NATIONAL RETAIL BAROMETER

Spring 2018

Research & Forecast Report

UK | Retail
2018

Colliers INTERNATIONAL

INTRODUCTION

The year to date has seen an unprecedented onslaught of bad news for the retail sector, with a raft of CVAs and administrations announced. In fact, the pace of announcements has made it a challenge to keep abreast of developments. Retailers and landlords are facing the most challenging environment since the post Global Financial Crisis (GFC) period of 2008/09 when we saw the failure of Woolworths, Stead and Simpson, Zavvi and First Quench, amongst others.

Over the last five years, changing consumer trends, higher inflation, lower consumer spend and higher costs for retailers have undoubtedly increased the pressure on retail business models. This has led to Toys R Us, Maplin and Jacques Vert going into administration and New Look, Carpetright , Prezzo, Select and House of Fraser seeking a Company Voluntary Agreement (CVA).

However, there is some positive news to partly offset the wall of negativity. The recent reduction in inflation and increase in real wages mean that pressure on consumers is due to ease and spending should increase in the second half of 2018. Encouragingly, a number of household name brands continue to be acquisitive, new retailers are still emerging and online brands and manufacturers are beginning to trial physical stores, such as Missguided in Westfield, Bluewater in Stratford and Dyson, on Oxford Street, London.

In this report, we consider how the retail market is adapting, how shopping pitches and rents across the UK are being shaped by new market conditions, and analyse the success rate of CVAs.

EXECUTIVE SUMMARY

Rents across the UK, outside of London, saw a major correction immediately post the GFC in 2008. Since then, the 'Rest of UK' rents have mostly stabilised, with some growth evident in stronger centres in recent years. However, on average, rents outside of London have not yet returned to their pre-2008 level.

Vacancy rates saw a slight increase in 2017, and are set to increase further in 2018 with a raft of CVAs and administrations announced in Q1 2018. Prime units are seeing relatively low vacancy rates and the divergence between both prime and secondary pitches continues to grow as secondary unit vacancy rates increase.

Over the last 10 years, CVAs have proven themselves to be largely unsuccessful in saving a company from administration. Companies are twice as likely to survive following administration as they are to survive following just the CVA route.

COMPANY VOLUNTARY AGREEMENTS (CVA) - LIFE SAVER OR STICKING PLASTER?

The biggest headline in the retail sector in 2018 has been the proliferation of CVAs – used ever more frequently to try and save struggling occupiers. Already in 2018, we have seen the likes of New Look, Byron Burger, Prezzo Prezzo, Select and House of Fraser entering into CVAs. The main concern in the market is whether this process can deliver long-term viable solutions, or if it merely delays the inevitable future failure. Analysing the raft of CVAs undertaken over the last 10 years provides a strong guide to what may happen to the latest round of CVAs.

Between 2008 and the end of 2017, 12 retailers have undertaken a CVA, and only 17% of these survived in the longer-term without going into a subsequent administration. The two businesses that survived had to undertake a comprehensive turnaround to enable them to continue trading. The most commonly referenced of these was Mamas and Papas, which not only reduced rents on 95% of its estate as part of the CVA, but also received a cash injection of around £20m, drastically restructured their business and invested in a new e-commerce platform.

50% of the companies that went into administration, following a CVA, were revived, but in a radically different size and shape. All of these companies survived by being bought out of administration in a pre-packaged deal by other current operators. A key example of one of these brands is Austin Reed. The purchaser, Edinburgh Woollen Mill, closed all 120 stores and within six months, the brand consisted of online and concessions only.

Debt is a clearly critical influencer in the company's survival after a CVA. Both BHS and Toys 'R' Us are two companies that failed to survive not only a CVA, but also administration and were burdened with significant amounts of debt. In both of these cases, the CVA failed to reduce the size of the debt and, with no significant investment, the company remained in financial difficulty and ultimately failed.

