Evolution, recent trends and prospects for the Retail Warehouse sector in the UK

Report prepared for Ediston Properties Ltd

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Executive Summary

The retail warehouse sector has undoubtedly evolved over the last 40 years. The first generation of retail warehousing emerged in the 1980s and was driven primarily by the needs of the bulky goods and DIY retailers. By the late 1990s the concept of the shopping park started to emerge with a more open planning consent which proved attractive to general merchandise and fashion retailers, thus attracting more traditional high street retailers looking to take advantage of the comparatively low rents. Fashion-led shopping parks began to include restaurants and other associated facilities that were designed to increase shopper dwell-time.

As a result we have seen the development and ownership of the sector broaden significantly. From the handful of specialist property companies and one or two institutions in the beginning, the start of the millennium saw increasing interest in the sector, particularly from a number of domestic institutions. The last five to seven years have seen an increasingly diverse group of buyers focusing capital in the retail warehouse sector. A steady reduction in acquisitions by UK Institutions has been taken up in part by a sharp rise in interest in the asset class from both Property Companies and Overseas Investors.

However, the global financial crisis (GFC) brought with it a combination of administrations, receiverships and tenant returns in the face of a weakening macro-economy. In common with the rest of the UK commercial property market, development activity in the retail warehouse sector fell back to record low levels as too did the sector's investment performance, which has since been slow to recover. It is important to note however, that this reweighting has been fairly unselective, with all of retail falling out of favour with investors and consequently delivering lower capital growth. Investment into all types of retail property has fallen from an average of 32% of the total in the period 2000-2005, to 10% of the total in the last three years.

However, the retail warehouse sector has consistently proven itself to be much more resilient to external market pressures than is true of other asset classes, and thus its comparative appeal has clearly been missed by a number of investors in recent years, evident in the reduction in activity from the UK institutions in particular. It is therefore Savills' belief that this blanket move away from all types of retail has been poorly thought through and the 'sell-off' of schemes and subsequent reduction of exposure to retail warehousing across investment portfolios has been overdone. Retail warehousing has displayed and continues to display a number of key advantages over other asset classes, making it more than worthy of a second look from an investment perspective going forward.

These key advantages include:

- The sector has proven to be much more resilient to the rise of ecommerce than the remainder of the retail market. Each of the retail sectors with a predominant out-of-town presence are better insulated from the rise of online retailing than is true of a number of goods traditionally sold on the high street in terms of the proportion of the goods that are sold online versus instore.
- Furthermore, ecommerce has perhaps unexpectedly provided the retail warehouse sector with a significant growth opportunity, particularly with its flexibility in terms of space. The large and comparatively low-rented units, combined with high car parking provision, means that retail warehousing has proven itself to be ideally suited for servicing click-and-collect orders where spend is therefore forecast to increase by £3.1bn in the next five years, rising 45.8% to reach £9.8bn by 2024.

- The continued importance of the store is evident in the pattern of above average acquisition activity in the retail warehouse market over the last 5 years, primarily driven by the value orientated retail operators who have sought to take advantage of falling rents in the sector. If consumers chose to be more cautious in their spending as a result of the recent pandemic, as they did post GFC, this pattern is only set to continue, a pattern that goes some way to explaining the sustained and comparatively low void rate which compares positively to that in other commercial sectors.
- The structural change and rebasing of retail rents have been far less stark in the retail warehouse sector, reporting declines half that of those seen on the high street and in shopping centres. This decline in net effective rents is now slowing, suggesting we are witnessing the early shoots of a recovery with the worst of the declines already behind us. The strongest recovery is visible in undersupplied catchments on foodstore anchored bulky-led schemes, where resilience to rental decline in the sector has been at its most robust.
- In terms of insolvency activity, retail warehousing has again shown strong resilience versus other asset classes. Proportionally it is the high street that has accounted for the largest slice of insolvency activity in each of the last three years, accounting for more than half in 2018 and two thirds or more in the years since. The out-of-town sector accounted for as little as 14% of activity last year, whilst so far in 2020 it accounts for a third of units that have been through an insolvency process in the retail market as a whole. Although an increase on 2019, it is important to note that more than half of those units have seen no disruption in trade and no reduction in their rental income.
- The retail warehouse market's response to the recent global pandemic has also highlighted the sector's strong resilience, pointing to evidence the sector has started to recover much faster and been less hard hit than is true for other comparative retail sectors. Firstly, of the retail operations deemed essential and allowed to stay open during the initial government imposed lockdown sanctions in March, the out of town market accounted for more than half. Secondly, the proportion of rent and service charge payments that have been met since March in the retail warehouse sector have been comparatively higher than is true of other retail asset classes. Footfall on retail parks has also recovered soonest due to the combination of large units and adjacent car parking, making shopping with social distance restrictions in place much easier on out-of-town schemes than in other types of retail location.
- Any fall in spend we have seen as a result of the pandemic hasn't been homogeneous across all retail segments either and again, it is subsequently the retail warehouse sector that has fared strongly in comparison to other asset classes - some submarkets with a focus weighted toward the out-of-town market have enjoyed a return to sales growth, above that of the same period last year. Foodstore performance and the homeware sector are two such examples that have thrived in the recent climate.

The positives the sector displays, coupled with the blanket re-pricing of the sector in line with other harder hit parts of the retail market, leads us to conclude that holding or acquiring retail warehouse assets, particularly dominant, value/bulky parks that are right-rented and have a strong convenience anchor, poses an obvious and significant opportunity for any fund looking for positive returns on their investment.

Introduction

The retail warehouse sector in the UK has, according to MSCI, delivered one of the strongest average annual rental and capital value growth rates (3.9% pa and 3.8% pa respectively) of any commercial property sector over the period 1980-2019.

This report examines how the sector evolved, why it has delivered an average total return of 10.4% pa over the last 39 years, and whether that out-performance will be sustained in the future in the face of both the huge structural change that is sweeping retailing across the world, and the more recent impacts of the global pandemic.

Evolution of Retail Warehousing as an asset class

The development of the first generation of retail warehousing in the 1980s was driven primarily by the needs of the bulky goods and DIY retailers. While a few general merchandise retailers such as Matalan were early adopters, the early schemes were viewed as the domain of large, low cost space users on the outskirts of towns and cities. Solus units or small clusters were more common than parks, and in many cases these were conversions of industrial and car showroom space.

The retailers' rationale for supporting this new segment of the market was straightforward - rents on the high street had been rising sharply, and there was a limited supply of retail units in excess of 10,000 sq ft in these locations.

From these fairly humble beginnings the sector started to evolve fast, and the first retail parks emerged in the mid-1980s. These parks tended to be anchored by a very large DIY or bulky goods retailer, with an increasing variety of other retailers also seeing the attraction of the marked rental discount to the high street in what was usually a highly visible roadside location with free parking.

The spread of unit sizes on offer started to widen as retail parks began to be developed, though it remained firmly in excess of 15,000 sq ft. More excitingly for shoppers, these new parks started to include restaurants, cash machines and toilets.

The strong tenant demand for this new trading location in the late 1980s caught the supply-side by surprise, and consequently rents started to rise sharply. Between 1985 and 1990 the average annual rental growth in the sector was 11.3% per annum.

With these levels of rental growth, and the consequent high total returns, it is no surprise that developers and investors swung into action and started to develop new schemes. We estimate that the stock of retail warehousing in the UK more than trebled between 1985 and 1995.

However, demand still exceeded supply, and rental growth throughout the 1990s was well ahead of other commercial property sectors, averaging 4.7% pa across the decade.

In the late 1990s the concept of the shopping park started to emerge. These parks with a more open planning consent proved attractive to general merchandise and fashion retailers, with the early successes being schemes like Fosse Park, Fort Kinnaird and the Fort. Typically, while they were of a similar size to bulky parks, they offered a wider variety of units sizes down to 5,000 sq ft or below.

Once again the factor that attracted more traditional high street retailers to the shopping parks was their low rents, in many cases 50% lower than the equivalent local high street.

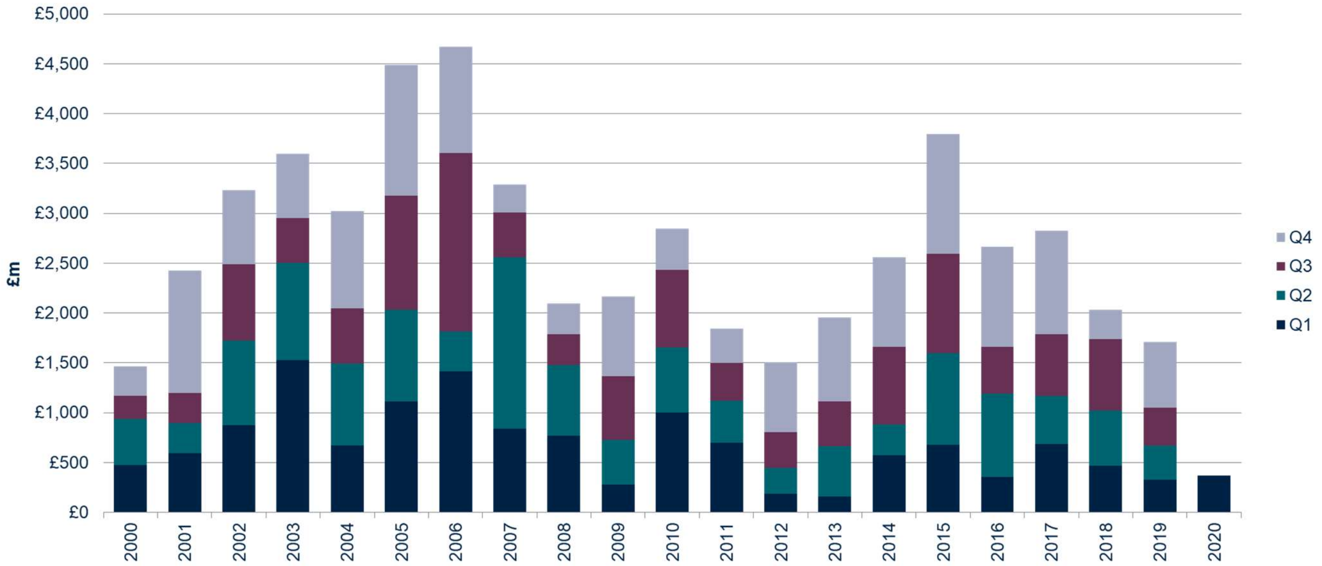
The arrival of high street retailers onto retail warehouse parks started to move the shopping park to a more mall-like offering. New schemes included restaurants and associated facilities that were designed to increase shopper dwell-time. Landscaping and design also started to improve, with this third generation of retail warehouse schemes bearing no resemblance to their 1980s forebears.

Of course more facilities on shopping parks led to higher costs to the tenants, whether in terms of rents or service charges. However, the imbalance between supply (in part due to the change to planning policy that was introduced in the late 1990s that discouraged out-of-town retail development) and demand continued to drive strong rental growth, with the sector showing an average annual rental growth of 5.4% per annum between 2000 and 2006.

The evolution of the shopping park (and the very attractive returns that the wider sector had been delivering) significantly broadened the ownership of the sector in the early 2000s. Prior to that, the developers and owners of retail warehousing had been limited to a handful of specialist property companies and one or two institutions.

Increasing interest in the sector, particularly from domestic institutions, led to investment turnover rising from £1.5bn in 2000 to over £4.5bn in 2006 (Figure 1). 2005/6 represented a bit of an inflexion point for the sector, with the vacancy rate trending upwards from below 6% to nearly 12% by 2009. This was caused by a combination of administrations, receiverships and tenant returns as tenants sought to save costs or improve margins in the face of a weakening macro-economy.

Figure 1: UK Retail Warehouse Investment Turnover £m



Source: Savills

As the global financial crisis (GFC) segued into a consumer downturn the vacancy rate remained high in the sector, though some segments (most notably value-orientated retailers) remained actively acquisitive. In common with the rest of the UK commercial property market, development activity in this sector fell back to record low levels, and it was this that set up the market for the steady falls in the vacancy rate that have been seen since 2012.

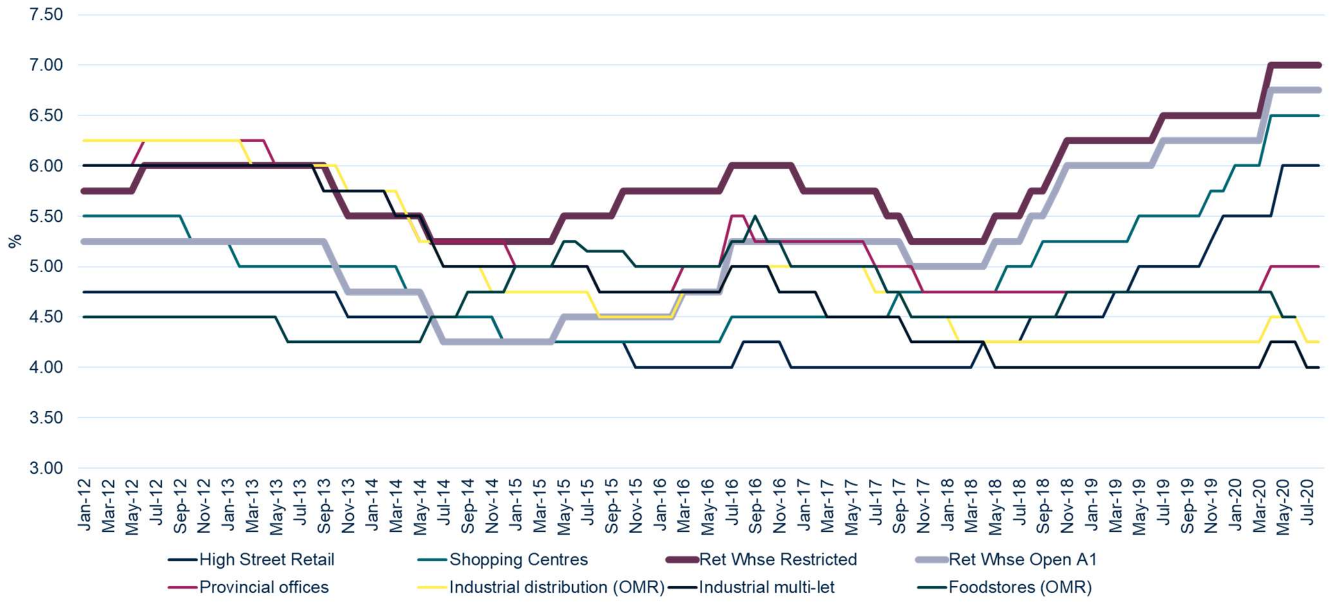
While the vacancy rate in the sector has recovered strongly since the GFC, the same is not true of its investment performance. While the average annual total return since 2010 has been a respectable 4.9% pa, for the first time in the sector's history it has under-performed the All Property return of 8.9% pa.

Rental growth has been weak (-0.4% pa) and capital value growth has also been weaker than normal (-0.5% pa). So, what has changed over the last decade to move the segment from being an out-performer to an under-performer?

The first, and most obvious, reason is that other sectors have become more popular. Distribution warehouse returns for example averaged 11.9% per annum in the ten years prior to the GFC, and averaged more than 14% per annum over 2014-2018 inclusive. Clearly this has much to do with investor's perceptions that retail property is being negatively affected by internet shopping, while industrial property is benefitting from it.

The general swing away from retail as an asset class can also be seen in the movements in the Savills prime yield indices (Figure 2), which shows that since 2018 yields on shopping centres and retail warehousing have risen by around 175bps.

