Spotlight
UK Retail Warehouse Market

November 2013

SUMMARY

- Consumer confidence recovered sharply over the summer, and we expect this to result in a pick-up in retail warehouse retail sales from 2014.

- Sentiment in the leasing market has also started to stabilise. The last quarter has seen a rise in requirements for new stores, as well as some new entrants to the sector. 2014 will see the continuation of this trend, with a strong polarisation in retailer demand between prime and tertiary locations.

- Investment activity has started to recover, albeit from a very low base. Investor demand is heavily biased towards prime parks, and these remain in scarce supply. We expect to see continuing downward pressure on prime yields in 2014.

- Special features in this issue include regional focuses on the North and Scotland, and an occupier profile on Costa Coffee and their new Drive Thru concept.

"2014's recovery in sales will spell a turning point for retailers."
Mat Oakley, Savills

Economic and consumer outlook

This summer and autumn has seen a marked change in consumer sentiment, with the GfK consumer confidence index moving from -27 in April to -11 in October.

Given that the long run average for this index is -9 it is clear that as far as consumers are concerned things are almost back to normal. So what has caused this change in sentiment, and is it sustainable?

Recent economic news has undoubtedly been more positive, starting with the revision away of the double-dip in GDP. Indeed, the acceleration in GDP growth has caught many economic forecasters on the hop, with Q2's growth of 0.7% well ahead of expectations. This means that the consensus for 2013 is now 1.6% growth, more than half a point better than the consensus 12 months ago. This obviously leads to better headlines, but does it really affect how consumers are feeling and spending?

The unemployment rate remains stubbornly high at 7.7%, which while it is down from its 2011 peak, is basically pretty much the same as it has been since 2009. The last few months has also not seen much positive movement in average earnings, with growth of 1.1% year on year. This remains firmly below consumer price inflation (2.8%), and means that the average household's real income is continuing to fall.

However, retail sales growth is accelerating with the year-on-year growth for August of 2.1%, though we have to remember that August 2012 was when much of the country stayed at home and watched the Olympics. Generally, we believe that the underlying trend for retail sales is at best flat.

So perhaps all the summer has seen is a pick-up in sentiment, and a couple of sun-driven uplifts in retail sales? However, even if this is the case, it does set up 2014 as being the first year of real recovery in the UK economy and in the nation's shops.

We now expect base rates to remain low for two to three years (despite the markets overreaction to recent positive economic news). This will combine in 2014 with a slowing in inflation and a recovery in average earnings. The most likely effect of improving consumer confidence will be a decline in the savings ratio, which should drop back from recent high levels. This alone will give consumers more money to spend.

This should mean that household spending in 2013 and 2014 will be better than it was in 2012, with a corresponding improvement in in-store sales.

Investment market overview

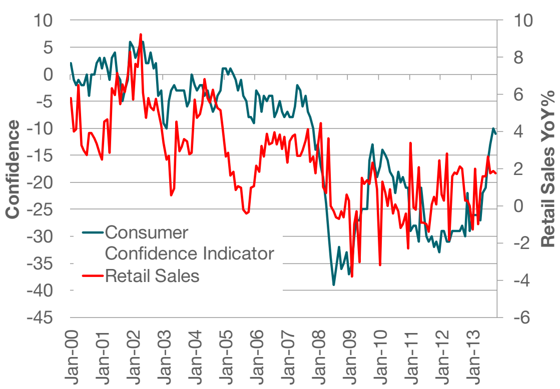
Investment turnover in the retail warehouse market has remained low in 2013 at £1.1bn for the first three quarters. However, this is 38% higher than the total for the same period in 2012, indicating that the market may now be past its nadir.

Investor demand remains focused on prime and dominant schemes, of which very few continue to come to the market. However, over the last few months the weight of money targeted at the sector has risen significantly, and the shortage of prime stock on the market has led many investors to widen their search criteria.

The rationale for buying retail warehousing is now very much reverting to the normal considerations of limited stock and rising tenant demand. While returns on retail are now well behind those on office and industrials, retail warehousing is delivering better average returns than the rest of the sector. Investors who are looking at retail warehousing are buying into both the fundamentals of the sector where average rents have now plateaued, and the expectation of a continuing recovery in tenant demand and voids. Added to this is the comfort that the worst is now past in terms of retailer failures.