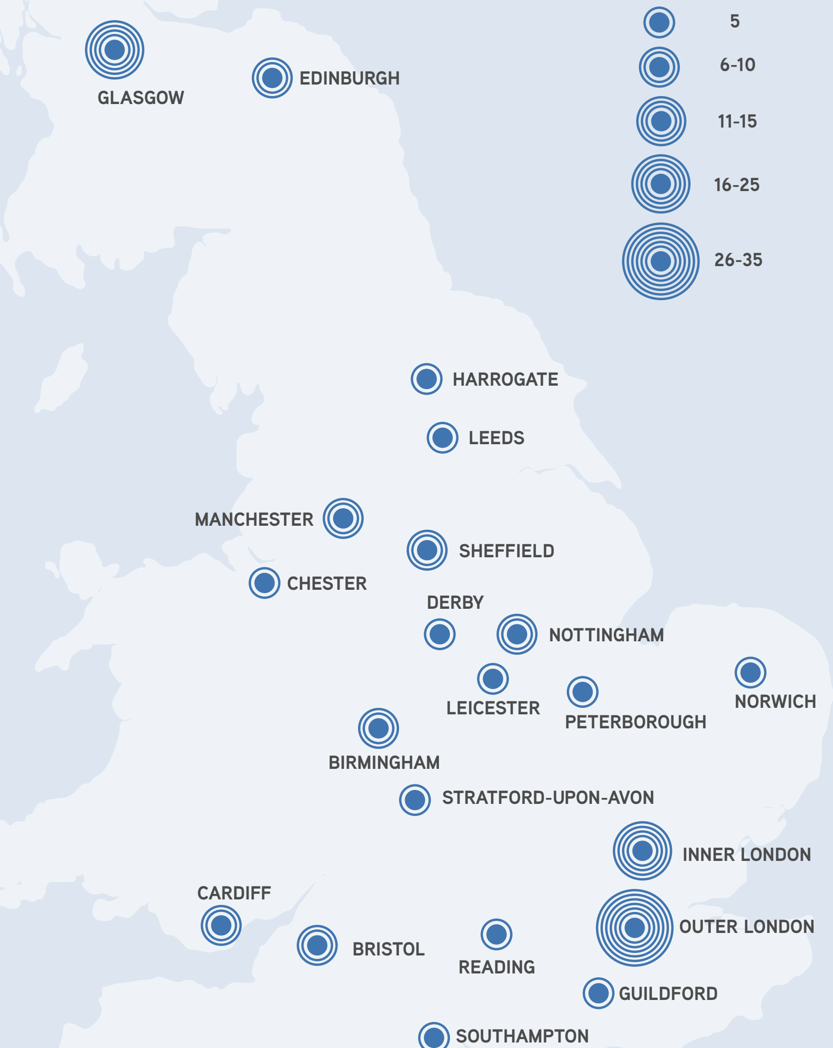
Over the last 10 years, 44 companies entered administration without undertaking a CVA first. Of these, 39% of the brands still exist. Therefore, the chances of surviving an administration have been double those of surviving a CVA. Administrations, unlike CVAs, facilitate a dramatic and wide ranging restructure and often will address and reduce corporate debt.

83% of companies that agreed a CVA subsequently entered into administration.

A CVA alone appears to be ineffective in preventing failure in the majority of cases. Without conducting a thorough business review and restructure, significant cost reduction, debt reduction and a cash injection, CVAs in isolation are unlikely to be successful and, therefore, should not be relied upon as a means of saving a company.

So far in 2018, we have seen a flurry of new CVAs, in some cases from companies which would not be associated with failing brands and large debts. It is our view that some stable and well performing retailers are now starting to use CVAs opportunistically to free themselves from leases on underperforming stores. It is conceivable, therefore, that we might see a dramatic increase in the success rates of CVAs in 2018/19 because, fundamentally, these businesses are generally trading well and are in better financial shape than previous examples.

STORE CLOSURES RESULTING FROM CVAs AND ADMINISTRATIONS IN 2018



*Companies with over 20 units, who have either gone into administration or went into a CVA prior to 2018.

Source: Colliers International

PRIME RENTAL CHANGE

Polarisation in rental performance between the different types of shopper catchment are apparent in Figure 1. Most notable of these is the difference between London and the Rest of the UK. Over the last five years, central London has seen double digit rental growth, whereas the rest of the UK, on average, witnessed minimal rental growth and negative growth in a wide range of locations.

Generally, regional dominant locations are perceived to have outperformed and, whilst the relative performance of dominant centres is good, rents are still -9% below 2008 levels and growth has been significantly lower than in central London. Although there has been some rental growth in major sub-regional locations in the last five years, average rents remain significantly lower than the 2008 level (-18%).

Dominant regional centres saw an overall decline of 14% between 2008 and 2013 and rents have not yet recovered to the level they were 10 years ago, prior to the GFC. However, they have seen 5% growth between 2013 and 2018 and are showing signs of momentum. Our forthcoming 2018 Mid-Summer Retail Report will provide further details on this. These regional dominant centres are expected to be the most resilient sector outside of central London over the next few years.