Figure 2: Prime yields on various asset classes



Source: Savills

This reweighting has been fairly unselective (Figure 4), with all of retail falling out of favour and consequently delivering lower capital growth. As Figure 4 shows, investment into all types of retail property has fallen from an average of 32% of the total in the period 2000-2005 to 10% of the total in the last three years. However, as we explore later in this report, we believe that this blanket move away from all types of retail was poorly thought through, and some subsectors such as retail warehousing are proving to be more defensive than others against both the rise of online retailing and behavioural change connected with Covid-19. These are themes that we will return to in the remainder of this report.

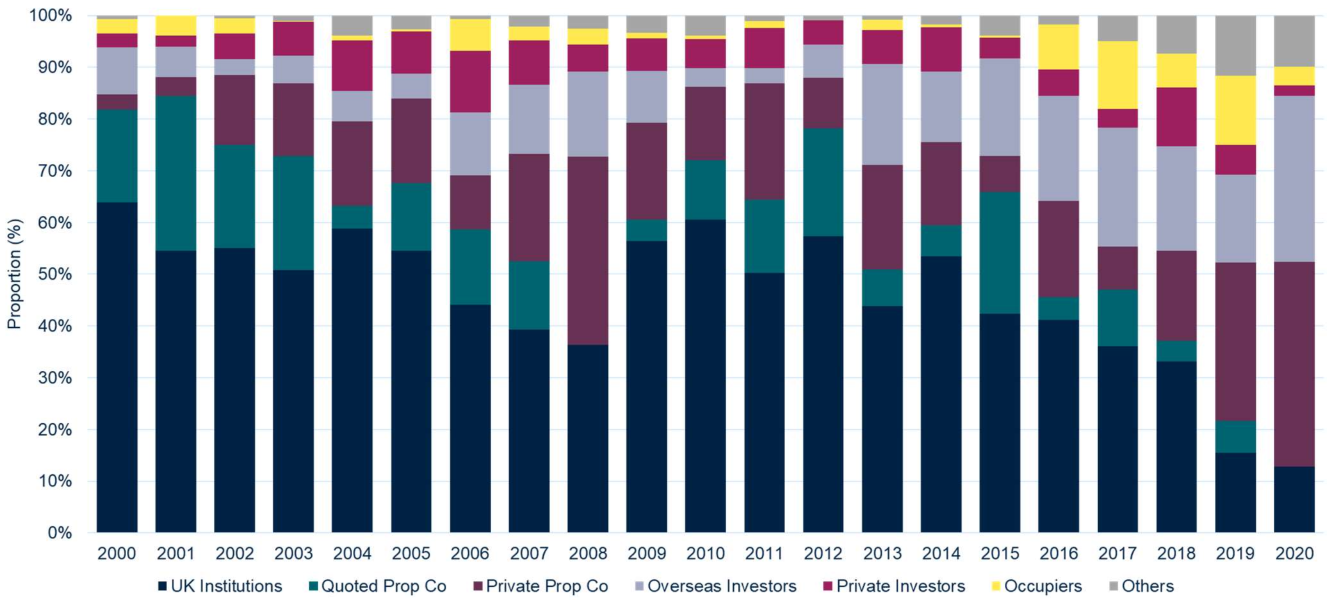
The second reason for this period of weaker performance was that in many cases the rental differential between retail warehouse parks and their local high street was no longer as persuasive as it was in the first twenty years of the sector's evolution. Rents, particularly on the best shopping parks, were driven up by strong tenant demand, and then as the post GFC recession hit, landlords on high streets and in shopping centres were quicker to cut rents than those on parks.

By late 2010 retailer demand started to recover for prime parks in the UK, with demand coming both from the traditional occupiers such as Dreams, Pets at Home and Halfords, as well as renewed interest from high street retailers such as Debenhams, Gap and New Look. Once again, the flow of retailers from the high street was driven by a shortage of suitable sized units on the high street, as well as rising rents.

Finally, the last five years have also seen the rise of the discount retailer both on high streets and out-of-town. These retailers, both in general merchandise and food, have been significant acquirers of retail warehouse space and have helped drive the vacancy rate down to record low levels. However, their low price model means that their margins are thin, and thus while activity has been robust their willingness to pay higher rents has been muted.

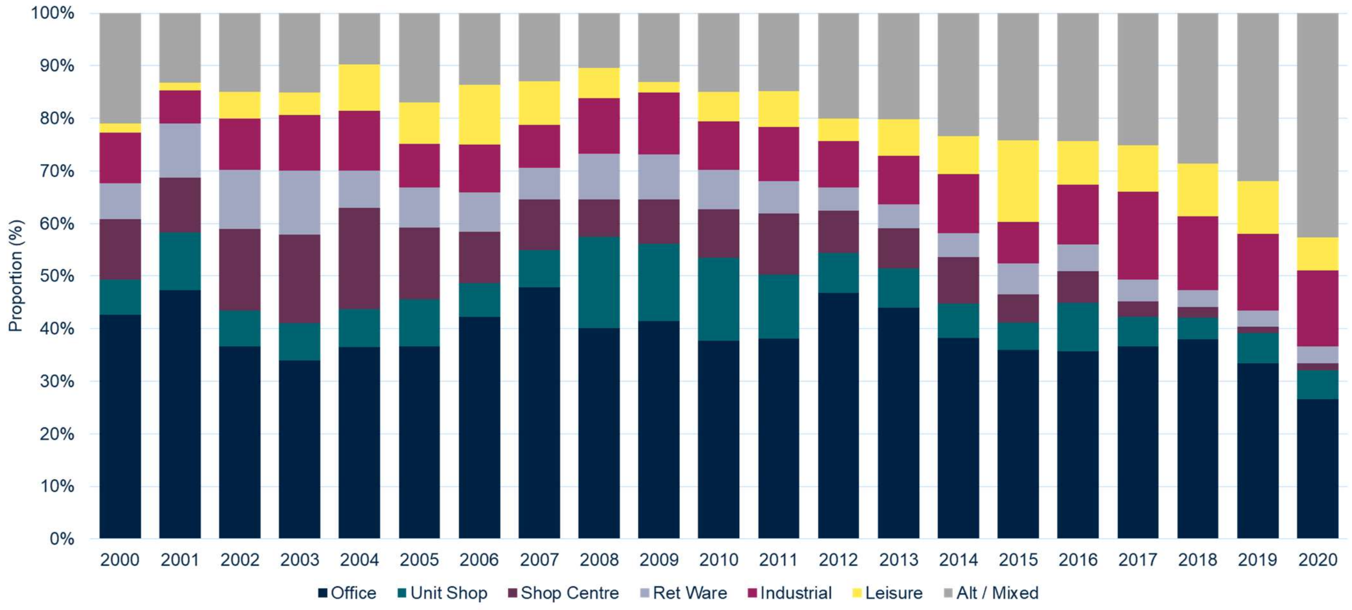
The last five years have also seen an increasingly diverse group of buyers investing in the sector (Figure 3). While the last seven years have seen a steady reduction in acquisitions by UK Institutions, their position has been taken up by a sharp rise in interest in the asset class from both Property Companies and Overseas Investors.

Figure 3: Purchaser type of UK retail warehouse assets (% of total volume)



Source: Property Data

Figure 4: Investors appear to have reweighted their portfolios away from all types of retail



Source: Property Data

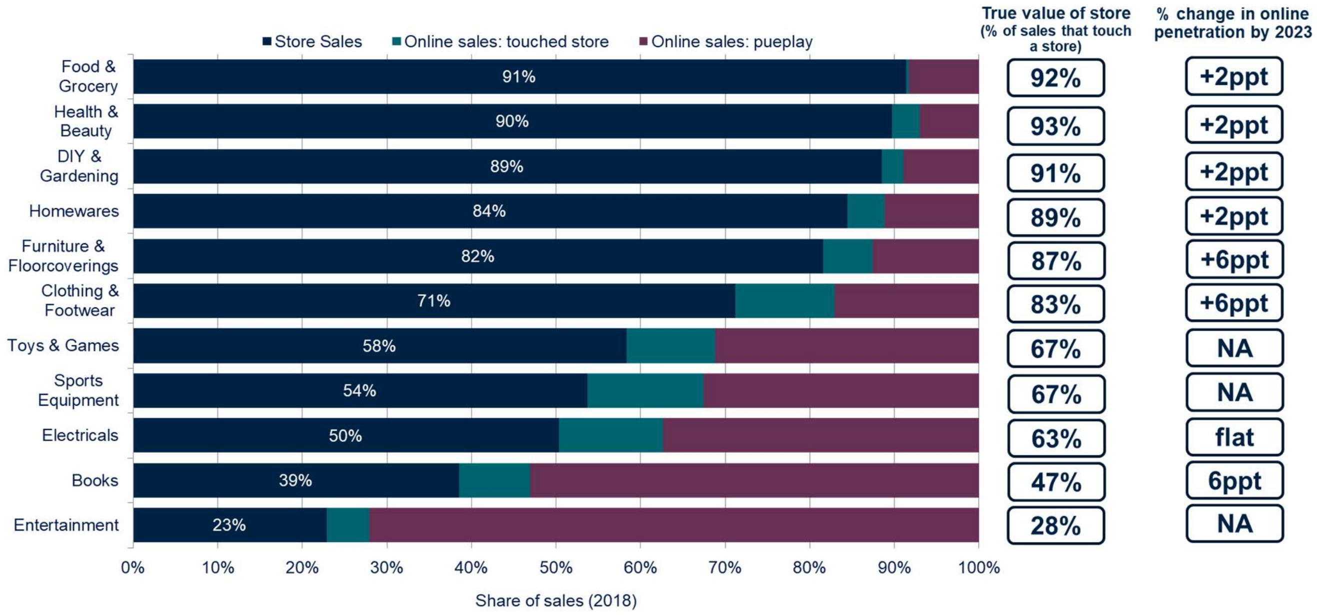
The impact of ecommerce on the Retail Warehousing Sector

The relative naivety some investors have shown in tarring all types of retail with the same brush is evident when we explore ecommerce in the retail warehouse sector. The assumption that retail is increasingly being fulfilled online and this is eroding the relevance of the physical store is overplayed and ignores the opportunities it presents in the retail warehouse market in particular. The oversight is twofold.

Firstly, Figure 5 highlights how each of the retail sectors with a predominant out-of-town presence are better insulated from the rise of online retailing than is true of a number of goods traditionally sold on the high street. This is the case both for the goods sold and the flexibility of the space that is available. Secondly, a significant proportion of the online retailing that is present is intrinsically linked to the store, highlighting its continued importance and providing a growing opportunity to drive significant sales growth in the market by way of store show rooming and click-and-collect sales.

Food & Grocery, DIY & Gardening, Homewares and Furniture & Floorcoverings all have more than 80% of sales fulfilled directly in-store. However, not all retail products are either bought purely online or solely in store. When we also consider the online sales that have touched a store in some way (either browsed in store and purchased online or via click and collect), the true value and continued importance of the store becomes even more evident. Between 87% and 92% of sales in these four retail sectors have required the physical store in some way in order to fulfil consumer demand.

Figure 5: UK online penetration by sector and the true value of the store



Source: Global Data

Operators that have adopted a clear and structured omni-channel approach to their business models, are therefore those that have recognised the importance of a well-placed store network to truly fulfil both their online business, as much as is necessary for the traditional off the shelf transactional side of their operations. In this regard, the store continues to play a key role in providing customers with a seamless and connected shopping experience.

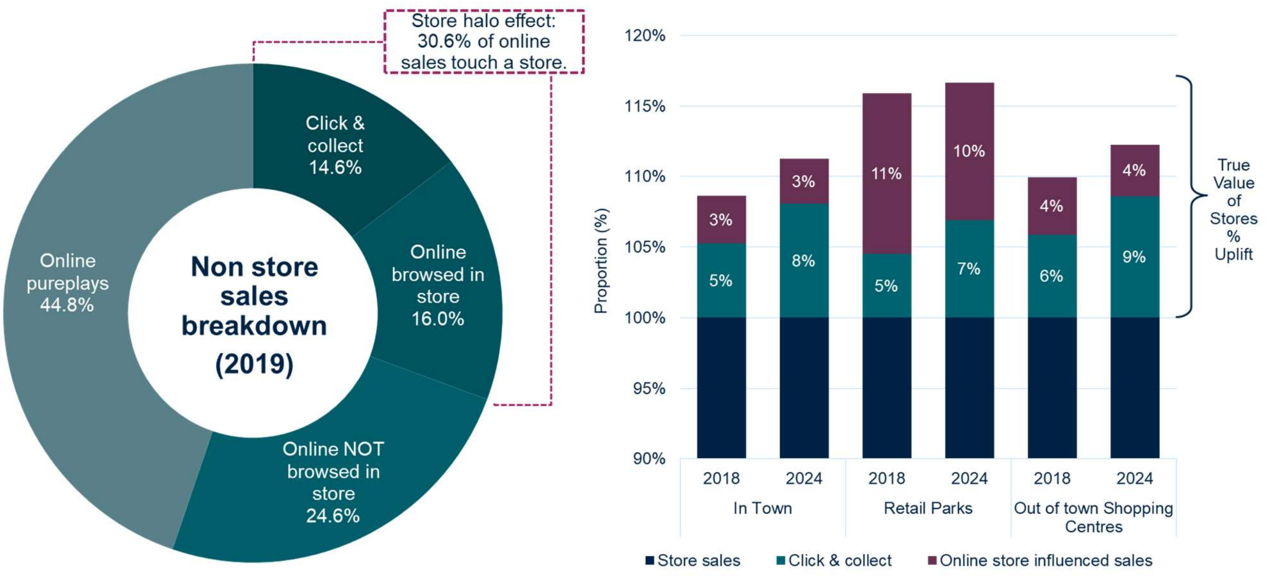
This point is highlighted no better than what the retail market has coined the 'store halo effect' (Figure 6a). In 2019 as much as 30.6% of non-store sales touched a store, be it through click and collect (14.6%) or being bought online having been browsed in store (16.0%) across UK retail as a whole. In comparison to other asset classes however, it is Retail Parks that see the most significant proportional uplift in online sales that touch a store in one of these two ways (Figure 6b).

Figure 7 highlights some of the UK retail market's most successful omni-channel brands, all of which have a significant out-of-town property footprint and for which the 'store halo effect' has proved much more pertinent. For these retailers click-and-collect is not only the key to fulfilling their pre-existing online sales, it is a significant driver for capturing additional sales in the market at the point of delivery.

For Argos, as much as 80% of their online sales are fulfilled through their stores (including collection from Sainsbury's stores). Next has had a longstanding multi-channel approach to their retail sales which included the early adoption of their mail/telephone order catalogue service alongside their network of stores. They are a good example of a retailer who have since evolved to adopt a modern omni-channel approach that now includes online sales and connects all these consumer channels together. Despite the choice of how to buy their products, as much as 50% of their online orders are fulfilled through their stores.