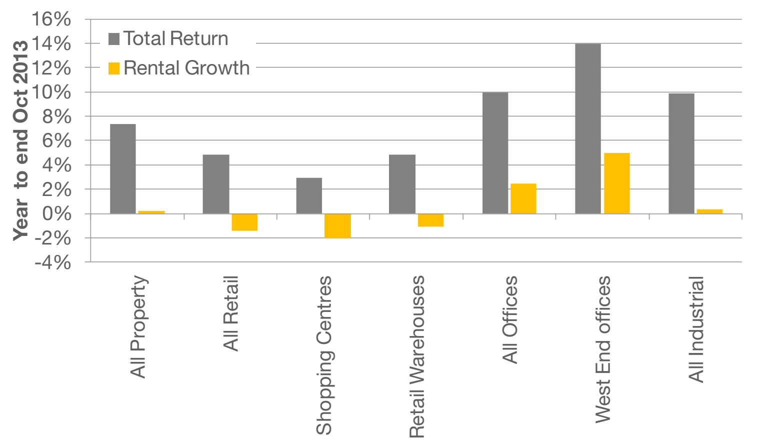
There is very little recent evidence of prime retail warehouse scheme sales, but where prime parks have come to the market they have achieved very keen yields. This is reflected in our prime and secondary yields data (Table 1), where all sectors have either hardened this year, or are currently experiencing downward pressure on their yields. Average yields, as measured by IPD, are generally identical to where they were six months ago.

GRAPH 1
Consumer confidence and retail sales



Source: ONS, GfK

GRAPH 2
Comparative total returns and rental growth



Source: Investment Property Databank

Leasing market overview

The major change that we have seen in the occupier markets over the summer is in sentiment. This applies both to retailer's expectations for future trade, and perhaps more importantly landlords and retailers view on market rents.

The widening acceptance amongst both parties that rents have either fallen, or need to fall further, is making it easier for tenants and landlords to agree on realistic rental terms.

This is important because while many retailers are still looking to exit from leases in poor-performing locations, the last quarter has also a seen a rise in requirements for new stores. This is predominantly due to retailers who are looking to upsize their footprints to offer a more "web-like" experience, but for the first time in years there are some new requirements from new retailers to the sector.

The most notable group of new entrants are the sports retailers, including Nike, SportingPro, Adidas and Decathlon. All of these currently have requirements for retail warehouse units, with Nike recently opening at Broughton Shopping park in Chester to add to their three out-of-town stores that will be open by the end of the year. Whether this is driven more by the Olympic legacy or the failure of JJB is debatable!

Moving from sports to fashion the tenant demand story is less strong, with the majority of the fashion retailers either downsizing or stabilising. The exceptions to this trend is Next who continue to busily look for opportunities to upsize stores to accommodate their Home & Garden offer.

Primark are currently in negotiation on six parks and we understand that they are being offered very attractive terms by landlords who see them as potential major footfall drivers, particularly amongst younger shoppers.

Another summer change was the rise in optimism (or concern) about the housing market recovery. The various stimuli announced by the government are clearly having an effect, with a 3% rise in transaction volumes in the first half. This is not just a southern story, with 10 out of 12 UK regions seeing a rise in transactional activity last year.

We are forecasting that mainstream house prices will rise in all regions of the UK this year, and will grow by 18.1% over the next five years (25.1% in London).

Rising house prices and better mortgage availability will stimulate more home moves, and we expect this to have a positive knock on effect on sales of home-related products. Homebase and B&Q should be the earliest beneficiaries of this recovery, as people dust off their DIY skills to ready their homes for sale.

While B&Q and Homebase continue to be firmly in period of rationalising stores, we do expect this to end as the economic and housing market improves.

Elsewhere in the household goods market Harveys continue to upsize into stores where they can put a Bensons Beds on the mezzanine, and similarly Wren Kitchens are expanding from 10,000 sq ft stores to 15-25,000 sq ft to accommodate their Wren Living concept. CSL (who were profiled in this publication last year) remain firmly expansionist in London and the South East, and Oak Furnitureland are now up to 40 stores from zero a few years ago.

Generally tenant demand remains highly selective, as it is across all of retail property, but we are seeing renewed tenant interest in locations rents have already rebased. The challenge for landlords will be differentiating between cyclical and structural voids, and coming up with asset management and refurbishment plans that refresh their projects without putting undue upward pressure on rents or service charges.

