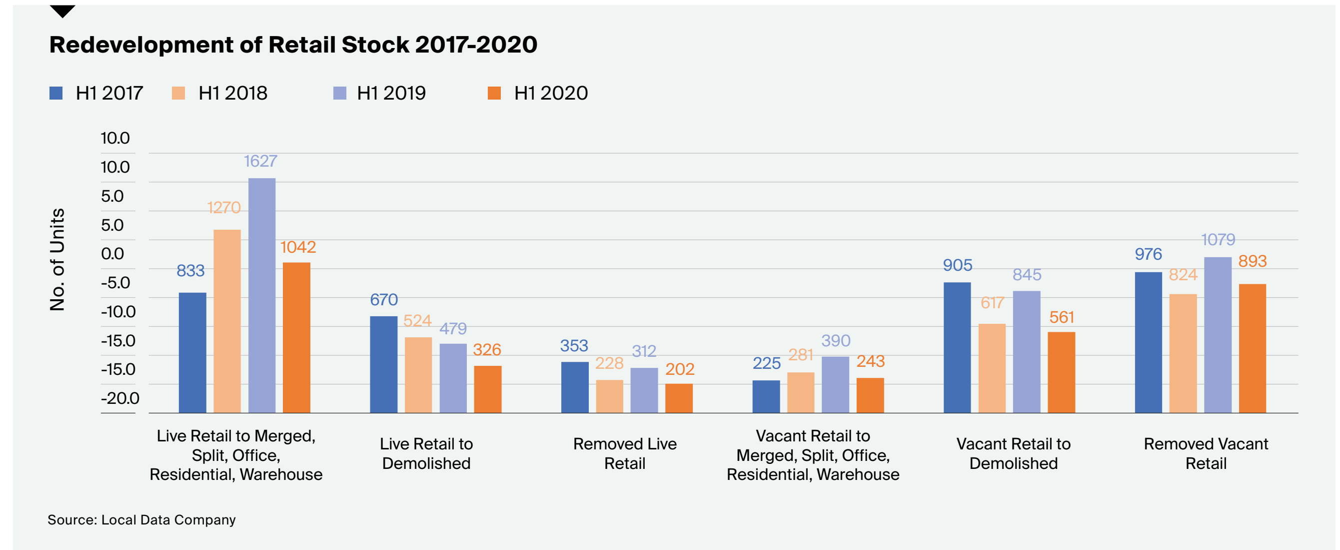
Top 10 Rental Performance		
Centre	**Growth 2010-20 (£)**	**Growth 2010-20 (%)**
Brixton	£98	68%
Tooting	£27	30%
Islington	£53	28%
Wandsworth	£25	23%
Putney	£18	20%
Hammersmith	£32	18%
Clapham Junction	£23	17%
Cirencester	£10	16%
Glasgow	£29	11%
Dorchester	£7	11%

Bottom 10 Vacancy Rate	
Centre	**Vacancy Rate**
Walsall	31.9%
Bradford	28.7%
Croydon	26.7%
Doncaster	26.0%
Stockport	25.9%
Bolton	25.7%
Stoke-on-Trent	23.1%
Swansea	22.7%
Hull	21.9%
Northampton	19.6%

Bottom 10 Productivity	
Centre	**Sales/sq ft (£/sq ft)**
Runcorn	£11
Bicester	£15
Ramsgate	£32
Llandudno	£36
Margate	£37
Gravesend	£40
Merthyr Tydfil	£45
Tamworth	£51
Bognor Regis	£51
Dewsbury	£51

Bottom 10 Rental Performance		
Centre	**Rebase 2010-20 (£)**	**Rebase 2010-20 (%)**
Falkirk	-£47	-68%
Neath	-£43	-65%
Southport	-£59	-65%
Port Talbot	-£29	-65%
Cumbernauld	-£32	-64%
Merthyr Tydfil	-£35	-63%
Hamilton	-£38	-63%
Dunstable	-£38	-63%
Greenock	-£44	-62%
Stockton-on-Tees	-£34	-61%

Source: Knight Frank, PMA, CACI, Experian GOAD



Source: Local Data Company

most salubrious of places and are unlikely to be particularly high on any would-be repurposing developer's wish-list. If a place is failing as a retail centre, it may well be failing as a wider town centre. The fact remains that the town centres that are most challenged and have the highest retail vacancy rates are not necessarily those with high demand from other uses.