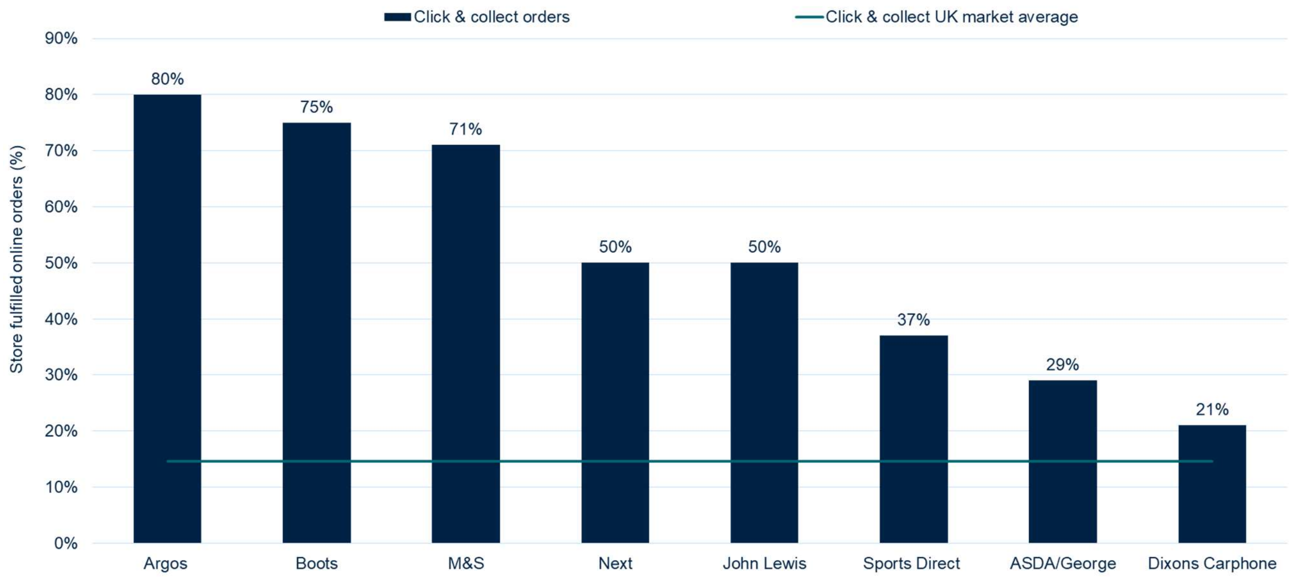
Figure 6: The store halo effect

(a) The store halo effect **(b) Store impact on online sales**



Source: Global Data

Figure 7: Click-and-collect is a key element of some retailers online strategy, highlighting the importance of their store network.



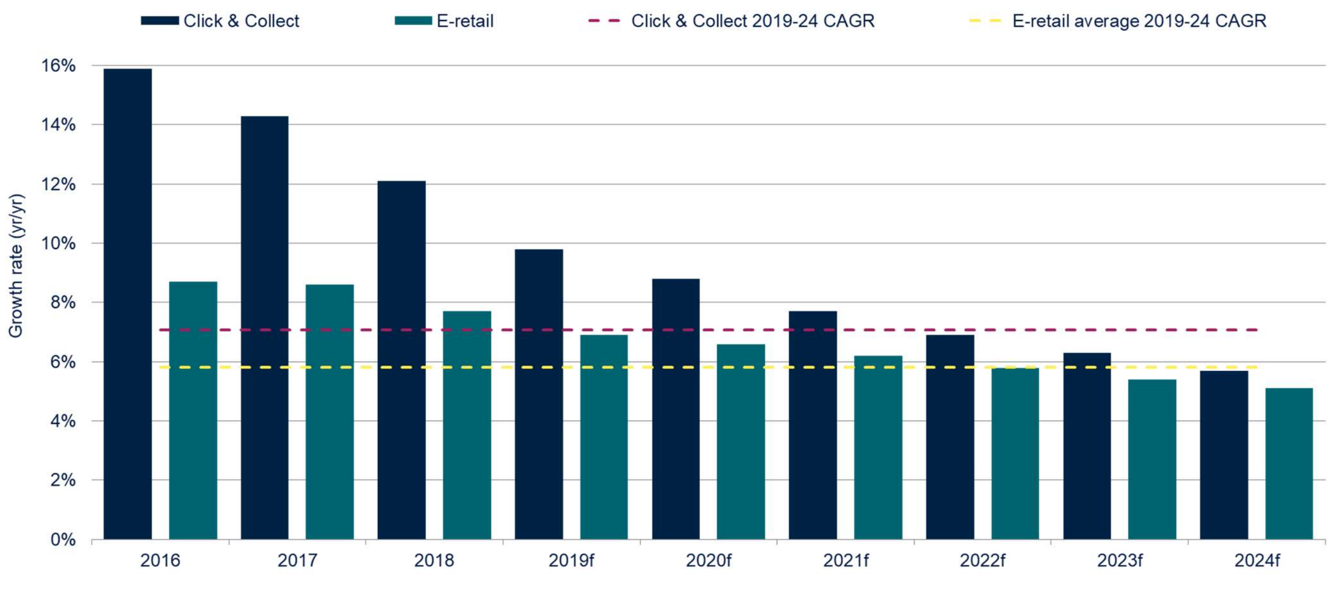
Source: Global Data

To continue to grow, going forward the out of town market should not focus on its defensiveness to online retailing, but rather how it can embrace the opportunities ecommerce can provide to enhance upon the strong position it finds itself in, particularly with its flexibility in terms of space. The large and comparatively low-rented units, combined with high car parking provision, means that retail warehousing has proven itself to be ideally suited for servicing click-and-collect orders, customer returns and home deliveries.

This is significant as more consumers are using click-and-collect due to improvements in speed and cost. Retailers are increasingly developing strong click & collect propositions and shoppers are encouraged to use the service as it becomes even more cost effective. For Sports Direct, 37% of online shoppers in 2019 chose to collect in store, an increase of 64% from the previous year. This example highlights the changing perception of click-and-collect; orders at Sports Direct cost the same as they would for home delivery but customers receive a £5 gift voucher when they buy online and collect in store offering greater value for money and encouraging uptake.

Click-and-collect spend is therefore forecast to increase by £3.1bn in the next five years, rising 45.8% to reach £9.8bn by 2024. With click and collect growth set to outpace that for e-tail delivery, the outlook for physical store presence is therefore positive. The average annual growth rate is forecasted to be 7.1% up to 2024, compared to e-tail growth of 5.8% (Figure 8).

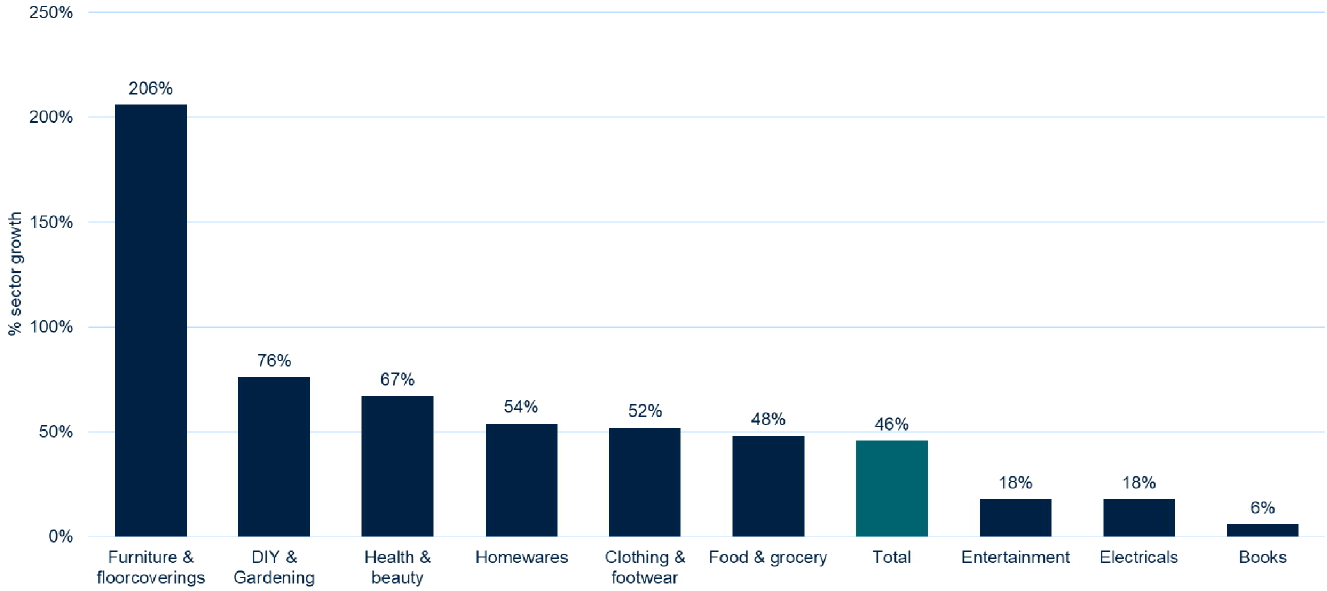
Figure 8: Click & Collect growth to support physical store presence



Source: Global Data

Significantly, it is retail warehousing that is set to see the strongest growth in click-and-collect services going forward (Figure 9). Collectively click-and-collect spend is set to rise 73.3% by 2023 for DIY & gardening, furniture & floorcoverings and homewares, outpacing overall growth in the channel. IKEA's plan to roll out a click-and-collect service will further bolster growth in the furniture and floorcovering sector, as too will the 2019 launch of Dunelm's operation in the homewares market.

Figure 9: Sector growth in click-and-collect



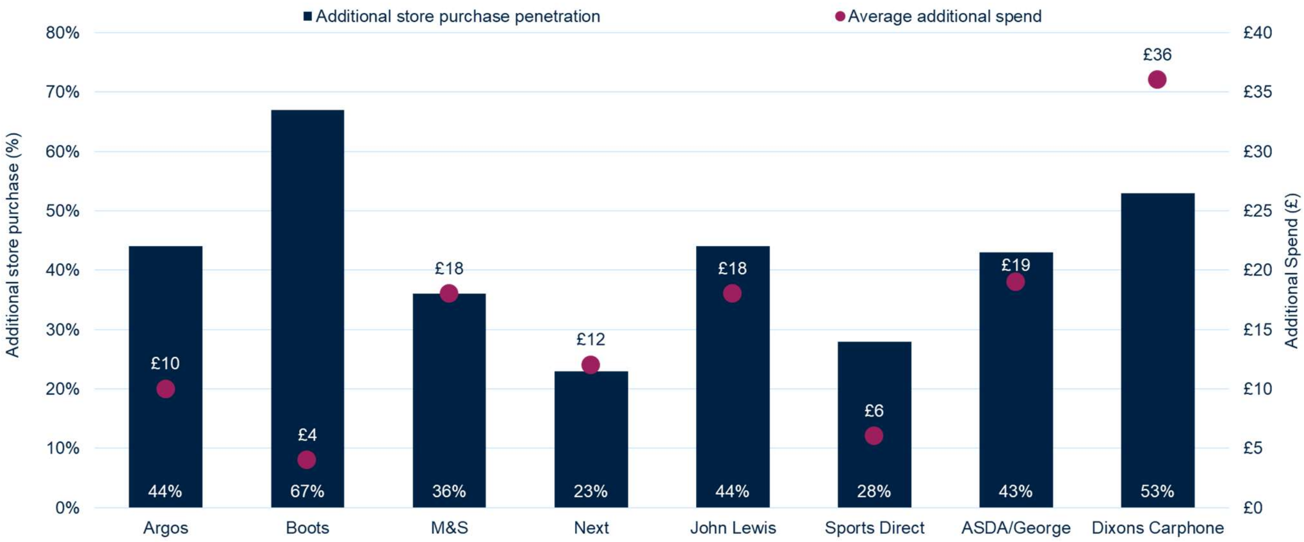
Source: Global Data

Fundamental to the importance of the growth of click and collect is what this might mean to retailers in terms of driving additional sales. In 2019 39.2% of consumers bought an additional item while collecting their last click & collect order. Figure 10 highlights that in the out of town market there are a number of key retailers for which additional spend penetration is even higher than this average. John Lewis for example fulfils half of its online orders through collection in stores (Figure 10). Of those customers that click-and-collect, 44% make an additional purchase with an average added value of £18.

Of course the price and the nature of the goods a retailer sells will influence which additional items consumers buy. Food and grocery has a higher additional sales potential than larger, more expensive electrical goods. The key for retailers selling more expensive product lines is to ensure the correct placement of lower priced complementary items to drive additional impulse purchases, evident in Dixons Carphone's 53% additional spend penetration that averages at £36 per visit on average and allows them to better compete with Amazon.

Click-and-collect is not the only way we have seen a strengthening in the relevance of the store in the retail warehousing sector. The move from 'Clicks-to-Bricks' has seen a number of DIY and home furnishing brands make the move from online pureplay to significant store network. Household names such as Screwfix (601 stores), Toolstation (331), Bathstore (164) and Oak Furnitureland (96) all started as online only brands. More recent examples include Matressman (11), Sofa.com (8), Loaf (7) and Made.com (3). Their justification for taking physical space is shared; to maximise their potential routes to sale and as a showcase for their brand. The risk of greater overheads and venturing into entirely new retail territory is offset by the opportunity to immerse their customers in their brand in a way impossible in the digital realm. This is particularly important for the home furnishings sector, where consumers' ability to look at and feel the product before purchase is important, or indeed in the DIY sector where the convenience of home delivery is offset by the chance to obtain a required item the same day to complete a job.

Figure 10: Proportion of click-and-collect that results in additional purchase and the average additional spend



Source: Global Data/BBC

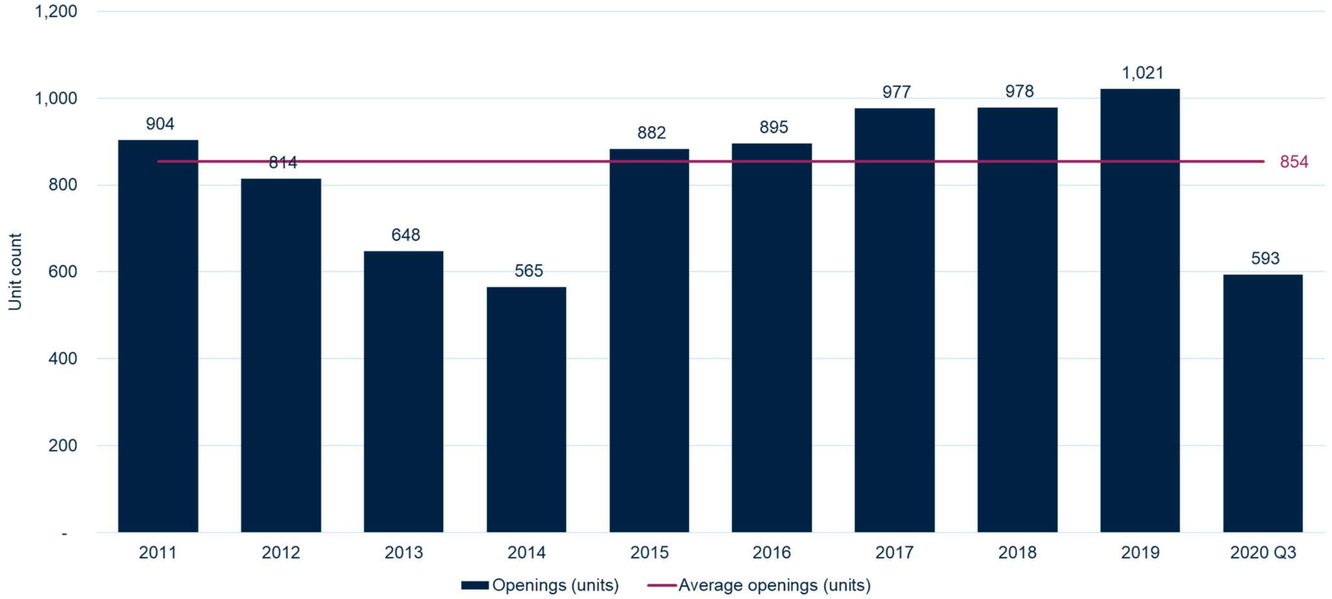
What does this all mean for the retail warehouse sector? Put simply, the role of the store is still paramount. The sector has been more resilient in the shift to online retailing than the rest of the market. In addition, the online sales the sector does support need the physical store as part of an omni-channel approach to truly fulfil consumer demand, all of which provides the opportunity to drive additional instore sales. In fact, the notion that the physical store is becoming increasingly less relevant couldn't be more debunked when we observe the pattern of acquisition activity evident in the retail warehouse market over the last 5 years, which we explore in the following section of this report.