TABLE 1

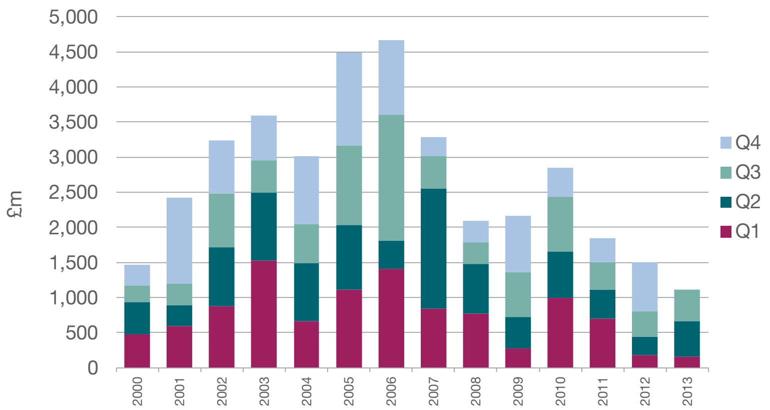
Retail warehouse yields

	Dec 2010	Dec 2011	Dec 2012	Dec 2013
Shopping Park	5.00%	5.25%	5.25%	5.25%
Prime Open A1	5.00%	5.25%	5.25%	5.00% ↓
Prime Restricted	6.25%	6.00%	6.00%	6.00% ↓
Secondary Open A1	6.00%	6.50%	6.50%	6.00% ↓
Secondary Restricted	6.75%	7.50%	7.75%	7.25%

Source: Savills

GRAPH 3

Retail warehouse investment volume



Source: Savills

Regional profile: Scotland

Whilst there have been several reasonably positive signals over the past 18 months with a number of new entrants to the market, the Scottish out of town market remains quite fragile particularly within the bulky goods sector.

Some encouragement should be taken from a number of notable and potentially exciting firsts. The Range and CSL both opened their first Scottish out of town stores in 2013 within Greater Glasgow at Glasgow Gait and Abbotsinch Retail Park respectively with strong trading performances reported. Both have committed to open further stores in Edinburgh which, in the case of The Range, is the former Big W at Newcraighall which opened strongly in October. CSL are due to open at Straiton Retail Park in the south of Edinburgh next spring. The Range are also due to open in Dundee and Dumfries in November and are considering further opportunities across Scotland as are CSL.

Nike opened their first Scottish retail warehouse outlet at Craigleith Shopping Park, Edinburgh in the spring, Starhkelvin Retailk Park, Glasgow in the autumn and have agreed terms for a further Edinburgh store. It is also anticipated that Homesense will enter the Scottish market in 2014. DFS chose Stirling to successfully trial their first UK small format (10,000 sq.ft) pilot store in late 2012 and it is anticipated they will consider further similar opportunities in the region.

Ongoing expansion from the likes of Dunelm, Wren, Oak Furnitureland, B&M, Home Bargains, Sports Direct and Pets at Home has helped keep the market ticking over however transaction volumes remain fairly low and demand has rarely been sufficient in depth to facilitate asset management or rental growth in any particular location.
Whilst these are encouraging signs, the bulky goods market remains challenging for the smaller operators and trading margins remain tight which in certain cases has led them to reassess their overheads.

Scotland was affected along with the rest of the UK following the demise of several significant occupiers particularly JJB Sports, Dreams and Comet. Whilst this inevitably resulted in a substantial volume of accommodation coming back onto the market, a reasonable proportion of this has been re-let and indeed facilitated the arrival some of the new entrants into the Scottish market.

Development activity is starting to slowly pick up – a second phase of 54,000 sq.ft is shortly due to commence at Abbotsinch Retail Park, Paisley and the development of the B&Q and Costa Drive Thru on Gallagher Shopping Park, Port Glasgow is nearly complete. We anticipate that development will continue to pick up on a selective basis to meet identified occupational demand.

Regional profile: North West

The northern market has been relatively static over the last couple of years with most deals being driven to minimise voids and holding costs but there are now signs of firm improvement. This is evidenced by Savills Retail Planning team reporting a significant increase in instructions from Developers and owners seeking to bring new sites forward and extend/ refurbish existing assets and further backed up by the increased level of retailer enquiries: Home Bargains are opening one store a week. To them it is all about affordability and sustainability. The UK offers many opportunities and although they still have a large amount of new territory to expand into, they will do this on terms that suit them or wait until such time that the market comes to their level. Whilst sometimes it is on terms below where a landlord may consider acceptable, you cannot question the benefits a quality value retailer brings to a park. A Savills client has recently commissioned a survey on a North West retail park of over 200,000 sq ft with 10 retailers trading. The customer survey showed 85% of the customers to the park visited Home Bargains, representing over 15,000 customers per week through their doors. Home Bargains replaced a bulky goods retailer who would have been lucky to see 500 customers per week. Home Bargains have been a catalyst in transforming a park struggling in a very difficult market.

