SUMMARY

- While the political and market shocks of Brexit are now well-established, the impacts on the consumer economy are yet to be felt. We believe that some commentators are overstating the risks around recession, but the next six months will be all about the leading indicators for Christmas trading.

- Occupational demand is unlikely to react quickly to the referendum result. However, the challenges facing retailers have undoubtedly intensified, and this will impact on requirements in 2017.

- Investor demand in the shopping centre sector was already faltering before the referendum, and this will continue in the remainder of the year. Investment volumes in 2016 are likely to be the lowest since the Global Financial Crisis.

- High street shop investment volumes will be more resilient, due to the smaller lot sizes. However, secondary assets in both sectors will see upward pressure on yields, and this will excite the increasing number of opportunistic investors who are now focusing on the UK.

“Brexit will create some investment opportunities, but nowhere near the scale that opportunistic buyers are seeking.”
The consumer economy
While the initial post-referendum turbulence might have settled in the equity markets, it is yet to be felt fully in the wider economy. Consumer confidence was already slipping in advance of the referendum, and we expect this to continue in its aftermath.

One argument to be cheerful is that unlike a more normal economic shock, this is one that many people voted for. Indeed, opinion polls in the run up to the referendum were suggesting that between 50% and 60% of people did not believe that they would be worse off in the event of a Brexit. If this is true, then the inevitable slowdown in consumer spending may be more modest than some forecasters are predicting.

Our core view currently sits somewhere between the two poles of opinion. Newsflow around risks of job losses and limited wage growth will definitely cause some shoppers to repeat the precautionary saving strategy that they carried out during the Global Financial Crisis (GFC). This will have a particularly strong impact on bigger ticket purchases. However, we expect so long as the newsflow does not significantly worsen, then there will be some relaxing of purse strings in the run up to Christmas, and that should ensure that retailers enter 2017 in a reasonably positive frame of mind.

2017 will see slower than forecast levels of spending and economic growth, but at present we do not expect that the UK will slide into recession.

The retail occupational market
Retailer attitudes to the Brexit result have been very measured, with all eyes focused on how the consumer responds to the news over the second half of this year, and most importantly over the crucial Christmas shopping period.

We do not expect to see any fundamental change in retailer demand over the remainder of the year, as most of the deals that were under offer appear to be going through to ensure that the shops are open in time for Christmas.

The other major topic of debate amongst our retailer clients is around the value of the pound and how that feeds through into the costs of purchasing products and shop fittings. Anecdotally we are hearing that most major retailers had already hedged against currency movements this year, so the question is more about 2017 than 2016.

Clearly if the pound remains weak into 2017 then this will reduce UK retailer’s margins going forward, particularly where they are buying and ordering in US dollars. This will exacerbate the pressures that they were already feeling this year from the rise in the minimum wage. Some retailers will also have to struggle with rising costs in the form of the business rates from 2017.

If the customer has slipped into precautionary saving mode by the end of this year, then some retailers will find it very difficult to pass on these rising costs, and this will in turn negatively affect requirements in 2017.

This will be particularly relevant to the fixed-price retailers. However, the GFC showed us that they have tended to do well in difficult consumer times, so the out turn for that group of retailers may be relatively benign. Generally, we expect value retailers to remain comparatively acquisitive in 2017, both in the food and clothing sectors.

The trading environment for bigger-ticket items such as furniture and floorcoverings will depend heavily on both consumer confidence and housing turnover. Luxury retailers, particularly in those locations that have a healthy supply of tourists, will continue to trade well.

We expect that the supply side of the occupational markets will remain relatively tight, regardless of the recent flurry of administrations. Indeed, it is arguable the UK retail landscape currently has fewer challenged retail offers than it did going into the GFC, and thus we do not expect to see a rush of administrations on the back of the Brexit news and subsequent trading. Indeed, while the development pipeline was already very restrained for the next few years, it is probable that some of the planned projects could be put on hold, and this will further limit the supply of suitable units in the more sought after locations.

Given that we were never forecasting any real growth outside London in 2017, we see no reason to downgrade that forecast at present. While some retailers may well try and chip rents in the forthcoming months, their success will depend heavily on the supply and demand balance in that location. There will still be competition for units of all sizes on good pitches in good towns, and the lack of supply will continue to support rents. However, we do expect that landlords will take a more flexible attitude on rents and terms during this period of uncertainty.

Shopping centre investment
Q2 2016 continued in the same vein as Q1, with investor confidence hampered by the EU Referendum on the 23rd June. Transaction volumes remained stable with £737.2m of transactions being completed in just 12 deals, compared with £770.7m in 9 deals in Q1. However, investment volumes are down 29% compared to Q2 2015, and H1 2016, at £1.508bn, is down 20% versus H1 2015 when we saw £1.881bn traded.