Strong acquisition and low vacancy in the Retail Warehouse market

Much of the focus in the wider retail market in recent years has been on falling rents and store closures, particularly with the flurry of insolvency activity we have seen since January 2018 (we will return to these topics later in the report). However, it is less commonly noted that out-of-town store openings have been above the decade average in the last 5 years, with the last 3 years proving particularly strong. This culminated in a record year in 2019 in terms of the number of new openings in the retail warehousing sector. 1,021 units were let, well above the decade average of 854. Taking closures into account, by year end the sector had an additional 479 stores than it had 12 months prior (Figure 11).

It is clear that the decline in rental values has not been indicative of a market struggling to get deals over the line. In fact, it is the structural change with regard to rents that has been the driving force behind the acquisition activity, with the discounters and value-oriented brands in particular seizing the opportunity to acquire space at a more favourable rent. Figure 12 highlights how 8 of the top 12 brands that have taken new space are value based retailers, whether ranked by number of units or by overall floorspace.

Figure 11: UK time series new openings (by unit)



Source: Savills Research

The overall pace of store openings however, certainly appears to have eased as a result of the pandemic. By the end of Q3 2020 the number of new openings had reached 593 (equating to 6.8m sq ft). This may be some way off the record total for the previous year but is by no means a disaster with a quarter of 2020 still to come. Simple arithmetic tells us if Q4 equals this year's quarterly average, the market will end on circa 800 new openings for 2020, not a million miles from the 854 decade average and a strong result considering all but essential retail was closed to the public for a large part of the year. Consider also that each year a superfluity of new openings usually manifest in the final quarter, it is not overly optimistic to assume the final total of new openings may be closer to that average than is immediately obvious (Figure 11).

It is no surprise that the bulk of the demand in 2020 has been driven by value orientated retailers. Those brands identified in Figure 12 have maintained a relatively aggressive acquisition strategy, even in a disrupted market and against a background of weak consumer confidence amid the global pandemic. The immediate post-GFC period showed that if consumers swing into belt-tightening mode, then it is the value end of the spectrum that benefits. This suggests that whatever the political and economic outcome of the recent pandemic, the strong growth in demand from the value retailers will very likely be sustained. By way of an example, Lidl opened 46 new stores in 2019 totalling 908,000 sq ft. So far 2020 has seen them open 52 new stores equating to just over 1m sq ft.

This trend goes beyond just the most acquisitive brands. When we look at the UK market as a whole, value-orientated retailers accounted for a greater proportion of new openings than mass market brands in 2019, albeit by the smallest of margins (49% versus 48% respectively). In 2020, value orientated retailers have accounted for as much as 42% of new openings (Figure 13), a significantly higher proportion than the existing provision at 18% for the retail warehouse market and 22% for UK retail as a whole.

Figure 12: UK 2020 out-of-town new openings – top 12 brands (ranked by units & sq ft)

Ranked by units						
Rank	Operator	Units	Total Floorspace (sqft)	Average Unit Size (sqft)	Category	Pitch
1	Lidl	52	1,007,064	21,400	Grocery	Value
2	Aldi	33	547,611	19,100	Grocery	Value
3	Costa Coffee	23	43,370	2,500	Food & Beverage	Mass
4	B&M Bargains	22	618,632	28,000	Variety Stores	Value
5	Home Bargains	21	588,884	23,300	Variety Stores	Value
6	Wren	17	192,699	10,900	Home	Mass
7	PureGym	16	156,143	10,000	Leisure	Value
8	Iceland	15	202,431	12,300	Grocery	Value
9	Starbucks	13	24,150	1,900	Food & Beverage	Mass
10	Greggs	11	13,150	1,500	Grocery	Mass
11	TheGym	10	96,768	9,600	Leisure	Mass
12	M&S	10	245,938	21,200	Grocery	Mass

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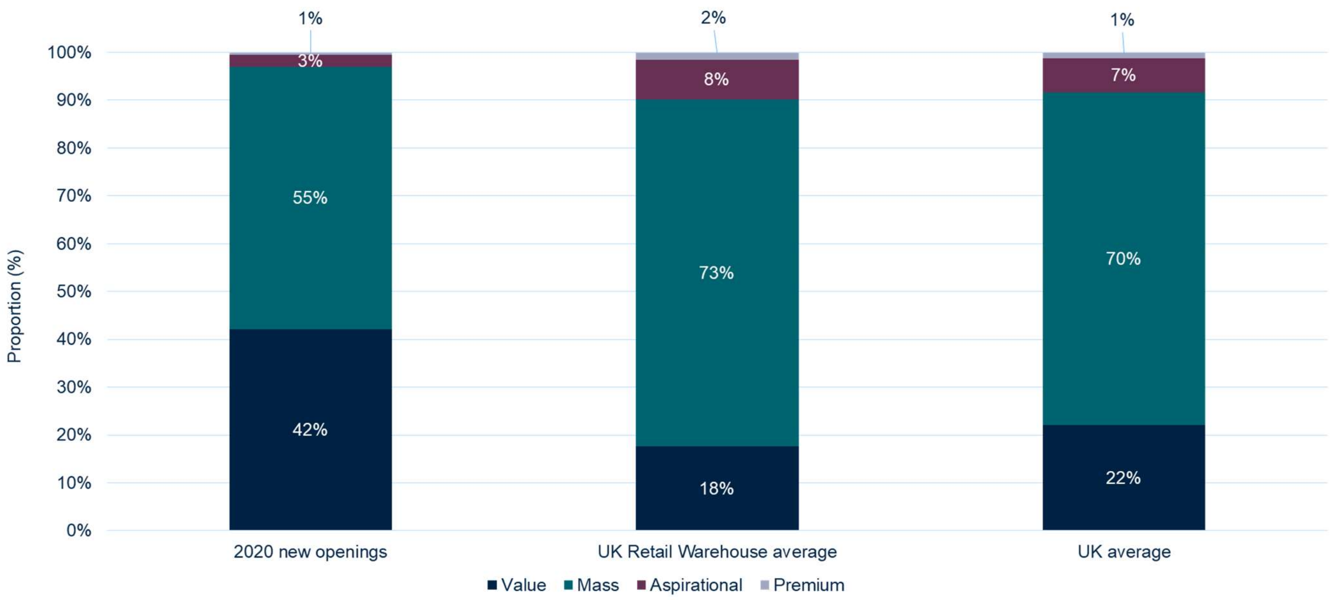
5	M&S	10	245,938	21,200	Grocery	Mass
6	Iceland	15	202,431	12,300	Grocery	Value
7	The Range	4	196,437	43,800	Home	Value
8	Wren	17	192,699	10,900	Home	Mass
9	PureGym	16	156,143	10,000	Leisure	Value
10	B&Q	3	110,844	32,400	DIY	Mass
11	TheGym	10	96,768	9,600	Leisure	Mass
12	JDGyms	3	70,973	20,500	Leisure	Mass

Source: Savills Research

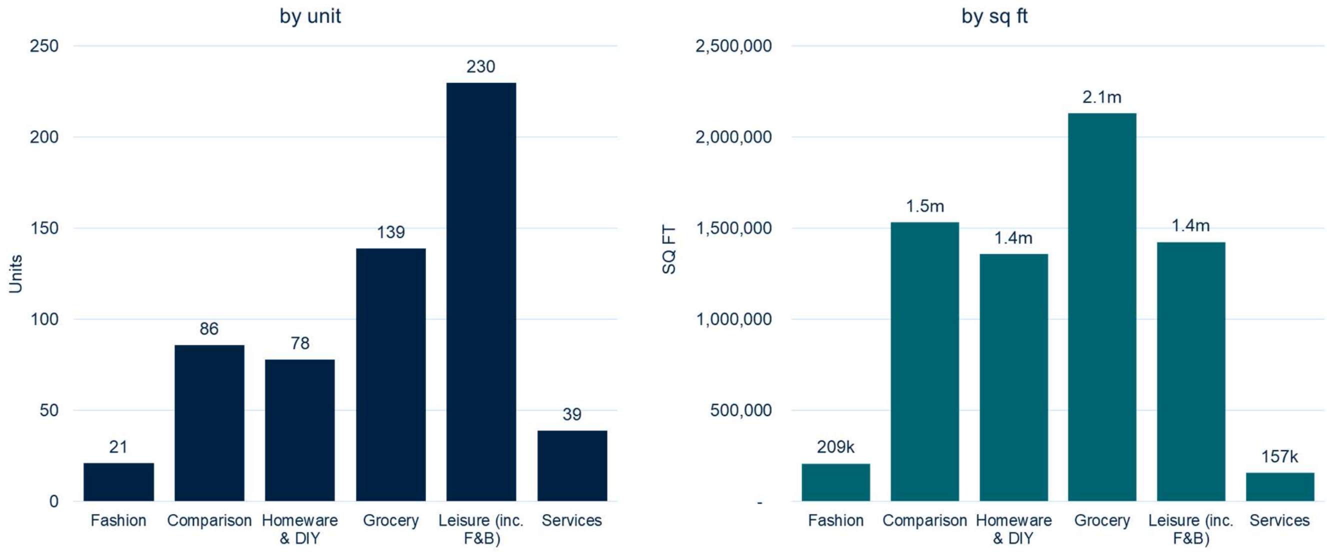
Figure 13: UK 2020 out-of-town new openings by retail pitch vs retail warehouse and UK market average



Source: Savills Research

On a sectoral basis comparison goods and grocery retailing are at the forefront of out-of-town openings, particularly in terms of overall space (Figure 14). This is to be expected when you consider B&M, Home Bargains and The Range from a comparison point of view and Aldi, Lidl and Iceland from the grocery perspective, are leading the charge in terms of store openings (Figure 12). Collectively they account for as much as 47% of activity in terms of additional retail warehousing space. These operators typically favour medium sized units that are on average between 15,000 and 40,000 sq ft. As a result, the last three years have seen total additional floorspace in the UK broadly in-line with the average for the last 8 years at 10.4m sq ft (Figure 15), significantly less than the space being taken in the pre-recession big box era of the late nineties and early two-thousands.

Figure 14: UK 2020 new openings by sector (by units & sq ft)



Source: Savills Research

Leisure as a sector also continues to see strong growth in the out-of-town market, predominately driven by value orientated gym brands and convenience F&B operators such as Costa Coffee, who so far have opened 23 new units in 2020 and who have consistently post strong acquisition numbers over the last 5 years. Many landlords have long since realised the value of the support these operators bring to a consumer shopping trip. They recognise that the most resilient schemes going forward are those where the consumer can adequately refuel, subsequently increasing dwell time, or can make their shopper journey multi-purpose with a visit to the gym or other such leisure activity. Strong acquisition in the leisure sector has seen the demand for smaller units increase significantly in the last few years. In fact, units under 2,500 sq ft were the only format to see positive growth in net effective rents between 2016 and 2019 at +2.0%.

What is clear from the the above average, value orientated acquisition activity we have seen in recent years is these opportunistic retailers have sought to take full advantage of the falling rents that have been evident in the retail warehouse market, taking the opportunity to significantly expand their operations or renegotiate existing leases on more favourable terms. This has been the driving force behind the above average number of new leases and has subsequently resulted in a sustained and comparatively low void rate which compares positively to that in other commercial sectors.

Figure 15: UK time series new openings (by sq ft)

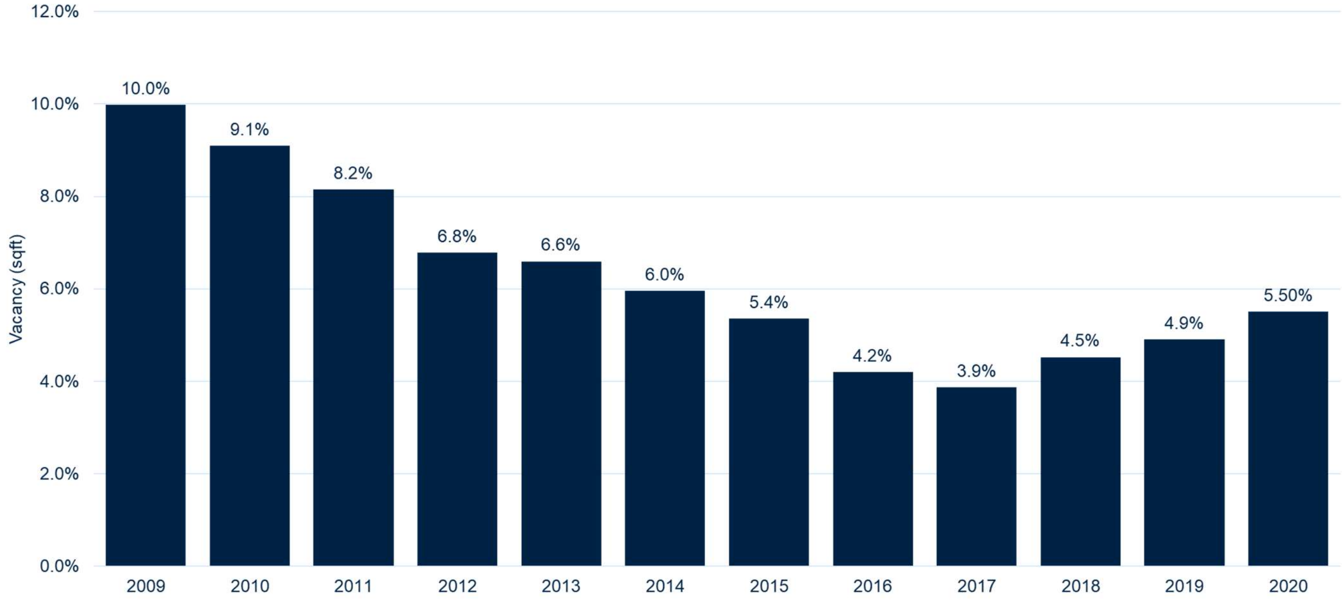
Source: Savills Research

Since the end of 2019 vacancy in the market has only increased by just over half a percent to 5.5% (Figure 16), despite the increase in insolvency activity across UK retail as a whole, as many operators struggle to get to grips with the impact of the global pandemic (we will return to this subject later in the report). This figure therefore remains low and preferable when compared alongside other asset classes, illustrating the sector's strong occupational demand by comparison. High street (11.2%), shopping centres (14.7%), regional offices (7.1%) and even UK logistics (6.2%) all have a greater proportion of voids..

It was our view at the end of 2019 that the low vacancy position in the market would therefore begin to help reduce the rental decline we have seen over the last 3 years, without necessarily eliminating it all together. Indeed by the end of Q1 with vacancy in the market remaining low, it seemed the slide in rental income had, at the very least, begun to plateau. Analysis on the deals Savills have been involved in, representing a fifth of activity in the market, had on average returned to positive territory for the first time since 2017 with a 1.7% growth on the average headline rents reported the previous year. Before the true onset of Covid-19 and a global pandemic, an optimistic analyst might have described this as the very early shoots of a recovery in terms of rental growth, particularly when it is considered 302 stores were let in Q1, half of the current total and already just under a third of 2019's record total. Retail agents could therefore be forgiven for getting excited over the prospect of another bumper year in terms of operator lettings, the strong pattern of acquisition activity showing no signs of slowing down.

The following section of this report therefore focuses on the structural change the UK retail market has undergone in terms of rents and the full extent of the declines that have been evident in the last 3 years both pre Covid-19 and the pattern of change, if any, we have seen since its onset. The pertinent question remains; has the early shoots of a recovery seen in Q1 remained intact, or indeed been trampled on as a result of the pandemic?

