Retail

Charles Miller, Partner, Head of Retail
+44 (0) 7970808272
charles.miller@kingsturge.com

Headlines

- **Damaging air bubbles in the supply pipeline.** The short-term response to a difficult market and finance constraints mean a significant lull in new development for the next two years. This will then transform into an overactive hive of activity in 2012 and 2013. The market would benefit from a more measured pipeline and financial means to facilitate this – notably a UK version of Tax Incremental Financing (TIF)

- **Christmas but a temporary respite for retailers.** A positive outturn on the back of recession-defying consumer demand and savvy, margin-protecting strategies on the part of retailers (eg planned promotions, non over-stocking) is likely to have resulted in a robust Christmas. But underlying retail sales will remain fragile and erratic, whatever the macro-economic environment. Key downside risks are rising interest rates and unemployment.

- **Occupier fall-out will recede in 2010.** Accordingly, vacancy rates will slowly start to recover from their near 20% nadir. However, the rates will be higher in some centres as the recession continues to cruelly expose towns that are failing and highlight the ongoing need for regeneration.

- **Occupier demand is not dead – merely very selective and opportunistic**. It is still a tenants' market and underlying rents are forecast to decline for another two years (2010: -3.1%, 2011: -1.3%).

***

Retail Sales

1 A year ago, with retail markets apparently in meltdown, no-one could have predicted how resilient retail markets would prove in 2009. Retail sales have

not tracked GDP performance - for the year as a whole, retail sales have been up on 2008 in both volume and value terms.

2 Christmas 2009 has encapsulated the year as a whole – better than expected. However, this was obviously against weak comparatives. However, a strong Christmas does not herald a measured recovery in retail markets. There are still ominous downside risks to the retail market. Interest rates will inevitably rise going forward, VAT will revert to its higher rate and the full effects of unemployment have yet to filter through to retail sales, even as the wider economy recovers. Rather than recover universally, retail sales will remain erratic throughout 2010 and beyond.

3 The rise of Internet shopping continues, with online sales now accounting for around 6% of all retail sales. This figure is forecast to hit 10% by 2013, but the rate of growth is decelerating as the online market matures. As ever, it's not merely a case of the Internet versus the high street – many of the key winners in the market are multi-channel as opposed to pure-plays.

Fall-out and Vacancy

1 The key shake-out amongst occupiers occurred a year ago as the onset of recession weeded out weaker players and those exposed to onerous finance structures. However, a number of players remain vulnerable and further casualties are to be expected. Encouragingly, vacated space is being re-absorbed back into the market. Overall vacancy rates may have risen as high as 20% during 2009, but are now starting to recede. We predict that they will be as low as 10-12% by the end of 2010.

2 This headline figure does not do justice to disparities between individual centres. In some secondary and tertiary markets, the figure may well exceed 30%. The onset of recession has served to place a microscope over those centres that were failing anyway. The regeneration needs of these centres is more apparent now than ever. In stronger centres, vacancy rates may well be less than 5%. Despite negative headlines that continue to surround the retail sector, space is still very hard to come by in many markets, where, despite fall-out, occupier demand is not met through current provision.

Occupier Demand and Rents

1 Occupier demand has not simply evaporated. Retailers are constantly striving to optimize their respective portfolios, even if they are not expanding aggressively. There has been a discernible increase in out-of-town retailer demand. We have identified more than 60 retail warehousing operators that are on the expansion trail (including high profile names such as John Lewis Home, Best Buy, Next Home and TK Maxx Homesense).

2 Despite signs of activity in both the in-town and out-of-town arenas, it will remain an occupiers' market. As a result, we expect rents to continue declining for two more years to come, albeit at a slower rate than in 2009. Bucking trends of recent years, retail warehouses are forecast to outperform standard shops and shopping centres.

3 Supermarkets will continue to provide some salvation for the retail sector. Despite lower price inflation, they remain highly expansive, and will continue to absorb some of the over-supply in bulky goods retail warehousing and fall-out from high street, as well as increasingly offering 'anchor' options for new developments. Foodstores are also the only commercial property sub-segment to see positive rental growth throughout the recession.

New Supply

1 In a very tight market, the supply pipeline has been derailed. Around 3 million ft^2 of new shopping centre space came on-stream in 2009. Although a significant proportion of this was let, it was on very favourable and incentivised terms to retailers. The pipeline will slow to a trickle over the next two years in the wake of financing issues and perceived occupier weakness. However, the next wave of development is already being lined up for 2012/2013, when market conditions are forecast to be far more conducive to new supply.

2 However, a 'lumpy pipeline' serves limited benefit. Despite current market conditions, there is still an underlying need for new floorspace in selected towns and markets in the short to medium term. Longer term, problems could arise through excessive new floorspace being delivered at the same time.

3 In the interests of achieving a balanced pipeline, we would endorse the recent submissions of the British Council of Shopping Centres (BCSC) to encourage rapid roll-out of a UK variation of Tax Incremental Financing (TIF) and, more generally, ensure that local authorities work with their development partners in constructive and progressive ways. In particular, more than ever, regeneration issues require innovative and proactive approaches.