Much has been written about the rise of the value/single price retailers and how without them the last 4 to 5 years would have been a much rockier ride. This is true also for the northern market but they have recently been joined by other new entrants and expanding brands.

For instance, Sporting Pro and Nike have taken several units in the north. The former have committed two thirds of their initial openings in the north. You could argue that this market offers affordability and access to a high spending consumer to test brands but we also assume it is because of proximity to the sister company, Matalan's Head Office. Nike have also stores in Manchester, Chester, Durham.

Bulky goods retailers have also been expanding; CSL have relocated at Whitebirk Retail Park, Hyndburn, initiating a long anticipated redevelopment of this Peel scheme. CSL have also agreed terms to take a new store at Deepdale Shopping Park in Preston where BL are adding a further c.45,000 sq ft of bulky goods retail to the hugely successful 235,000 sq ft shopping park. Development commences in October 2013. Other bulky retailers including Steinhoff have taken new stores in Bury, Manchester and Oldham and Oak Furniture Land have acquired at Oldham.

Turning to the POD operators, Costa have been putting in the 'hard yards' to secure units at Stanley Green, Brombrough and Aintree. Other leisure activity is coming forward at Broughton Shopping Park where British Land will commence building a new cinema and restaurant development with prelets to Cineworld, Frankie & Benny's, Pizza Express and Chiquitos.

An indication of further signs of confidence returning to the region is evidenced by other notable large scale developments which are now likely to come forward include Derwent Holdings 600,000 sq ft open A1 scheme consented at Edge Lane, Liverpool and Spen Hill moving close to a start on site in late Summer 2014 at Kirkby which will total over 300,000 sq ft of food/non food open A1 Retail and the Barons Quay, Northwich scheme comprising c 150,000 sq ft to be foodstore anchored and including a cinema and non food retail.

Notable recent success stories include London Metric's scheme in Bishop Auckland. Pre-lets to M&S Simply Food, Next, Boots, Poundland, Pets at Home and Costa. The opening has proven very successful with Phase II now starting on site in October this year. Other similar towns are now experiencing more development

interest as a result.

Smaller foodstores are also coming forward in the region. Land Securities in Chester, Brookhouse in Stockport have both secured consents for c. 40,000 sq ft stores and LaSalle in Carlisle have recently refurbished the former MFI at St Nicholas Gate and let this extending c. 35,000 sq ft to Asda. Rents are not at the previous levels but there is a drive to ensure the right retailers are accommodated on more parks going forward.

Outlook

Verdict are predicting that 2013 will be the last year of this cycle in which the sales of retail warehouse goods fall. 2014 will see growth in sales across all categories, and an overall increase in sales of 3.5%. Thereafter, the average annual growth in sales for 2014-2018 is forecast to be 2.9% per annum. This recovery in sales will spell a turning point for retailers, and a return to some selective rental growth for investors in the sector.

One of the main attractions of the sector to investors over the last 20 years has been its relatively restrained supply-side, and we do not expect this to change over the foreseeable future. There will be few net additions to stock from development or extensions, and the overall vacancy rate is forecast to continue to decline from 2014.

Tenant demand will remain highly selective on location, but we expect the better catchments to benefit from the pick-up in consumer confidence, and the forecast rise in housing transactions. This should support trading and expansion on both shopping and bulky goods parks.

Where supply is falling and tenant demand stable to rising then we expect to see some upward movement in rents from 2014. However, average annual rental growth rates will remain muted, with a range from 1.5% to 2.5% per annum over the next five years dependant on quality and location.

Occupier profile - Costa Coffee

According to the most recent Estates Gazette retailer ranking, Costa has been the most acquisitive retailer in the UK over the last year, acquiring 159 stores from June 2012 to June 2013. Savills have been fortunate to work for Costa for a number of years and, most recently, we have been appointed to acquire sites across the UK for their new Drive Thru operations. In this article, Charlie Greenhalgh of Savills and James Hamilton, Head of Estates and Acquisitions at Costa UK, outline the brand's current requirements and its plans for the future.

Costa was established in London in 1971 by Sergio and Bruno Costa as a wholesaler of coffee with no shops. At the time of writing they now have in excess of 1,400 shops across the UK, and will open around 300 stores worldwide in 2013, half of which will be in the UK. Costa invests heavily in its estate with 67% of Costa's UK equity stores either been opened or refurbished over the past three years and the brand has a strong pipeline of new store openings for 2014. The new growth milestone for the business is to double system sales to £2bn by 2018.