Figure 16: UK time series vacancy (by sq ft)



Source: Savills Research

What has really been happening to rents?

For some time prior to the Covid-19 heath crisis, the UK retail market was already undergoing deep structural changes. Changing consumer behaviour and the rapid expansion of online retailing were posing major challenges to retailers and owners of retail real estate. However longer term, the decline of physical retail is being overstated, particularly in the retail warehouse sector which has shown some resilience to such external market forces.

Nevertheless, the transitional phase we currently find ourselves in is proving to be difficult for many operators, some of whom are not destined to survive. As the market adjusts to a cocktail of rising business rates, staff and supply costs, falling consumer confidence, an increase in precautionary saving, the continued growth in ecommerce and the increasing need for an omni-channel approach to retail operations, rental values have been falling across most retail segments and markets across the UK. Operators have increasingly been looking for ways to reduce their costs and continue to turn a profit, thus it is no surprise we have seen a flurry of CVAs, administrations and liquidations in this same period for those retailers that have failed to successfully do so.

What the insolvency activity has made clear is rents are often the only cost that retail operators have any degree of control over, making the rent reductions we have seen inevitable and imposing an unjustly disproportionate impact on the landlords of retail property. Retail warehousing has not been immune to these challenges, but the evidence again suggests the sector has fared much better than others in this regard and is worthy of a second look from an investment perspective.

The following section therefore outlines the structural change with regard to rents pre Covid-19 and whether or not this has changed since it began. Looking at the data for the last full year pre pandemic, the MSCI rental value index suggested rental declines of -4.1% in the out of town retail market in 2019, marginally better that shopping centres at -4.5% and directly comparable to high streets at -4.0%. On the whole, these declines seem relatively modest despite the numerous and well documented challenges facing the retail market in recent years. What's more, the declines are comparable across asset classes with none of the three sectors faring significantly worse than any other.

Many landlords could therefore be forgiven for having hit the panic button when they compared the declines they were seeing on their own retail warehousing portfolios, to those reported in the MSCI index last year. Anecdotally the market was awash with owners of retail parks suggesting the rental declines on their schemes were much more severe, collectively suggesting the industry was experiencing something different to what the MSCI forecast was reporting.

So what really happened to rents in 2019? It is important to remember the MSCI index is a strong and well established criterion for rental trend statistics, not least because it is a comprehensive accumulation of valuation evidence which is used to calculate the fluctuations we might see in the market over a given period of time. However, the fact the index is a valuations based benchmark can result in a lag with between what the results are reporting and what is being seen on the ground. A sudden and profound drop (or indeed surge) in rental income will take time to filter through as data needs to be collected and takes time to pass through the valuation process.

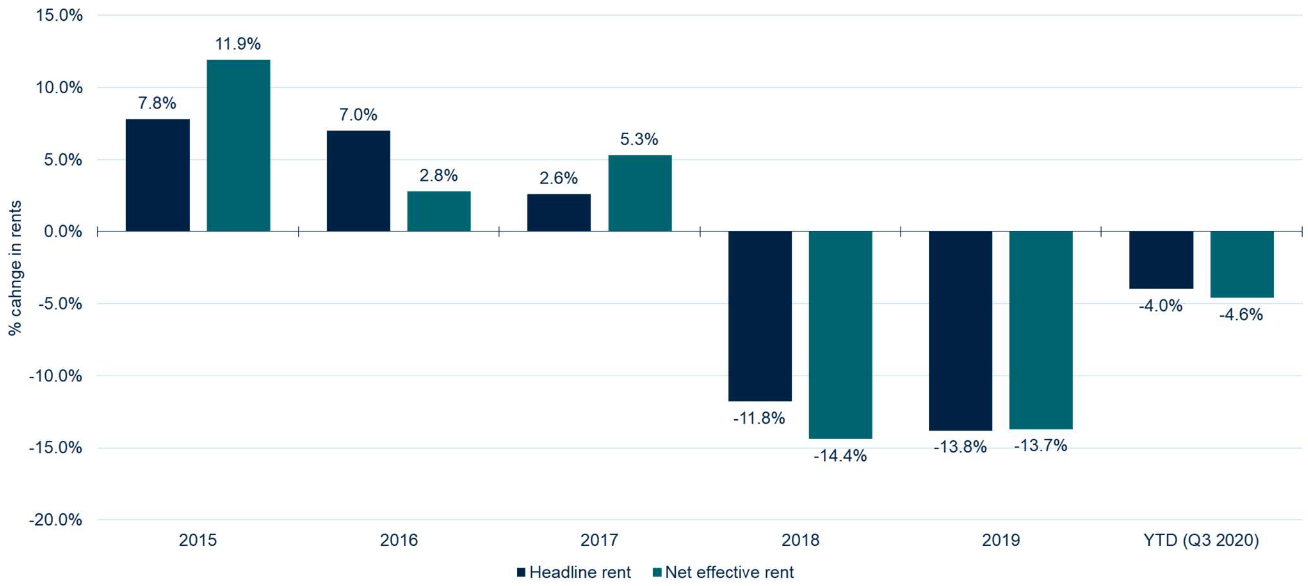
In order to more accurately determine what has really happened to rents over the last few years, Savills have therefore undertaken their own piece of internal research, analysing all of the deals they have been involved with, whether that be open market lettings or regears. Our net effective rental value index, that includes rent free periods and capital contributions, suggests declines were much more pronounced in 2019. Out of town retail units have seen average declines of -13.7% on net effective rents, a statistic based off c.200 deals, equating to 2.3m sq ft. This represented a quarter of all openings in terms of physical space (a robust sample size from which we are able to form a more realistic view of declines in the short term). The decline in rents we saw in 2019 were therefore much more profound than the -4.1% MSCI benchmark.

There are however some positives to draw from this analysis for the out-of-town market, despite what has proven to be a more dramatic decline in rents than was initially obvious. Firstly, retail warehousing in particular has shown strong resilience in comparison to other sectors in the market. The declines for shopping centres were much more austere at -26.8% on average, almost double what we were seeing in the out of town market (based on c.200 deals, 650,000 sq ft). High street declines have also been much more significant equating to -24.9% on average across the UK.

The second positive to take from our analysis of rental declines in the retail warehousing market is that the decline in net effective rents is slowing. While MSCI's decline of -4.1% was actually an acceleration on what they reported in 2018, Savills deal data suggests the decline of -13.7% in 2019 was a reduction on what we saw the previous year when net effective rental declines were recorded at 14.4% on average (Figure 17).

What is more pleasing for the retail warehouse sector, is that both its resilience and slowing rental decline have continued into 2020. Savills data for the year up to the end of Q3 2020 has seen net effective rents fall by -4.6%, half that of shopping centres and high streets combined at -9.5% and a drastic deceleration on the previous year at -13.7%. It seems the early shoots of a recovery are still present. At the very least the figures for 2020 suggest we have seen the worst of the declines in terms of rent and we are close to the bottom with regard to how far they will fall. Assuming we don't see significant loss in the market through insolvency as a result of the pandemic (the initial signs this will be averted are good for the retail warehouse sector), vacancy will remain low and the fall in rents we have seen since 2017 should soon come to an end.

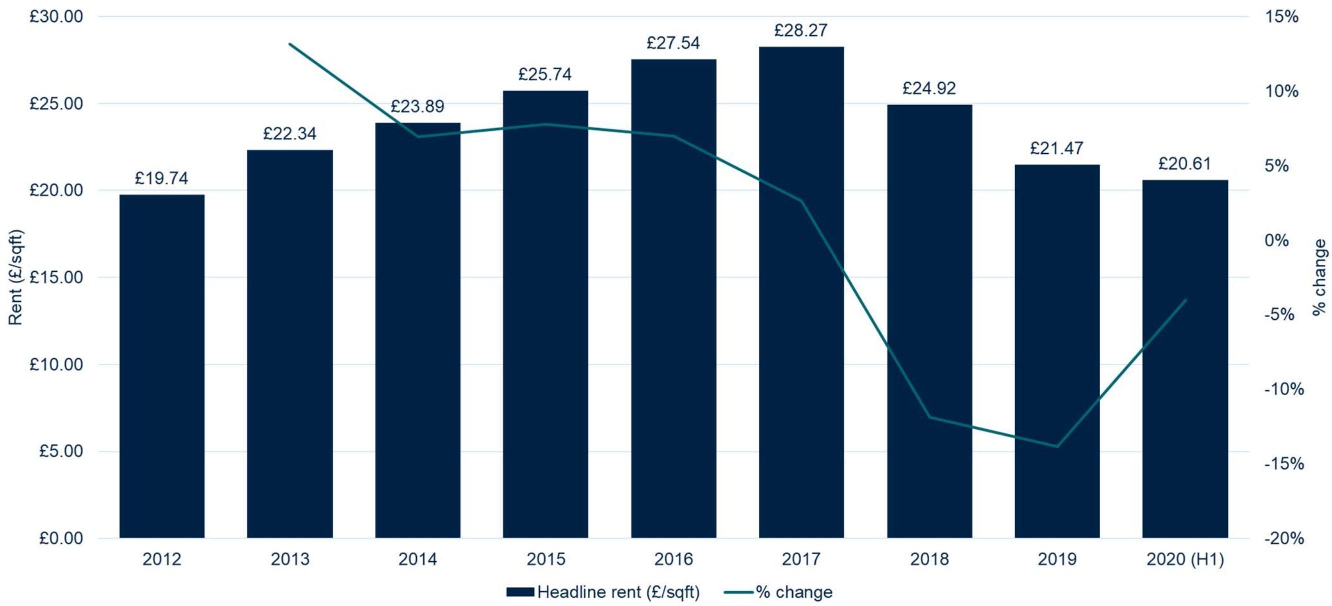
Figure 17: Change in average headline & net effective rents



Source: Savills Research

Figure 18 highlights the true extent of rental decline over the last 3 to 4 years. The schemes Savills have been involved with have seen a 25.2% decrease in rents since 2016, falling from an average of £28 psf to £21 psf at present (25.8% from an average of £26 psf to an average of £19 psf in terms of net effective rents – Figure 19). With much of UK retail considered to be over-rented in recent years the balance of power in most negotiations has remained in favour of the retailer, leaving landlords and potential investors alike wondering where the bottom was in terms of rental decline. The sharp reduction in rental declines observed over the last 9 months suggest we are somewhere near.

Figure 18: UK retail warehouse rents (Savills deals)



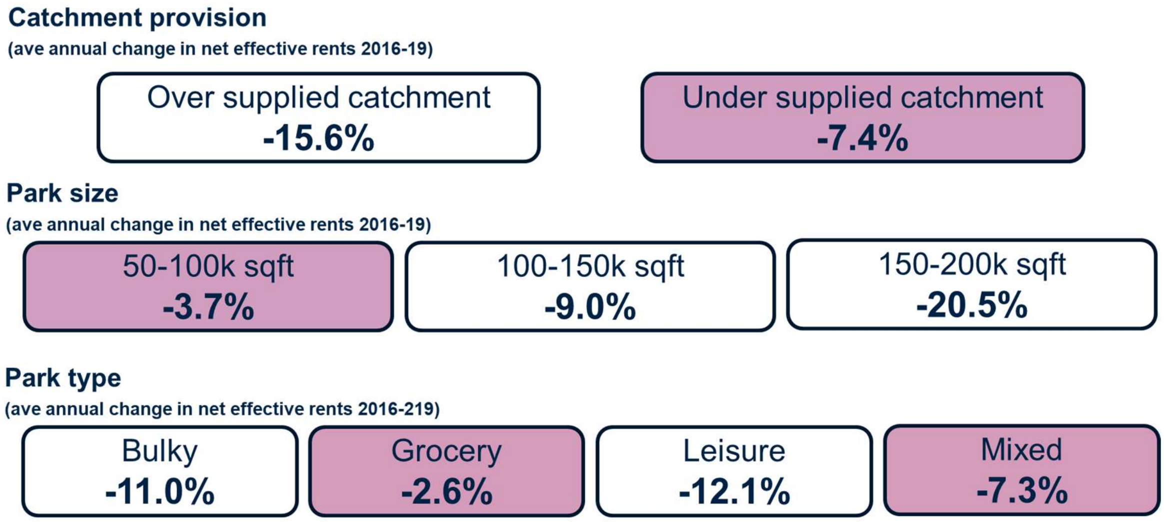
Source: Savills Research

Figure 19: UK retail warehouse net effective rents (Savills deals)

Source: Savills Research

Although the headlines point to a resilience in rental decline versus other asset classes, it is important to note not all retail warehousing schemes are equal and we have seen a divergence of performance across different types of assets in the sector. By categorising each of the Savills deals according to catchment provision, park size and park type we are able to add more flesh to the bone and highlight those schemes within the sector that will likely be the most resilient going forward and therefore have stronger appeal from an investment perspective (Figure 20).

Figure 20: Rental performance by types of asset



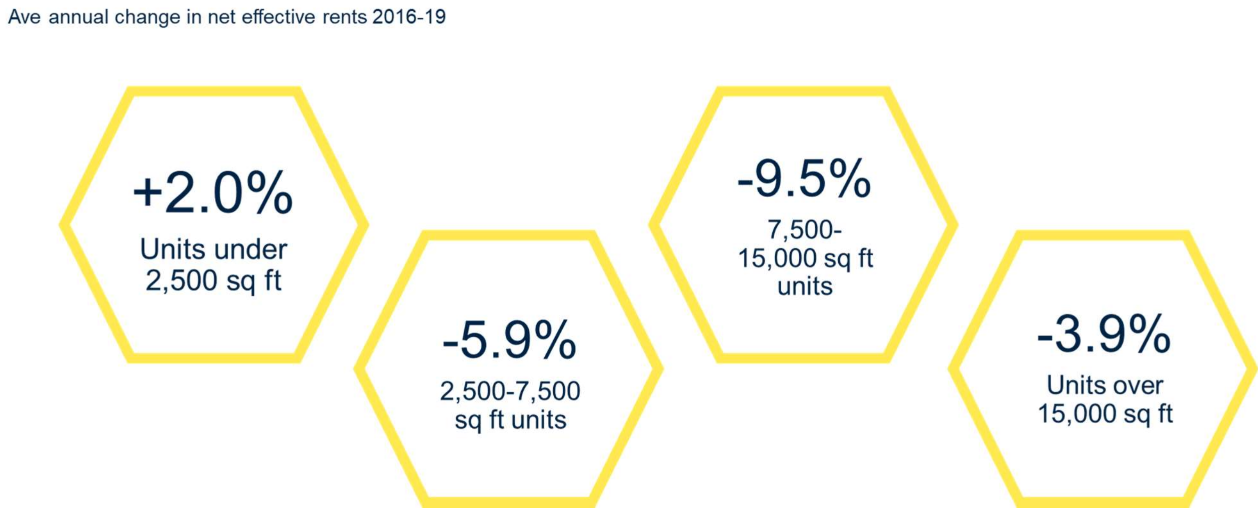
Source: Savills Research

It is no real surprise to see that average annual change in net effective rents has seen significantly more resilience in under supplied catchments since 2016, with rental falls accounting for half those seen where the catchment is saturated. In terms of park size the smaller schemes of between 50,000 and 100,000 sq ft have seen the lowest drop of -3.7% since 2016. At the larger end of the scale the declines have been much more pronounced (-20.5% for schemes between 150,000 and 200,000 sq ft).