Thirdly, the retail floorspace has to be configured appropriately and not be subject to fragmented ownership. As a general rule, retail warehousing often ticks these boxes more readily than in-town floorspace. If the in-town asset is a free-standing block or part of shopping centre that easily detaches from the rest of the scheme, then fine. But a lot of vacant retail floorspace takes the form of scattered, high street units, with disparate ownership. Rarely does it conveniently carve out exactly as a would-be developer would require.

Fourthly – and most critically – values have to stack up to make repurposing financially viable. This is often an insurmountable issue. Despite all its structural challenges and significant re-basing, the value of retail real estate is still much higher than other property classes in many (most?) locations.

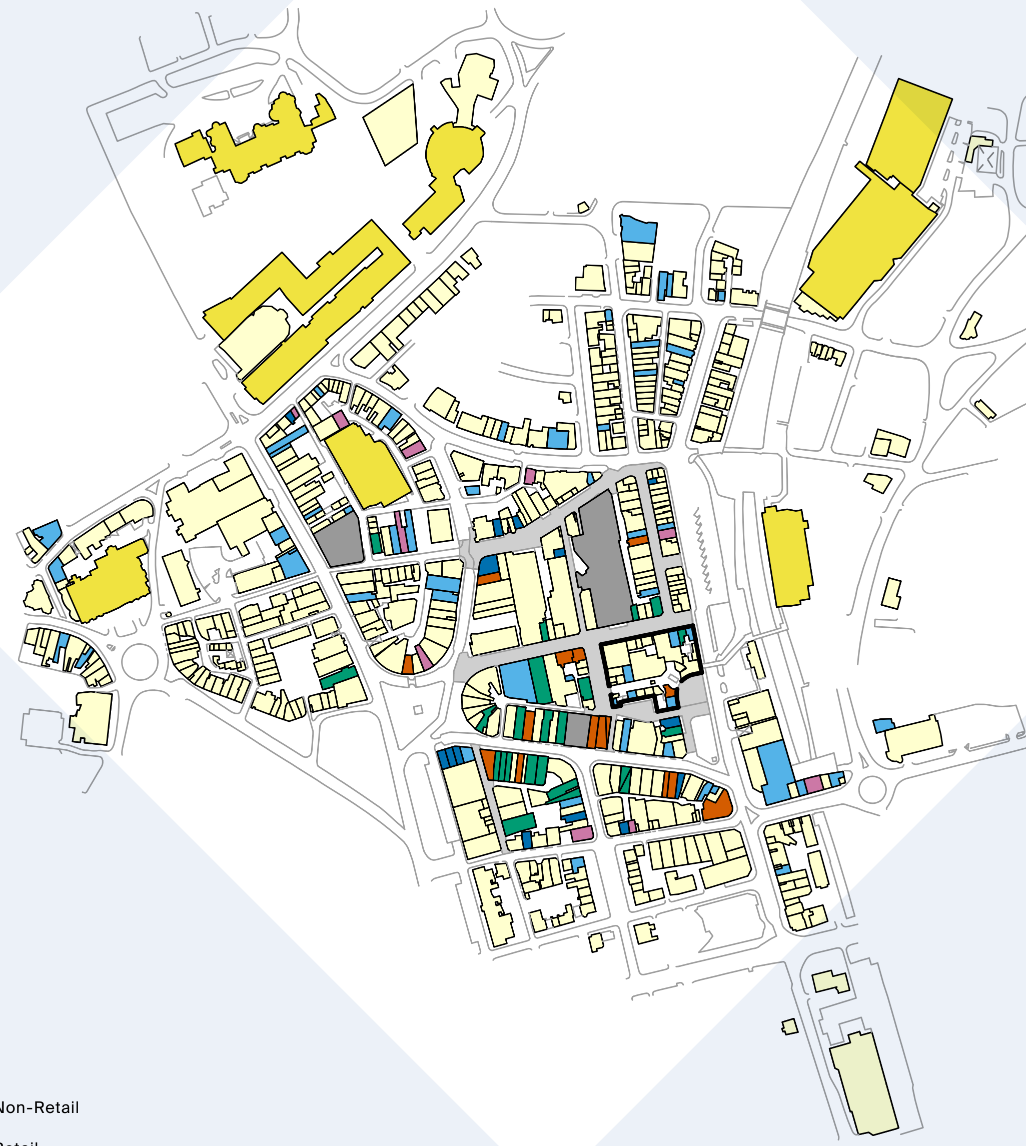
As a very general rule, there is usually only any semblance of value alignment within Greater London and select towns in the Home Counties. In most regional locations, development does not stack from a cleared site, let alone factoring in securing vacant position of semi-occupied retail and then demolition / conversion. Even in locations where values do align, decommissioning, demolition and construction costs need to be factored in – a lot of moving parts to weigh up. The reality is that many mixed-used developments, however sound they may appear on paper, will need considerable government or Local Authority subsidy. They just won't work purely under private sector funding.