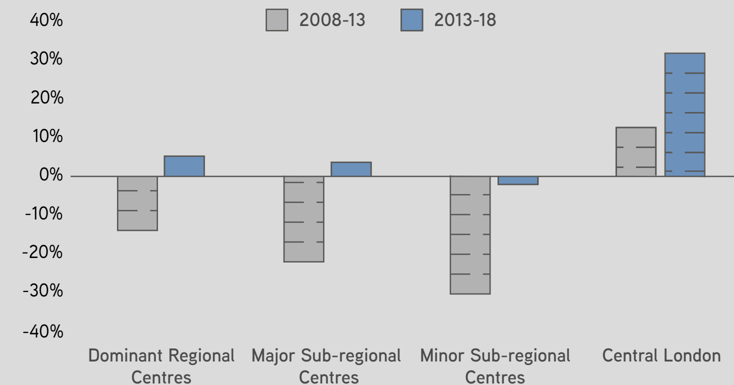
Major sub-regional shopping locations have seen an overall decline of 18% in rents since 2008, but have recovered by 4% since 2013. These centres are unlikely to see much further growth without investment to encourage more retailers and improve the attractiveness of the centre to customers. These retail hubs are likely to be affected the most by CVA closures over the next year, which will likely have a negative knock-on effect to rents.

Minor sub-regional locations have witnessed the most dramatic decline (-33%) over the last 10 years, with this being the only group to see negative growth between 2013 and 2018, with rents declining by 3%. Rents in these locations could still witness further decline. These locations predominantly have declining footfall and challenging vacancy rates.

Over the more recent five-year period 2013 to 2018, the picture outside of London is one of relative stability in rents (see **Figure 1**). Minor sub-regional and local sample towns are the only locations that observed negative growth (-3%).

In contrast, central London has witnessed continual strong rental growth, that has seen 13% growth over the last 10 years, with growth of 32% over the last five years. central London rents are expected to see further rental growth, albeit at a slower rate, due to London's relative economic strength, buoyant tourism and the tightness of supply in prime pitches. The rate of rental growth last year remained at 3% for the second successive year, following three years of double digit growth.

FIGURE 1: AVERAGE CHANGE IN ZA PRIME RENTS



Source: Colliers International

REGIONAL DOMINANT CENTRES

Major city or regional mall shopping centre that attracts shoppers from a broad catchment area. Includes cities such as Birmingham and Manchester.

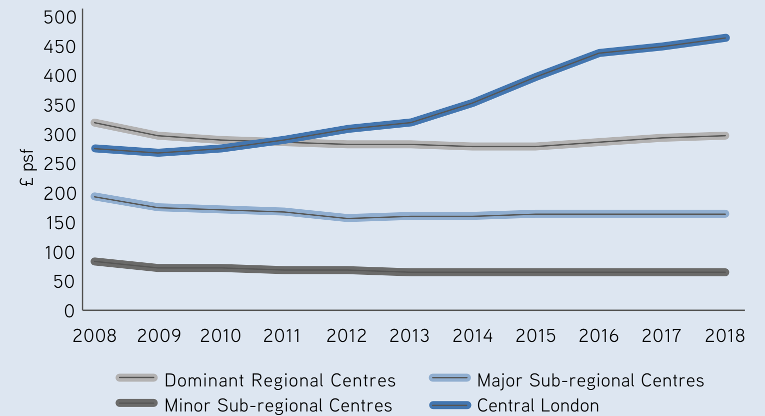
MAJOR SUB-REGIONAL CENTRES

City centres where the majority of shoppers live/work within a 15-minute drive time. Includes cities such as Aberdeen, Bath and Oxford.

MINOR SUB-REGIONAL AND TOWN CENTRES

City and town centres where the majority of shoppers live/work within a more localised catchment area. Includes locations such as Darlington, Swansea and Coventry.

FIGURE 2: AVERAGE ZA PRIME RENTS



Source: Colliers International

Figure 2 shows the relationship between the four different location types. Pre-2008, average prime ZA rents in dominant centres were higher than in central London. However, post-financial crisis, central London rents increased as the London economy and tourism supported the retail sector. In contrast, the rest of the UK, with significantly less tourism and weaker economic growth, has provided less support for the sector. Unsurprisingly, minor sub-regional location rents have continued to be lower than all other location types. The chart also shows that growth has mostly stabilised in both dominant regional and major sub-regional locations. However, minor sub-regional locations continue to see a decline in rents.