Similarly, schemes anchored by a foodstore have shown the greatest resilience, (-2.6% fall in rents since 2017), however declines have been starker on schemes dominated by bulky goods provision. Fashion orientated schemes have been omitted from the analysis in Figure 20 as the sample size of Savills data is too small to make a solid assumption on the degree of rental encumbrance. That said, the lack of deals on fashion parks since 2016 tells its own story, anecdotally we hear the rental decline on these schemes to be greater than any other. Despite a lack of evidence for fashion led schemes, we can make some inferences when we look at rental performance across unit sizes.

Similar to size and type of park, not all unit sizes have been equal in the structural change we have witnessed with regard to rents (Figure 21). Units under 2,500 sq ft were the only unit size to report an increase in net effective rent in the last three years, unsurprising considering the likes of Costa Coffee and Co-op Food via their convenience store offer have been very acquisitive at that format. At the other end of the spectrum units over 15,000 sq ft have shown comparative resilience, driven by the aggressive acquisition strategies employed by Aldi, Lidl, B&M, Home Bargains and The Range, all taking space at this format and above, albeit at a lower margin than we have seen in the past. Indeed it is the 7,500 to 15,000 sq ft units where rents have been most exposed – this reverts back to the fall in demand for fashion retailers and their reluctance to take new space.

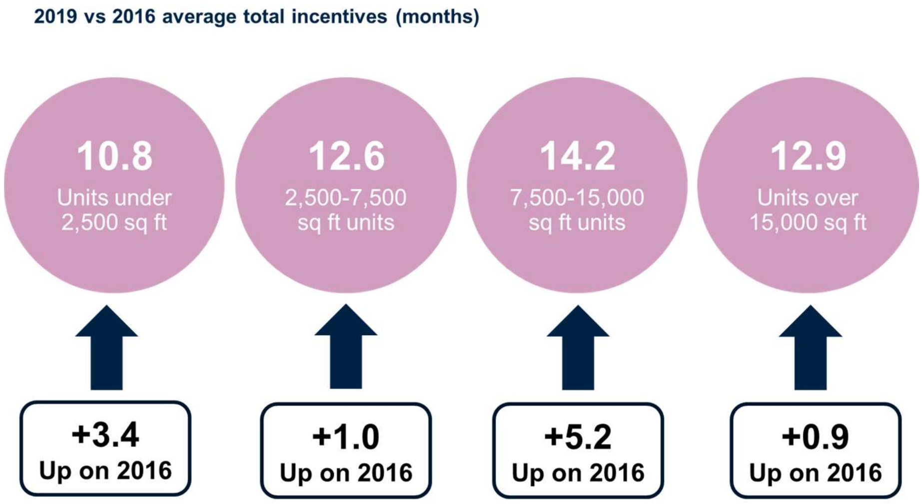
Figure 21: Rental performance by size of unit



Source: Savills Research

These rental demand patterns are clearly demonstrated when we consider the total incentives on offer (including rent free periods and capital contributions - Figure 22). The smaller units under 2,500 sq ft on average have the lowest incentives in terms of months at 10.8. There is also some degree of resilience for units over 15,000 sq ft with just under 13 months of total incentives. Again it is the 7,500 to 15,000 sq ft size banding that has seen the highest incentives at 14.2 months. Compared to 2016 we have seen an increase in incentives across the board, however what is pertinent is the fact we have only seen an increase of 0.9 months on average for units of 15,000 sq ft an above. This strong degree of resilience is clearly on the back of the demand for units at this format, demonstrated by the acquisition activity of the discount grocers and value orientated comparison goods operators.

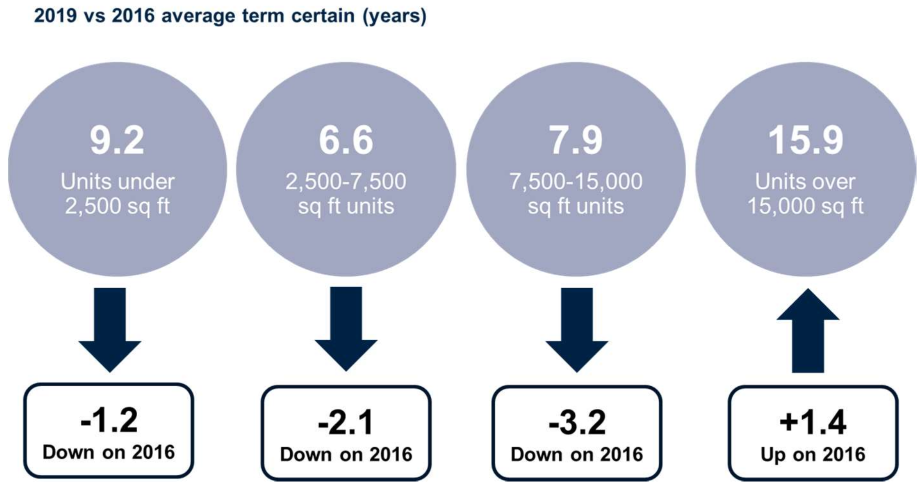
Figure 22: Unit sizes are shaping incentives



Source: Savills Research

For term certain periods we also see a similar pattern across different unit sizes. Units under 2,500 sq ft see a relatively healthy 9.2 years, whilst at the other end of the spectrum units at 15,000 sq ft+ are nearer 16 years. In comparison to the figures in 2016, we have seen a decline in term certain periods across most unit sizes with the exception of the largest stores. It is no surprise retailers are demanding shorter lease lengths on the whole, however we have seen the greatest increase in term certain periods at the larger end of the market, again purely driven by the likes of Aldi, Lidl, B&M, Home Bargains and The Range keen to secure new sites at this format (Figure 23).

Figure 23: Unit sizes are also shaping term certain periods



Source: Savills Research

There is something to be said therefore, for where we are seeing demand coming from in the UK retail market. Retail warehousing has shown some strong resilience in terms of rental declines in comparison to shopping centres and high streets. However within the sector itself, preference seems to be for small to medium sized parks in undersupplied catchments in particular, preferably anchored by a foodstore operator with the potential to drive additional footfall to the scheme.

This pattern of resilience has been underlined when we explore the insolvency activity in the UK retail market over the last 3 years, to which the focus of this report now turns.

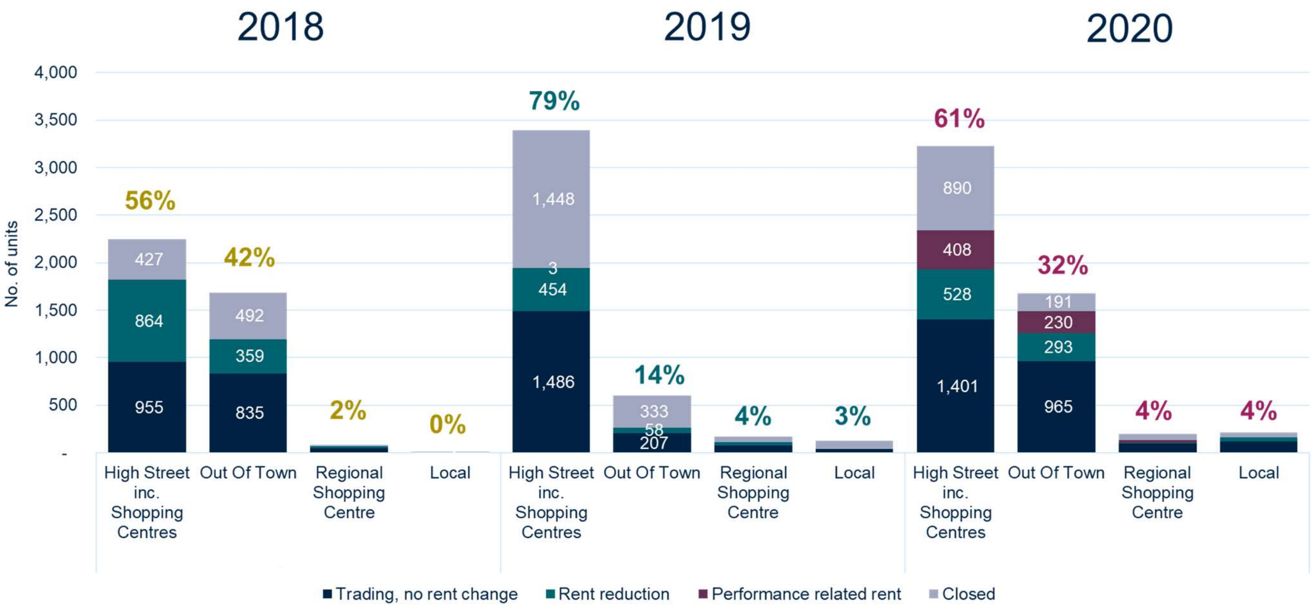
Insolvency activity – how has Retail Warehousing fared versus other asset classes?

This year the UK retail market has seen a total of 5,318 retail and leisure units pass through an insolvency procedure up to the beginning of October, spread across 138 brand fascias and 85 holding companies. This includes all units that have been through a CVA, administration or liquidation. The previous two years saw totals of 4,017 units and 4,283 units in 2019 and 2018, respectively.

The results suggest 2020 has thus far experienced insolvency activity in excess of the overall levels seen previously, unsurprising in light of the unforeseen pandemic which has heaped more pressure on retail operators across the globe. With a quarter of the year remaining, it is likely the overall volume of insolvency activity will eclipse the previous two years in terms of the number of units that will be affected by one of the three procedures.

Although these headlines are the cause for some obvious concern across the retail and leisure market as a whole, again it is investors with portfolios more heavily weighted toward retail warehousing that can take some degree of comfort when judged comparatively against other asset classes (Figure 24).

Figure 24: Time series insolvency activity by asset class



The percentages above each bar in the chart above refer to the proportion of the total units to pass through an insolvency process in that year

Source: Savills Research

Proportionally, the high street has accounted for the largest slice of insolvency activity in each of the last three years, accounting for 56% of units in 2018, 79% in 2019 and 61% in 2020, including both individual units and those found in shopping centres. By comparison, the out-of-town sector accounted for as little as 14% of activity last year, whilst so far in 2020 it accounts for a third of units that have been through an insolvency process in the retail market as a whole. Although a significant increase on 2019, it is important to note that more than half of those units (965, 57%) have seen no disruption in trade and no reduction in their rental income. This compares to 1,401 units, and only 43% of units for the high street including in-town shopping centres.

Conversely, and perhaps more significantly, closures have been much more pronounced in the in-town market that they have out-of-town. So far 2020 has seen only 191 closures in the retail warehouse sector (11% of all units to pass through an insolvency procedure in that market). High street units have seen 526 closures equating to more than a quarter of insolvent units (26%) and high street shopping centres 364 closures, equating to as much as 29%.

Furthermore, the number of units to pass through an insolvency procedure in the out-of-town sector were swelled by struggling retailers with a larger in-town presence (New Look and Pizza Express are both good examples). Harvey's furniture store and its partner retailer Benson for Beds was the largest out-of-town retailer to go through insolvency in 2020 with their administration in June of this year. It is important to note however, that with more than 380 stores between them, this administration grossly inflates the impact we have seen in the retail warehouse sector in terms of insolvency in 2020. Although Harvey's was struggling to turn a profit and ultimately needed to enter an administration in order to survive, Bensons is still considered to be a strong and viable business and thus all 220 stores were immediately sold and removed from any danger.

Analysing insolvency by retail sector for the whole of the UK market sheds further light on perhaps why the retail warehouse sector is faring better than the high street in terms of insolvency. Fashion and comparison goods retail were the sectors with the most insolvency activity in 2019, respectively accounting for 1,977 units (46%) and 2,070 units (48%) of all those that underwent either a CVA, administration or liquidation in that year (Figure 25). It is a similar story in 2020 with fashion (2,322 units, 44%) remaining the most prominent sector to see insolvency activity so far and comparison goods retailing also proving significant (1,417 units, 27%).

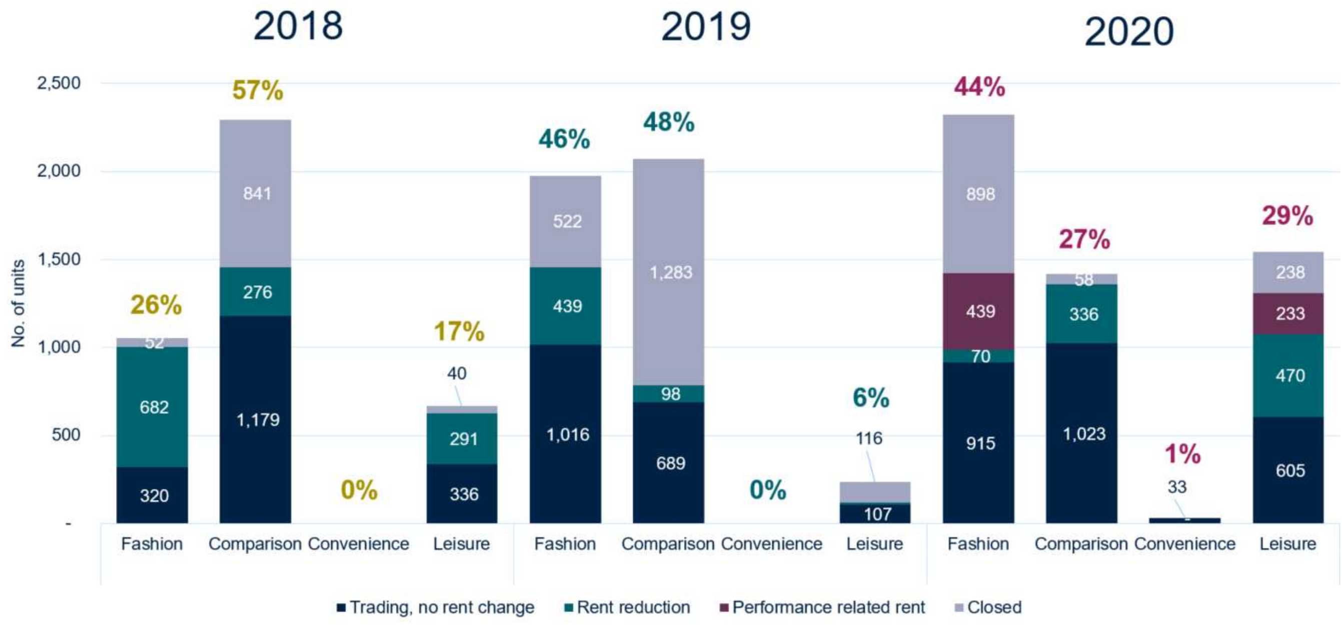
However, leisure now accounts for over a quarter (29%) of all units to have entered an insolvency process in 2020, compared to only 6% the previous year, accounting for 1,546 units in 2020, compared to only 263 units in 2019 (Figure 25). With much of the leisure sector unable to trade at all during the lockdown period and the sector seemingly being the last to see some return in consumer traffic, it is unsurprising the sector has seen an increase in brands facing financial difficulty, particularly as the industry is service led and much less able to serve consumers online.

All three of these sectors have exposure in the retail warehouse sector, but fashion retailing has consistently been the worst hit over the last three years and this industry is much more deep rooted in the high street than it is out-of-town. Where retail warehousing really out performs the high street is in its exposure to convenience retailing. The convenience sector has seen a very low proportion of units subject to an insolvency procedure in 2020 (less than 1%) and none in the previous two years. This is again unsurprising when supermarket and other food store operators were considered essential and allowed to remain open and trading after the government imposed sanctions on store closures in March. These operators recorded a 10.4% increase in sales in the following month in the early panic buying phase of the pandemic (ONS). Many have been reporting above average trading figures ever since.