It should also be noted that 2016 investment volumes have been bolstered by the sale of a small number of large lots. These larger sales comprised a 35% stake in Liverpool One (£300m); Grand Central, Birmingham (£335m); Broadway Shopping Centre & Broadway Square, Bexleyheath (£120m); and a 50% stake in Merry Hill (£410m). If these larger transactions are disregarded, just £342.9m of deals have completed so far in 2016. Interestingly, just two shopping centres have transacted in the UK that openly came to the market in 2016; Riverside in Erith (£17m, 8.00% IY) and the Harpur Centre in Bedford (£22m, 7.35% IY).

The balance of the transactions were completed in just 12 deals, compared with £770.7m in 9 deals in Q1. However, investment volumes are down 29% compared to Q2 2015, and H1 2016, at £1.508bn, is down 20% versus H1 2015 when we saw £1.881bn traded.

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The balance of the transactions were carried over from 2015.

There is limited new stock of any quantum in the market. The only assets brought to market in Q2 2016 at lot sizes above £50m were intu Bromley (£255m, 5.50% IY); Southside, Wandsworth (£310m, 4.25% IY); The Rock, Bury (£100m, 6.00% IY); and Manor Walks, Cramlington (£73.5m, 7.50% IY).
Given the lack of prime available stock and the wider economic uncertainty caused by the EU Referendum, the institutional and UK based market remained reticent to transact in Q2 2016. The only investor group to be particularly acquisitive were UK Local Authorities, with 7 assets this year having been exchanged / put under offer by Councils. These schemes comprise; Market Walk, Newton Abbot; Merseyway Shopping Centre, Stockport; The Square, Beeston; Flying Horse Walk, Nottingham; Red Rose Centre, Sutton Coldfield; The Swan Centre, Leatherhead; and Whitefriars, Canterbury. We foresee continued Council activity over the next 12 months, given cuts in central government funding, a desire for income, and the ability to borrow at interest rates sub 2% and attractive loan to value ratios.

In the aftermath of the ‘leave’ vote we are seeing a rising number of transactions falter that had either exchanged subject to a “Brexit” clause or were under offer. Few ‘leavers’ anticipated that market sentiment and confidence would be hit this hard this quickly. It is now likely that investor redemptions will rise and fund managers will need to sell assets as their cash balances erode.

The emerging picture from overseas and opportunistic investors is one of ‘appetite’. The vast majority believe in the fundamentals of UK property. The issue today is that they want to acquire assets across the spectrum at circa 10 – 15% discounts from their current valuations. Will this happen? We have seen a number of UK institutions including Henderson, M&G Investments, Standard Life Investments, Aberdeen and Legal & General cut values by between 4.5% and 5% in order to prevent redemptions at values above the market. Valuers are moving to weekly valuations, allowing prompt value corrections if required. In addition a number of retail funds have now been closed for redemptions to stem further outflows. However, it is worth noting that the retail funds account for less than 10% of the total market.

We are aware of significant equity pots waiting to enter the market, from across the overseas and opportunistic investor spectrum. We suspect that like 2008 / 2009 while a significant weight of equity is seeking to be deployed, unless there is a ‘need to sell’ we will see very little quality stock come to the market, and assets will be / have already been refinanced and held periods extended. These opportunistic buyers will need forced sales, which we will only foresee if fund redemptions rise significantly. We believe that there will be opportunities but not anywhere near the scale opportunistic buyers are seeking.

The Banks are presenting their status as ‘business as usual’, but in all likelihood the quantum of lending will be much reduced and involve several banks as opposed to a single lender. We are likely to see margins rise and loan to value ratios fall to reflect the current increased risk profile. However, the spread between property yields and the cost of money remains wide making property very financeable.

We anticipate that the total investment volume for 2016 will reach circa £2.5bn, well below the long term average of c. £4bn and a level which has not been seen since 2012 when £2.71bn was transacted. We are aware that circa 40 to 50 centres were being prepared for sale prior to the Brexit vote, but it is likely that much of this stock will no longer be brought to the market as potential vendors choose to hold assets until there is greater certainty and stability in the market.

Yields on prime quality shop investments are unlikely to move much in the remainder of this year, but yields on some secondary assets will reverse the gains that they saw in late 2015 and early 2016. For example assets that were trading at 8% this time last year, will revert to that level from the 7% that they had hardened to in the interim period.

These kinds of price corrections will only be available on a handful of deals, and we do expect that transactional volumes in the high street sector will be lower than normal in the second half of 2016.

Investors will be keeping a very close eye on consumer confidence in the run up to Christmas 2016, and then on the trading figures as they trickle in during January and February 2017. Once those figures have been digested by retailers and investors alike, then the path for UK retail post-Brexit will become clearer, and this will ultimately decide the direction for both pricing and trading volumes in 2017 and beyond.
UK Shopping Centre and High Street Bulletin

Savills plc

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GRAPH 1

Shopping centre investment volume

Source: Savills

GRAPH 2

Shopping centre yields

Source: Savills, Investment Property Databank

GRAPH 3

Consumer confidence

Source: Gfk