These four divides must all be crossed and all stars have to align for conversion / repurposing to be feasible and financially viable...

If a place is failing as a retail centre, it may well be failing as a wider town centre.

UNDERSTANDING A TOWN'S FOOTPRINT AND REPURPOSING POTENTIAL

Harrogate Example



Vacant Non-Retail

Vacant Retail

'At Risk' Retailers

CVA/Administration Affected

Department Stores

Large Sites > 25k

Leases Expiring <18 months

Source: Experian GOAD

THE SHOW MUST GO ON – RETAIL PROPERTY MARKET OUTLOOK 2021

Positive case studies

Some retail repurposings will be far more straightforward than others and positive case studies are emerging. Altrincham in the North West is a good example of a town that has completely re-invented itself, with the local authority being the catalyst for intervention. The advent of the Trafford Centre back in 1998 undermined Altrincham's credentials as a major retail destination and a reappraisal of the town's role has seen it de-emphasise its retail offer in favour of other leisure and community-led uses. Rather than a retail-led 'ghost town', it is now a broader-based centre in which retail has a more supporting role to other uses.

Ravenside Retail Park in Edmonton, North London is a rare example of the much touted panacea for the retail market – a conversion to high value last mile logistics uses.

Similarly, the conversion of the Nicholsons Centre in Maidenhead could become the blueprint for town centre regeneration, with owners Areli Real Estate seeking to replace the shopping centre with a functioning new town centre. The property, which had fallen into administration, was acquired well below its historic value and was failing with vacancy increasing and tenants seeking to leave the town. Higher value residential, office and retirement uses, along with the arrival of Crossrail, will combine to see a truly mixed use redevelopment on the site.

Knight Frank recently advised Aberdeen Standard Investments on the sale of Broadwalk Centre in Edgware, North London, to Ballymore. The property was a unique proposition, providing 13 acres of freehold land adjacent to the Northern Line underground station. Whilst functioning as a local convenience scheme, the opportunity for wholesale town centre regeneration will see a major, high density residential-led redevelopment come forward on the site. As with Altrincham town centre and the proposed Nicholsons Quarter, reprovisioned retail space undoubtedly has an important role to play in supporting the other uses within the development.

Knight Frank also recently advised on another Greater London regeneration project, The Walnuts in Orpington, South London. The centre, once the heart of the town, had suffered at the hands of local retail park developments and an ever-extending high street. A partial regeneration was already underway but much of the centre needed reimagining to fit with modern shopping, living and working requirements. Areli Real Estate are applying their expertise to another urban regeneration project here, where collaboration with the local authority and other local stakeholders are more important than ever due to the complexities of town centre ownerships.

Out of town, Ravenside Retail Park in Edmonton, North London is a rare example of the much touted panacea for the retail market – a conversion to high value last mile logistics uses. Prologis acquired the retail park, which sits directly adjacent to a major arterial road in North London.