The reasons we see and hear in the press for the rise in the number of failing or stuttering businesses are well-trodden; declining footfall, a shift from tangible to experiential retail, spiralling business rates, the increase in the living wage and most commonly the ongoing penetration of ecommerce. It is argued that CVAs are therefore nothing more than a symptom of the wide-ranging and tumultuous issues that are killing the UK retail market. However, it is important to remember the press can get carried away with their assessment of the insolvency process, often suggesting that any such activity ultimately results in business failure and ignoring the success a well implemented CVA and administration process can have in saving a business.

2018 saw 1,686 units pass through an insolvency process in the out-of-town market, representing only 6.2% of all multiple retail operators in that sector (excluding independents). In 2019 it was only 598 units, equating to only 2.2%. So far 2020 has seen 1,678 retail warehouse units pass through insolvency, accounting for only 6.2% of the market as a whole. In terms of closures this equates to only 1.8%, 1.2% and 0.7% of the retail warehouse market in its entirety, across each of the last 3 years respectively. Furthermore the fact the vacancy rate has remained low (Figure 16) tells us that these closures are quickly being re-let.

Figure 25: Time series insolvency activity by retail sector



Source: Savills Research

No one is denying these issues don't bring their challenges, but unlike the events of 2008/09 when we last saw a flurry of CVAs, administrations and business failures, it has, until the recent pandemic, been less about a receding economy and more about the evolutional of retail. In the UK retail market as a whole, since January 2018, only 4% of brands that have been through a CVA and/or administration have subsequently been liquidated (6 brand fascias in total). In the same period 7% went straight into liquidation without entering a CVA or administration (9 brand fascias in total), whilst the remaining 89% of brands entered a CVA or administration and have since survived to continue trading (123 brand fascias). This suggests the process is having some degree of success. In 2018 23% of brands with out-of-town exposure that went through an insolvency process were liquidated, predominately as a result of the loss of Toys R Us, Maplin and Poundworld. In 2019 we lost a quarter of insolvent brands through liquidation. So far in 2020 only one brand with exposure to the retail warehouse sector has been lost, equating to 2% of all those with an insolvency issue.

It is certain that this year the out-of-town market has seen a significant rise in the number of cases that have passed through an insolvency process. An increase of 181% on the previous year points to the fact retailers in the sector are not immune to the financial challenges that face the market as a whole, and that they have only been compounded by the onset of Covid-19. That said, of those stores that have passed through an insolvency process in 2020, closures in the sector remain low and those stores where there has been no change in rent collection remain high. The significant proportional increase we have seen this year has come from the fact the rise started at a low base. In 2019 only 598 stores passed through an insolvency process, a -65% decrease on the levels we saw in 2018. The fact that so far in 2020 the retail warehousing sector has seen no more cases than were present in 2018 provides a further degree of comfort. By comparison, high street units have only seen an increase of 4% on 2019 levels. However, cases of insolvent units have consistently been higher and increased by 43% in 2019 compared to the previous year.

COVID-19 and Retail Warehousing

While the UK remains in a confused state between total lockdown and total freedom, there is a reasonably wide body of evidence that is pointing to the retail warehousing having been less hard hit than other retail sectors, and also recovering faster.

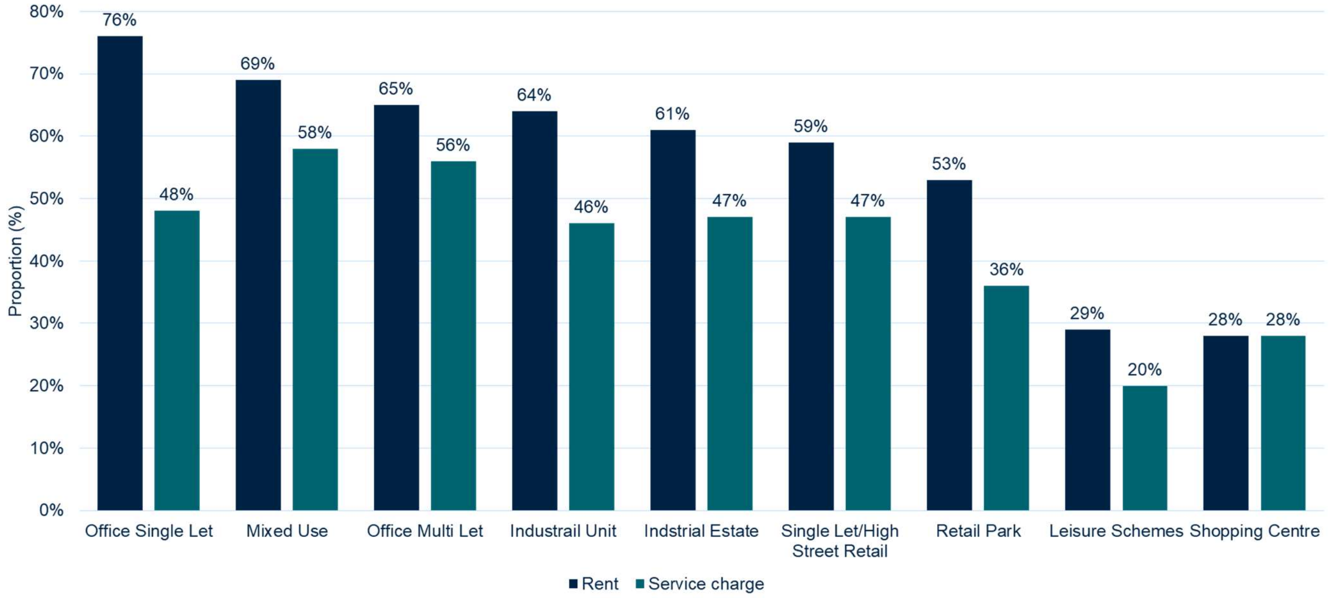
Firstly, despite the widespread retail and leisure closures, the out of town market displayed some level of resilience with a quarter of all UK retail warehouse floorspace remaining open after the government imposed sanctions came into play at the end of March. In the week following the beginning of the lockdown restrictions, 73% of all retail and leisure operators were classified as 'non-essential' with only 27% of the market being eligible to stay open. However, of the retail floorspace that was eligible to stay open, the out of town market accounted for more than half at 54%, in comparison with the high street, shopping centres and individual shops.

Furthermore, as much as 61% of the floorspace in the retail warehousing market was designated as essential due to large supermarkets and DIY stores accounting for a significant proportion of the sector. In comparison, high streets have seen just 37% of the floorspace considered essential, with shopping centres seeing only 25%.

This means that both landlords and some tenants on retail warehouse parks will have had a slightly less painful lockdown than in some other parts of the retail market, and thus the future potential for failures is more limited. This was seen in the data on what proportion of rent and service charges due that were paid on the June quarter day, with tenants on retail warehouse parks paying 40% of rent due and 24% of service charge due. In comparison, on the same date tenants in shopping centres had only paid 19% of the rent due, and 23% of service charges. These figures have since improved. On the September quarter day, rent payments by tenants on retail warehouse parks had grown to 53%, 36% for service charge due. Shopping Centres however, remain much lower at 28% for both rent and service charge collection (Figure 26).

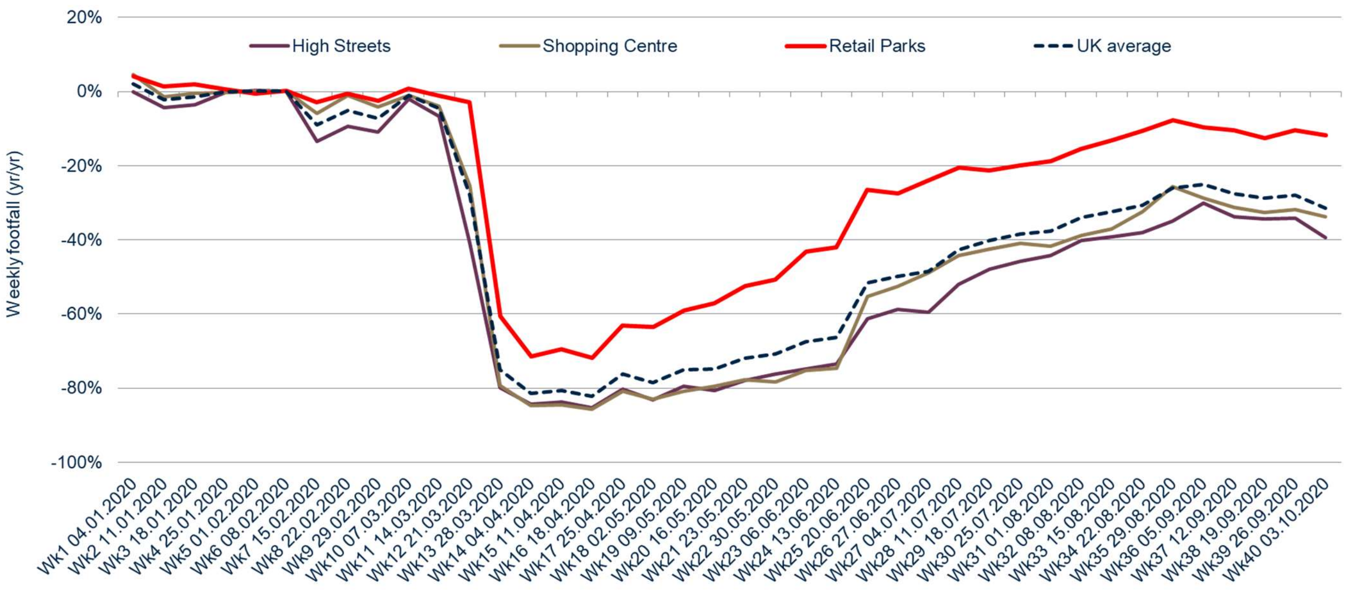
As lockdown ended across all parts of the UK retail economy, the next question that arose was what part of that spectrum was recovering fastest to normal levels? As Figure 27 shows, footfall on retail parks recovered soonest, and at of the start of October was only 11.8% down year-on-year. We would suggest that the combination of large units and adjacent car parking makes shopping on retail parks more easily done in a socially distanced fashion than in other types of retail location.

Figure 26: Collection of rent and service charge by property type across September Quarter



Source: Savills Management Research

Figure 27: UK Weekly Footfall by type of destination (difference from previous year)

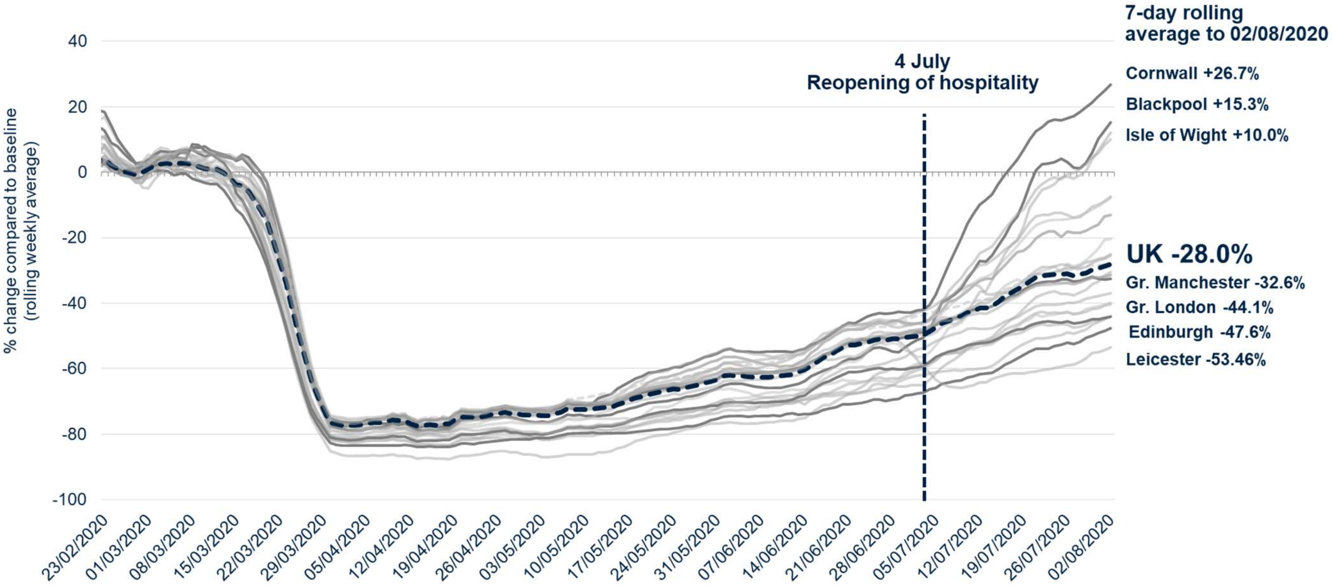


Source: Springboard

Google Mobility data supports these findings, suggesting consumers have been much more tentative in returning to high streets and shopping centres across the UK since the reopening of the retail and leisure sector. Figure 28 details movement across retail and recreation locations indexed against a five week period pre-Covid. In the week to 2 August, total UK movement recorded a fall of 28% on average compared to pre-Covid. What is evident from the data is the significant surge in movement since the reopening of hospitality from 4 July in some locations, reinforcing the strong relationship between hospitality and physical retail.

The majority of recovery has been steered by traditional leisure-led domestic holiday destinations, including Cornwall, Blackpool and the Isle of Wight, which are all now reporting positive growth compared to pre-Covid levels. The feed through to larger municipalities remains delayed in line with the ongoing absence of local office workforce and international tourism, while local lockdowns have been detrimental to recovery levels in locations such as Leicester. Trade has therefore been slow to recover in major city centres and destination-led retail places, with consumers continuing to favour local and convenience-based locations that make socially distanced shopping easier and safer for the consumer, hence why we have seen stronger footfall recovery in retail warehousing versus other retail sub-sectors.

Figure 28: Retail & recreation by UK destination (rolling 7-day average)



Source: Google Covid-19 Community Mobility Report

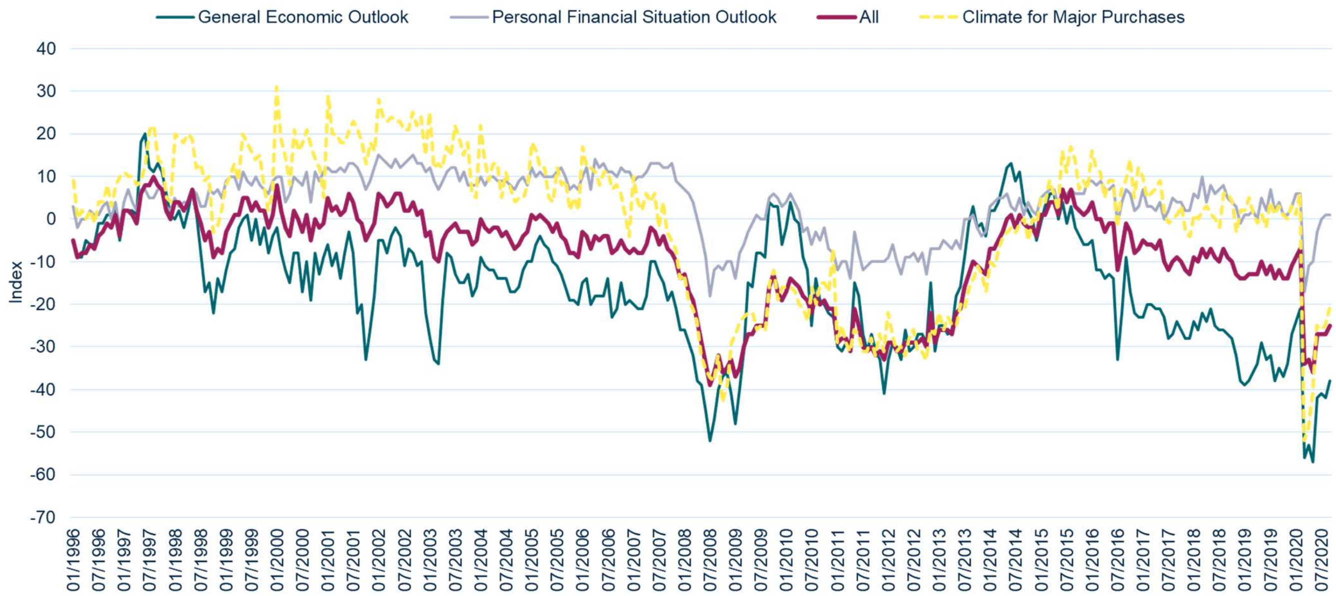
As footfall growth continues and more and more consumers return to shops, even with a number of Covid restrictions in place, as ever, the next question is how long it will take to get back to normal levels of GDP and retail sales growth.

