

# RETAIL *Spotlight*

## RIGHT SPACE RIGHT PLACE

*Not enough space, too much space, or  
merely not enough of the right space?*

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## 7 FACTS OF THE UK RETAIL INVESTMENT MARKET



JONES LANG  
LASALLE®

*Real value in a changing world*

## FOREWORD

Welcome to the first edition of Retail Spotlight, our new biannual magazine, which gives our overview on the performance of the UK retail and leisure sectors.

2011 has been a turbulent year. Most consumers have felt the squeeze and have altered their shopping habits as a result. With further increases in utility bills expected this Autumn there will be continued pressure on sales performance. Most shocking has been the recent evidence of civil unrest which had a direct impact on our high streets and shopping centres.

In order to make strategic decisions, we feel it is more important than ever to be in touch with market events at the ground level. The feedback we receive from retail clients on trading performance and growth plans help us to predict where robust retail property performance can still be achieved in this market.

Please do pick up the phone to members of our team if you would like to discuss any aspect of the retail market in more detail.

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In both retail and retail property, the next 12 months will see the good slowly get stronger and the bad falter.

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# SPOTLIGHT ON THE UK RETAIL ECONOMY

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Before the crisis the good the bad and the ugly in retail survived, supported by easy credit, healthy consumer spending and non-food price deflation which fuelled shopper appetite. The next five years promises to be very different.

Retail spending is facing a number of significant challenges. Shoppers continue to de-leverage, face increased cost of financing mortgage debt when interest rates increase and experience inflation at a time when economic growth is fragile and real wage growth is in decline. Furthermore, it is likely the trend of non-food price deflation will reverse, as the price of materials, energy and labour costs in lower cost manufacturing markets such as China increase, placing upward pressure on retail prices.

Put simply, costs are going up at a greater rate than consumer and retail spending and this will manifest itself in different ways across the country. This impact on shoppers and retail spending will differ significantly across the UK, which will in turn influence retailers' requirements and will contribute to further retail polarisation.

The right space for retailers in this market will be characterised by optimum unit sizing and configuration, in locations that have critical mass,

destination appeal and stronger than average, more robust fundamentals.

Prospects for some pockets of the UK that are overly reliant on public sector employment and are more reliant on the domestic economic recovery, are bleak in the short term. Unlike London and the South East, that are benefiting from the global economic recovery. With retail vacancy rates increasing to 40% in some regional towns, the debate will turn from vacancy to obsolescence.

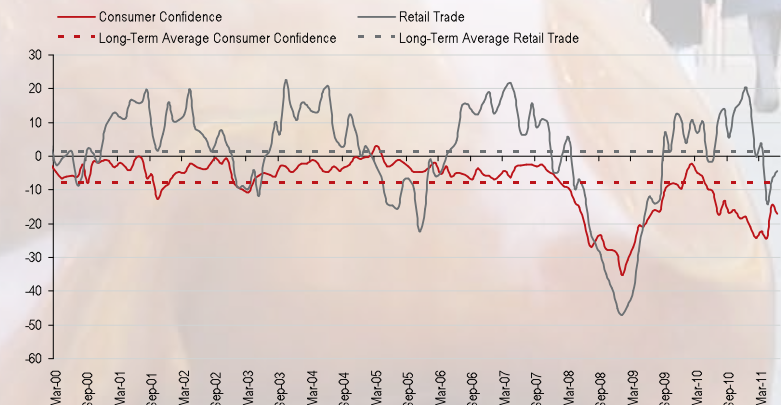
On the flip side, some retail locations are well placed, providing optimum units in retail locations with destination appeal and with a stronger than average economic outlook. We are witnessing a structural change in our UK retail hierarchy. Prime locations are still in demand from shoppers and from acquisitive retailers that are positioning themselves for growth. We are likely to come to the conclusion that we simply don't have the right space in the right locations, or that we have the wrong space in the wrong locations rather than we have too much space.

In both retail and retail property the next 12 months will see the good survive and slowly get stronger and the bad will falter and will need to rethink their raison-d'être. As for the ugly, the outlook looks very bleak, but if strong market conditions are the only drivers keeping these afloat, it is time for a clear out, to position the market for the next phase of growth. >

With retail vacancy rates increasing to 40% in some regional towns, the debate will turn from vacancy to obsolescence.