VACANCY RATES

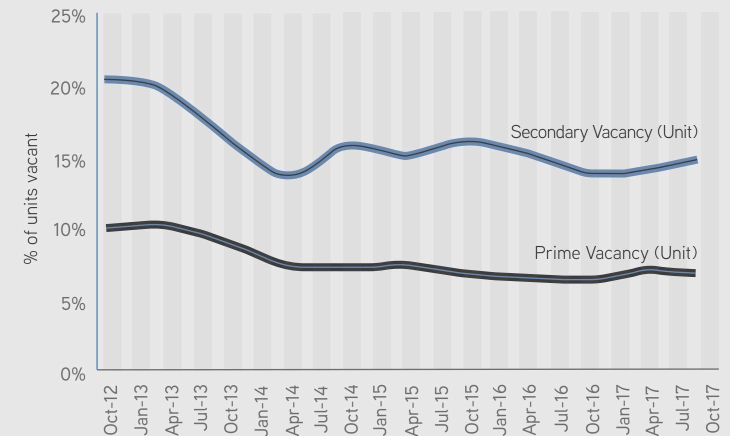
Colliers' national sample of 15 town centres indicated an overall vacancy rate of 12.6% (no. units) in October 2017, up from 11.9% in October 2015. Overall vacancy rate by floor space has been stable at 10%. However, this is likely to increase with the upsurge in CVAs seen in Q1 2018, with operators such as Byron, Prezzo and New Look looking to close a number of underperforming stores, whilst the hangover from BHS' failure remains, with over 100 of its large town centre units remaining empty.

Vacancy rates in prime pitch locations peaked in mid-2013 at 10.2%. Since then, the rate has been steadily declining. In October 2016, the prime vacancy rate was at a five-year low of 6.3%. However, 2017 saw a slight increase in vacancies, followed by a decrease towards the end of the year. Prime vacancies are not expected to decrease any further and, with New Look looking to close a number of its high street stores, the rate could increase given relatively thin demand.

Secondary pitch vacancy rates have been on a steady decline since the end of 2012. However, since October 2014, the rate has fluctuated around 15%, reaching a two-year low in October 2016 of 14%, although this has recently started to increase.

Figure 3 shows the relationship between both primary and secondary pitches. As expected, the secondary vacancy rate has always been significantly higher than the prime vacancy rate, but in the last year, there has been a divergence, with the prime vacancy rate decreasing, whilst the secondary vacancy rate is increasing. This gap is only set to widen as prime pitches become more condensed, which should keep vacancy rates in prime locations at low levels.

FIGURE 3: PRIME VACANCY (UNIT) VS SECONDARY VACANCY (UNIT)



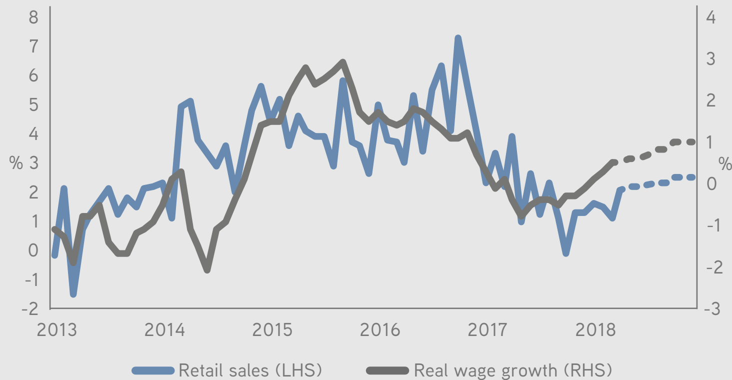
Source: Colliers International

THE NEWS ISN'T ALL BAD

Whilst some retailers are closing up shop, others are continuing to expand. Zara is an example of a brand that continues to grow its portfolio. Zara's brands, which include Zara Home, Massimo Dutti, Bershka and Pull and Bear, continue to be a key player in opening in new locations and increasing their presence on the high street and shopping centres. JD and Foot Asylum are continuing to expand as they become market leaders and experts in their categories. In the grocery market Aldi and Lidl continue their aggressive growth strategies. Seasalt, Boden, Oliver Bonas and Uniqlo are further examples of expansionary retailers. Of course, closures resulting from CVAs and administrations provide opportunities for emerging brands and independents.

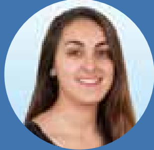
FIGURE 4: INCREASED RETAIL SPENDING TO COME

With real wage growth increasing, we forecast a growth in retail sales as the year progresses



Source: Colliers International

CONTACT



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