Massive government intervention to stop people losing their jobs has undoubtedly helped to stop consumer confidence and retail sales plummeting to record lows at the height of lockdown. However, questions remain about what happens as furloughing and other support measures begin to end and over the level of support for businesses going forward.

At the start of May 2020, the consensus view of most economists around the UK was that Q2 was going to be the low point of the current cycle with a 13% quarter on quarter fall in GDP. Q3 and Q4 are then expected to show modest positive quarterly growth rates, though not at a rate that could be described as a V-shaped recovery. Figure 29 indicates that for Q3 at least this assumption was a sound one.

GDP growth recovering in Q3 is definitely good news, but may not tell the whole story for the retail economy. Unemployment, which was at near record low levels at the end of last year, is only forecast to recover slowly over the next five years. Indeed, the consensus view at present is that it will not get back to its 2019 low level until 2025. Higher levels of unemployment will impact consumer confidence, savings ratios and ultimately retail spending.

Figure 29: Consumer confidence index

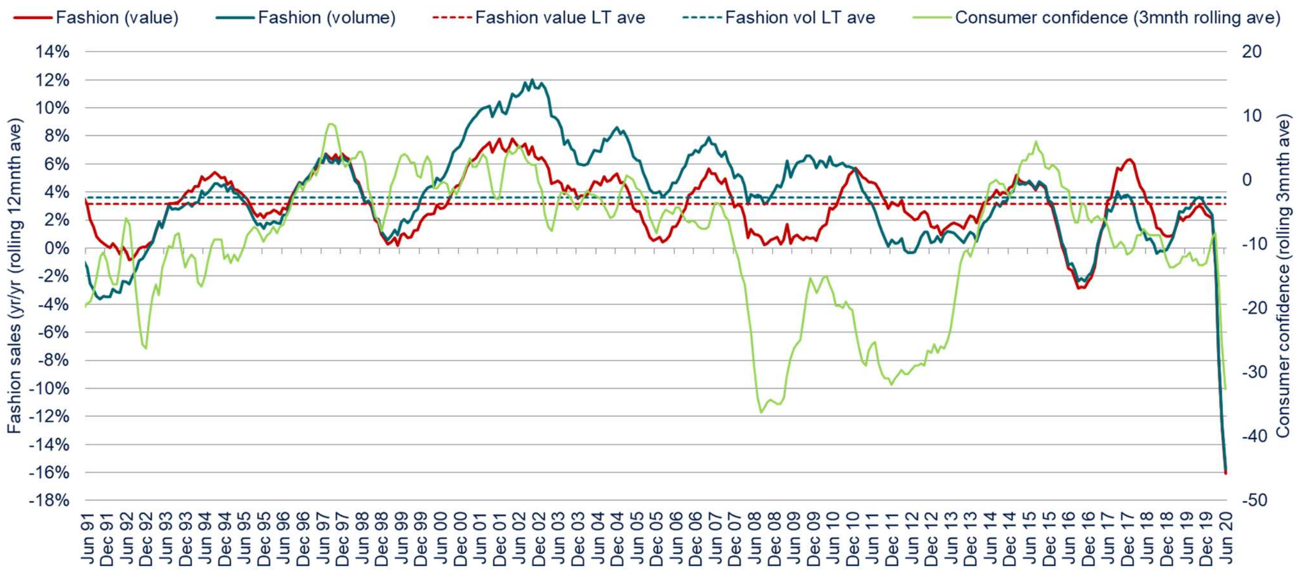


Source: GfK

Significant questions still remain about the pace of economic recovery in 2021. Most notable for the UK are those around what happens when government support is removed and whether the Brexit transition period ends this year. The lasting economic effect caused by the pandemic and subsequent lockdown continues to restrict any major bounce in consumer confidence, with GfK's latest monthly index suggesting sentiment for spend remains subdued whilst personal saving is up. The potential increase in unemployment post-furlough will push up uncertainty in the consumer market, during which the continuation of distancing measures and safety restrictions will hinder the potential for physical retail sales to flourish in the short-term.

As a result, 2020 retail spend forecasts have dampened significantly, with GlobalData estimating year-end volumes to be down 3.9% year-on year, and £20.1 billion lighter than pre-Covid projections. This drop in spend is expected to be led primarily by those more exposed subsectors including fashion and footwear. Figure 30 illustrates how fashion sales in both value and volume terms have experienced significant year-on-year declines, falling to -16.1% and -15.8% in June on a rolling 12-month basis, primarily as a result of the closure of non-essential stores between late March and mid-June.

Figure 30: Retail sales: Fashion (clothing & footwear)

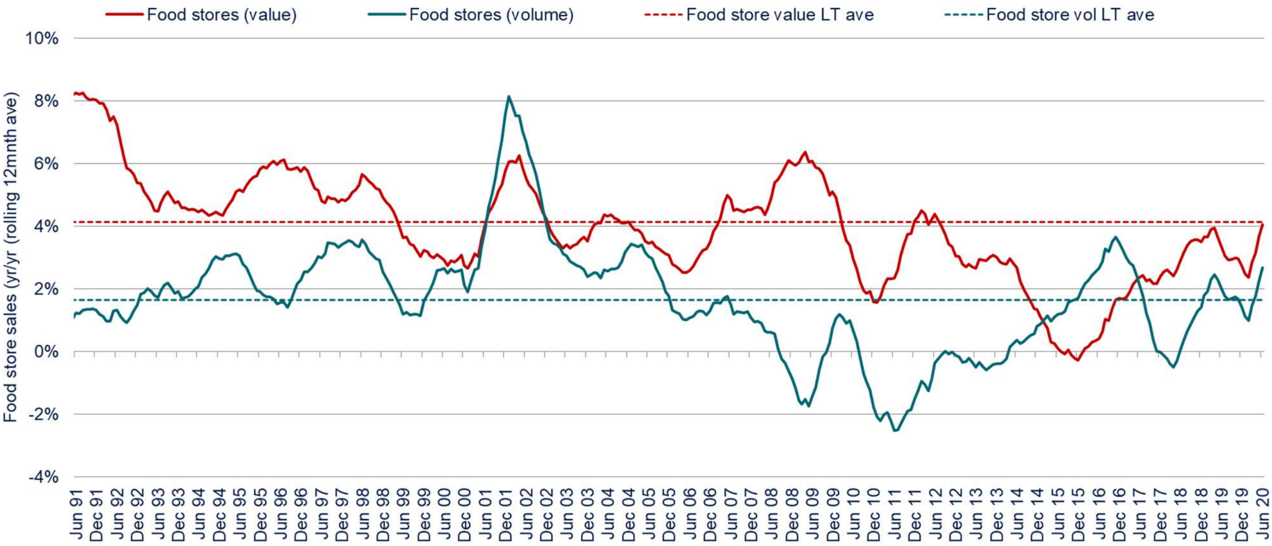


Source: Savills Research; ONS; GfK

However, the fall in spend hasn't been homogeneous across all retail segments and subsequently the retail warehouse sector has fared strongly in comparison to other asset classes – some submarkets with a focus weighted toward the out-of-town market have enjoyed a return to sales growth, above that of the same period last year. Foodstore performance continues to outperform, with take-home grocery sales up 9.4% for the 12 week period to 12 October, according to Kantar. These findings are echoed in Figure 31, which highlights how the Covid-19 outbreak prompted a surge in supermarket sales following consumer stockpiling and the immediate need for essential items. Despite the immediate demand surge easing slightly, supermarket sales in both value and volume terms continue to perform well, increasing 4.1% and 2.7% year-on-year in June respectively, on a rolling 12-month basis.

The homeware sector, another out-of-town stalwart, also appears to have thrived as of recent, with the BDO July sales barometer recording a 33.6% year-on-year growth in like-for-like sales - a stark contrast compared to other subsectors and outstripping the UK average of -4.6%.

Figure 31: Retail sales: Food stores



Source: Savills Research; ONS

Conclusions

It is clear from our analyses that Retail Warehousing has out-performed most other retail segments for some time and continues to do so through both the rise of online retailing and the more recent pandemic shock.

However, it is also clear that this resilience is not widely recognised and that the sector has repriced in-line with the wider retail market which, in our opinion, represents an significant investment opportunity.

Key factors that support these conclusions include:

- Retail sectors with a predominant out-of-town presence are much better insulated from the rise of online retailing than is true of a number of goods traditionally sold on the high street. More than 80% of sales of Food & Grocery, DIY & Gardening, Homewares and Furniture & Floorcoverings are fulfilled directly in store;

- Secondly, a significant proportion of the online retailing that is present in these sectors is also intrinsically linked to the store, highlighting the continued importance of physical space in the retail warehouse sector versus other asset classes. Between 87% and 92% of sales in these four retail sectors have required the physical store in some way in order to fulfil consumer demand, either through direct sales, being browsed in store and purchased online or via click and collect;

- Furthermore, the large and comparatively low-rented units, combined with high car parking provision, means that retail warehousing has proven itself to be ideally suited for servicing click-and-collect orders, customer returns and home deliveries. This is significant as click-and-collect spend is forecast to increase by £3.1bn in the next five years, rising 45.8% to reach £9.8bn by 2024. With click and collect growth set to outpace that for e-tail delivery, the outlook for physical store presence is remains positive. (the average annual growth rate is forecasted to be 7.1% up to 2024, compared to e-tail growth of 5.8%);

- Significantly, it is retail warehousing that is set to see the strongest growth in click-and-collect services going forward. Collectively, click-and-collect spend is set to rise 73.3% by 2023 for DIY & gardening, furniture & floorcoverings and homewares, outpacing overall growth in the channel.

- This creates a significant opportunity in the retail warehouse sector as click-and-collect is not only the key to fulfilling their pre-existing online sales, it is a significant driver for capturing additional sales in the market at the point of delivery. In 2019 39.2% of consumers bought an additional item while collecting their last click & collect order. In the out of town market there are a number of key retailers for which additional spend penetration is even higher than this average.

- The notion that the physical store is becoming increasingly less relevant is erroneous in the retail warehouse sector in particular, especially when we consider the pattern of acquisition activity evident in recent years. It is less commonly noted that out-of-town store openings have been above the decade average in the last 5 years, with the last 3 years proving particularly strong. This culminated in a record year in 2019 in terms of the number of new openings in the sector. 1,021 units were let, well above the decade average of 854. Taking closures into account, by year end the sector had an additional 479 stores than it had 12 months prior.

- As a result, the vacancy rate in the retail warehouse sector remains low in comparison, not only to other parts of retail, but also to other commercial property sectors, illustrating the sector's strong and continued occupational demand. The out of town vacancy rate is currently 5.5%. However, the high street (11.2%), shopping centres (14.7%) regional offices (7.1%) and even UK logistics (6.2%) all have a greater proportion of voids.

- The retail warehouse sector has also been showing strong resilience compared to other sectors with regard to the structural change in rents, largely as a result of the strong on-going occupational demand the sector has recoded. Out of town retail units saw average declines of -13.7% on net effective rents in 2019. The declines for shopping centres were almost double this at -26.8% on average, whereas high street declines have also been much more significant, equating to -24.9% on average across the UK.

- Furthermore, the decline in net effective rents is slowing in the retail warehouse sector. Savills deals data suggests the decline of -13.7% in 2019 was a reduction on what we saw the previous year when net effective rental declines were recorded at 14.4% on average.

- What is even more pleasing for the sector is that both its resilience and slowing rental decline have continued into 2020. Savills data for the year up to the end of Q3 2020 has seen net effective rents fall by -4.6%, half that of shopping centres and high streets combined at -9.5% and a drastic deceleration on the previous year at -13.7%. Parks of 50-100,000 sq ft, in under-supplied catchments, with a mixed tenant-offer and preferably a grocery anchor have been most resilient to the falls in rents that have been seen since 2016.

- Retail warehouse parks have also been comparatively less affected by retailer failures than is true of other retail segments, which in general is due to their lower exposure to mid-market fashion. Fashion accounted for as much as 46% of units to pass through an insolvency process in 2019, decreasing slightly to 44% in 2020.

- Proportionally, the high street has accounted for the largest slice of insolvency activity in each of the last three years accounting for 56% of units in 2018, 79% in 2019 and 61% in 2020. By comparison, the out-of-town sector accounted for as little as 14% of activity last year, whilst so far in 2020 it accounts for a third of units that have been through an insolvency process in the retail market as a whole (with more than half of those, 57%, seeing no disruption in trade and no reduction in their rental income).

- More significantly, insolvency related closures have been much more pronounced in the in-town market than they have out-of-town. So far 2020 has seen only 191 closures in the retail warehouse sector (only 11% of all units to pass through an insolvency procedure in that market). High street units have seen 890 closures, equating to more than a quarter of insolvent units (28%).

- During lockdown a higher proportion of retail warehouse retail units were deemed as essential than in other parts of the market, and thus remained open. As much as 61% of the floorspace in the retail warehousing market was designated as essential due to large supermarkets and DIY stores accounting for a significant proportion of the sector. In comparison, high streets have seen just 37% of the floorspace considered essential, with shopping centres seeing only 25%.

- Furthermore, the Covid related fall in spend hasn't been homogeneous across all retail segments and subsequently the retail warehouse sector has fared strongly in comparison to other asset classes - some submarkets with a focus weighted toward the out-of-town market have enjoyed a return to sales growth, above that of the same period last year. Foodstore performance for example continues to outperform, with take-home grocery sales up 9.4% for the 12 week period to 12 October, according to Kantar. The homeware sector also appears to have thrived in recent months, with the BDO July sales barometer recording a 33.6% year-on-year growth in like-for-like sales - a stark contrast compared to other subsectors and outstripping the UK average of -4.6%.
- The resilience the retail warehouse sector has shown since the onset of the pandemic has been reflected in the proportion of rent and service charge payments that have been made in comparison to other sectors. Tenants on retail parks payed 40% of rent due and 24% of service charge due on the June quarter day. In comparison, on the same date tenants in shopping centres had only paid 19% of the rent due, and 23% of service charges. These figures have since improved. On the September quarter day, rent payments by tenants on retail warehouse parks had grown to 53%, 36% for service charge due. Shopping Centres however remain much lower at 28% for both rent and service charge collection.
- As lockdown ended across all parts of the UK retail economy, footfall on retail warehouse parks has recovered more quickly than in other retail destinations, and at of the start of October was only 11.8% down year-on-year. We would suggest that the combination of large units and adjacent car parking makes shopping on retail warehouses parks more easily done in a socially distanced fashion than in other types of retail location.

The combination of all these factors, and the blanket re-pricing of the sector in line with other harder hit parts of the retail market, leads us to conclude that holding or acquiring dominant, value/bulky parks that are right-rented, preferably with a strong convenience anchor, is a sensible strategy at present. We expect to see more investors focusing on this sector in coming months, though currently the comparative appeal of retail warehousing as an asset class is not widely understood.