Costa has a varied trading portfolio across different sectors to meet different sales drivers and customer occasions, and in terms of the out of town market, a focus in 3 key areas:

- **Costa Retail Park stores** – Costa remains highly acquisitive in the out of town market and is now the major coffee shop occupier on retail parks. Typical store size has generally increased due to the success and increase in customer visits to retail parks, with floor areas c. 1,500–1,800 sq ft and additional key requirements including good prominence with fully glazed frontages and signage and an area for dedicated outside seating incorporating tables and chairs, umbrellas and balustrading. Proximity to the main pedestrian flows and synergy with adjacent retailers are good sales drivers and, in the case of retail parks, proximity and easy pedestrian access from car parking are also taken as read. Standalone pod units or in-line are both accepted, dependent upon position in the scheme.

During the earlier stages of their out of town acquisition programme, Costa initially targeted dominant shopping parks, with their bias towards fashion and the high street, but with the growth of customer visits and strength of retail parks they now consider busy parks with a blend of retail and strong traffic flows and footfall. Costa increasingly engages with park owners to fully understand a park's customer and sales profile.

- **Costa Drive Thru** - the latest concept from Costa, offering hand-crafted barista coffee and meeting customers desire for convenience, the Drive Thru store has both catering and seating in store and a dedicated Drive Thru lane. Store sizes are 1,800 sq ft on high visibility plots with main road frontages. Proximity to other major

IMAGE 1

Costa Coffee Drive Thru, Nottingham

traffic flow and footfall drivers such as large retail parks and food stores is preferred; with other generators including large employment sites e.g. business parks and industrial estates. Typically, the best locations for a Drive Thru will be a major commuter route, have a minimum 20,000 vehicle movements per day and direct highways access in all directions e.g. off a roundabout or major junction. This enables Costa to pick up morning commuter trade and then trade throughout the rest of day peaking at lunchtime and also at weekends.

- **Costa Express** – Costa has developed Costa Express self-serve machines, which have successfully rolled out across a number of sectors in particular Petrol station forecourts and service station formats. Costa Express combines a unique telemetry system, with the same freshly ground Mocha Italia coffee enjoyed in stores and fresh milk, to provide the quality Costa experience for customers on the move complementing Costa store offerings.

Rent and lease terms obviously vary across the country, but typically the rents agreed for Drive Thrus have been in the £25-35/sq ft range, on a 15 year lease with a break at the 10th year dependent on the strength of the location. This is longer than the typical 10 year lease on a drive-to, reflecting the higher costs of construction and fit-out for both landlord and tenant. Costa will also often insist on a break at 5th or 6th year on a 10 year term. They will generally not consider any element of turnover rent.

Costa's specification is very straightforward with the standard shell including glazing, signage, screeded floor and their usual utilities requirements. They are generally flexible on the design of their units and work with landlord to provide the best coffee shop environment within the confines of the park.
There are currently 12 Costa Drive Thrus open in the UK, with several more due to open this year. The pipeline is growing with a planned roll out in the medium term to 75 Drive thru stores. Expansion in all other types of locations continues apace with a strong pipeline across all sectors. Commenting on their plans for the future, James Hamilton of Costa stated, "Costa continues to grow across the number of traditional sectors for our coffee shops, complemented by the exciting new channels such as Drive Thru. New store openings remain strong, both based upon the growth of the coffee market in the UK and the strength of the Costa brand, and the out of town market continues to be one of our best performing and growing sectors driven by the customer demand for convenience".

Savills out-of-town retail team

Please contact us for further information

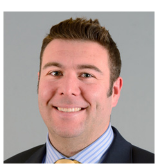
Dominic Rodbourne
Agency
020 7409 9945
drodbourne@savills.com

Jaime Dunster
Investment
020 7409 9929
jdunster@savills.com

Charles Mocatta
Lease consultancy
020 7409 8726
cmocatta@savills.com

Johnny Rowland
Agency
020 7409 8721
jrowland@savills.com

Matthew Whiteley
Management
0161 277 7232
mwhiteley@savills.com



James Hurst
Investment
0207 409 9927
jhurst@savills.com

Jeremy Hinds
Planning
0161 277 7278
jhinds@savills.com

Craig Hudson
Agency - The North
0161 277 7219
cphudson@savills.com

Mike Spens
Agency - Scotland
0131 247 3814
mspens@savills.com

Mat Oakley
Research
020 7409 8781
moakley@savills.com