## UK CONSUMER & RETAIL TRADE CONFIDENCE

Marginal improvement in consumer and retail confidence at end Q2  
Source: The European Commission, Jones Lang LaSalle



# 7 FACTS OF THE UK RETAIL INVESTMENT MARKET

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## 1 THE OCCUPIERS' PERSPECTIVE

- › More sophisticated businesses with better access to sales and customer information, therefore more targeted locational requirements
- › Good stores display stock better and need to replicate and enhance the online offer
- › Move to larger space
- › Only department and fashion stores will now trade levels other than ground
- › Move away from covered and multi level shopping centres, apart from the very best schemes
- › Price of goods up
- › Supermarkets and dominant retailers driving prices down, therefore reducing margins and squeezing marginal businesses

## 2 THE INVESTORS' APPROACH

- › Disconnect between the economy and institutional investors approaches
- › Why? Defensive, low interest rates, yields above long term average
- › Low maintenance costs
- › Identifiable covenant risk
- › Reasonable unexpired lease terms
- › Parity between dominant resilient towns and blighted or over developed secondary locations or towns
- › Widening gap between strong shopping centre locations and weakening ones

## 3 ISSUES TO ADDRESS FOR INVESTORS

- › Performance aspirations
- › IPD
- › Gearing
- › Private investors in default

## 4 WHY ARE HIGH STREETS IMPORTANT?

- › Civic pride
- › Life blood of our communities
- › Economic growth catalysts
- › Health and prosperity and vitality of a town
- › Visible and noticeable local government investment



Guildford High Street

## UK High Street at a cross road

### UK RETAIL YIELDS

IPD All Standard Retail Yields  
Source: Jones Lang LaSalle



Retail yields continue to compress, albeit with a flattening trend.

# 5

## WHAT ARE THE SOLUTIONS?

- › Realistic and combined approach between local authority and effective town centre management
- › Controlled planning approach
- › Drastic reduction in business rates for small units to encourage new businesses
- › Trends for tax take from Business Rates to a localised business tax based on success and profit
- › Safe and secure town centres
- › Car parks with public facilities
- › Flexible leases encouraging entrepreneurial business, pop up stores
- › Following pedestrianisation, continue the creation of attractive community environments
- › Sensitive and well thought out leisure, restaurant and evening offer
- › Marketing of town centres (rather than just shopping centres)
- › Customer and retailer events
- › Regional development control to stop over development in one centre permanently damaging another
- › Holistic approach to town centres which could operate as businesses
- › Financial assistance or tax breaks in converting upper floors to residential
- › Implement tougher restrictions on out of town parks and shopping centres
- › Click and Collect
- › Loyalty schemes to encourage frequent and return visits

# 6

## THE ROLE OF MARY PORTAS

- › Address the problem of vacant shops
- › Adopt a new business model for the high street that fits the needs of the modern shopper
- › Prevent the proliferation of clone towns
- › Increase the number of small and independent retailers doing business in town centres

## THE BLOCKS

# 7

- › FRI upward only leases
- › Institutional valuations and IPD performance requirements
- › Historic loan to values and break costs
- › Business Rates
- › Banks reluctance to lend to marginal or new businesses
- › Over geared, poorly modelled businesses

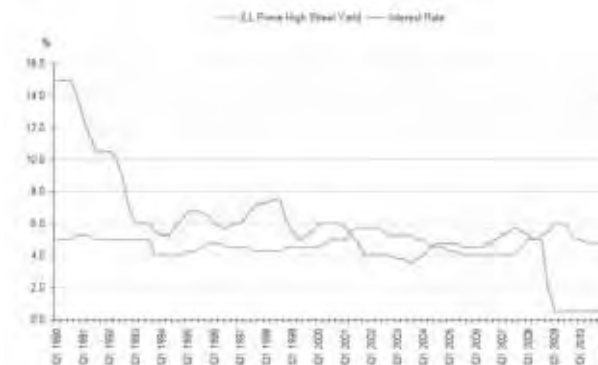
## Key Points

Factors contributing to the change in the UK High Street Market:

- › Improved communication and transport access
- › Mobile customers
- › Catalogue shopping and internet marketing
- › Planning consents for retail parks and opening up on bulky goods consents to Open A1
- › A rash of supermarket planning consents and the expansion of supermarkets from food to durable goods
- › Better quality of produce and cheaper prices in supermarkets
- › Development of regional malls (Metro, Meadowhall, White Rose, Trafford, Cribbs, Westfield West London, Westfield Stratford)
- › Over development

### UK RETAIL YIELDS

Jones Lang LaSalle Prime Retail Yields  
Source: Jones Lang LaSalle



Prime retail yields have held up fairly well, fluctuating between a relatively tight band of 4.00% and 6.00%.