The principles of industrial conversion are sound, with retail warehousing offering buildings of flexible configuration with low site coverages, located on the periphery of major towns and cities. The practice, however, is more difficult, with a resurgence of the retail warehousing market meaning only those assets in the highest value logistics locations warrant conversion (unless greater density or even multi-storey development is considered). Outside the M25 we expect well let income producing retail parks to remain so, with industrial developers continuing to seek cleared land elsewhere to satisfy their demands.

KEY RETAIL REPURPOSING PLAYS

ALTRINCHAM TOWN CENTRE

- Owner – Trafford Council / Bruntwood
- Acquisition Date – Q4 2019
- Acquisition Price – £33m
- Proposals – retail, residential, community uses

NICHOLSONS CENTRE, MAIDENHEAD

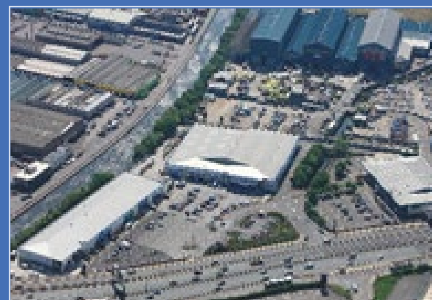
- Owner – Areli Real Estate / Tikehau
- Acquisition Date – Q1 2019
- Acquisition Price – £25m
- Proposals – mixed use, residential, office, community uses

BROADWALK CENTRE, EDGWARE

- Owner – Ballymore
- Acquisition Date – Q3 2020
- Acquisition Price – £71m
- Proposals – residential

THE WALNUTS, ORPINGTON

- Owner – Areli Real Estate / Tikehau
- Acquisition Date – Q4 2019
- Acquisition Price – £31m
- Proposals – mixed use, residential, office, retirement, community uses



RAVENSIDE RETAIL PARK, EDMONTON

- Owner – Prologis
- Acquisition Date – Q4 2019
- Acquisition Price – £52m
- Proposals – last mile logistics

Some perspective

The phrase 'the death of the high street' has become commonplace, leading to assumptions that all town centres as we know them have no future. This is clearly an over-simplistic generalisation. Some towns continue to thrive (Covid-19 notwithstanding), while others admittedly face major struggles in their current incarnations. It is all about defining what the role of that centre is going forward, frankly not all town centres need to be retail-led as has often been the case in the past. In some, the role of retail could be de-emphasised and surplus retail floorspace repurposed to other, more appropriate uses.

If there is one lesson we have surely learnt in retail, it is that there cannot be a "one size fits all" solution to the high street. Every town centre is different and has its own story to tell. And its mix of uses has to reflect that. Too many town centres haven't embraced this notion and haven't capitalised on their full potential. The role of retail within a town centre will vary – in some, it will continue to dominate, in others it will assume a more supporting role. National retail multiples will continue to be the mainstay of some retail destinations, others may have a greater bias towards local or independent traders. Some will have a mix of both.

If there is one common denominator for a successful town centre it is people. People define what makes a location tick and are its very lifeblood. Selective repurposing of retail space will actually bring people back into town centres in a way that brings holistic benefits for all use classes. It is not necessarily a straight substitution, it is much more about achieving the right blend.

Our narrative on retail repurposing may come across as defensive. On the contrary, we see a reduction in the UK's retail footprint as a positive catalyst to wider change within the industry. Reducing supply addresses one of the retail sector's key structural failings and leaner, more fit-for-purpose retail infrastructure can only be of wider benefit. There are undoubtedly opportunities to repurpose retail space to other uses and indeed, we shouldn't be precious about preserving surplus or obsolete retail stock. But the fact remains that the window of repurposing opportunity is perhaps far smaller than many imagine.

Needless to say, Knight Frank is uniquely placed to advise on all aspects of retail repurposings, with expertise not just in retail but in all key alternative use sectors (mainstream and specialist), underpinned by a cross-sector planning team. Repurposing plays are not turnkey but highly bespoke – Knight Frank can help navigate what could be a minefield.

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If there is one common denominator for a successful town centre it is people. People define what makes a location tick and are its very lifeblood.

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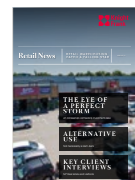

Retail News Issue 11, Retail Warehousing: catching a falling star

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