Chippside, Barnsley



# RIGHT SPACE RIGHT PLACE

Spiralling vacancy rates and a severely constrained development pipeline are two of the most prominent concerns of the retail property industry. However, there is more than an element of paradox between these two concerns – surely they cancel each other out? If there is a surfeit of retail floorspace to the extent that much of it is unoccupied, there is seemingly no compelling case to establish swathes more of space that will merely exacerbate the problem. In simple terms, if there is already too much space, why build more?

If only it were that simple. The third 'key concern' needs to be included in the mix. Real retail sales growth is proving much harder to come by, whilst retailers' cost bases (gross and operating) are increasing. Taking these factors into consideration, retailers need floorspace to be much more productive. It is this drive to make retail floorspace work much harder that bridges the apparent paradox of high vacancy rates and new floorspace need – it partially accounts for the former, whilst simultaneously fuelling the latter.

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During the past three years, some of the most exciting and innovative retailers have been acquiring increasingly larger retail units across both new and established shopping centres across the UK.

The extraordinary trading successes of, in particular Apple, Hollister, SuperGroup and Urban Outfitters, have seen a wave of unit shops being amalgamated to accommodate these brands, which have undergone significant expansion in the last couple of years.

With smaller unit shops becoming more challenging to let in difficult market conditions, is the creation of larger stores with 50 foot frontages the way forward? Or does it limit consumer choice and reduce fascia variety by creating “category killer” stores dominating our prime retail pitches?

# RETAIL VACANCY TOO OFTEN MISUNDERSTOOD

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Retail vacancy is an emotive theme and is often regarded as the ultimate barometer of the health of the high street. The Local Data Company (LDC) has established itself as a leading authority in this area and their figures are most readily quoted by the media. However, figures for vacancy rates in retail are notoriously suspect and vacancy as a whole is often a misunderstood concept.

The debate over the veracity of the figures and the tendency to not look beyond national figures or facile North – South divides, detracts from the real issues surrounding retail vacancy, namely why it has occurred and what measures can be taken to reduce it.

Contrary to popular view, there are different types of vacancy – a shop isn't just trading or empty. There is a tendency for occupier churn to be interpreted as vacancy. However, the process of assigning a lease can be a lengthy one. Properties may remain in solicitors' hands for several months and agreement of heads of terms may take many more. Fit-out and possible reconfiguration may also significantly delay the re-occupation process. Many outlets undergoing this process are erroneously deemed 'vacant'.

Non-churn vacancy is a much more serious issue – outlets that are empty, have been so for a prolonged period of time with little prospect



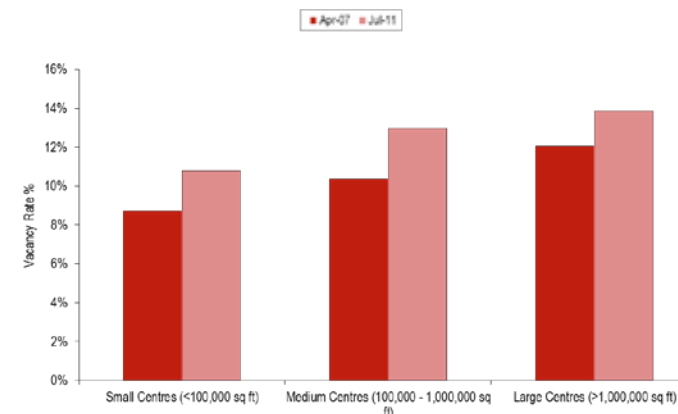
of any retailer interest in either the short or long term. Again, it is worth differentiating between types of outlets in this bracket. Some occupy high profile locations in prime pitches – these are obvious blots on the retailing landscape of that town, and very damaging to the landlords that own them.

However, the greatest level of retail vacancy tends to be away from these prime pitches - there is an undeniable 'ugly tail' of retail vacancy. This is retail stock that is never likely to be re-absorbed back into the market because it is too old, poorly located and ill-configured for the demands of modern day retailing. Often, this takes the form of standard shops in very tertiary locations and largely redundant local parades. There is no prescriptive solution to retail vacancy. However, intervention will often be required to make empty premises viable for re-occupation. Often this will take the form of re-development and reconfiguration, such as knocking together adjacent units to create a larger, more uniform floorplates. Conversely, larger units (eg former department stores) may need to be carved up to produce a series of smaller stores. How this is managed will depend on the demands of retailers in any given location – essentially creating the right space in the right place. Realistically, large proportions of the 'ugly tail' of retail vacancy are unlikely to be reabsorbed back into retail use and are fundamentally obsolete. In these instances, the onus is on planning to find more

## VACANCY RATES: BY SIZE OF RETAIL LOCATION

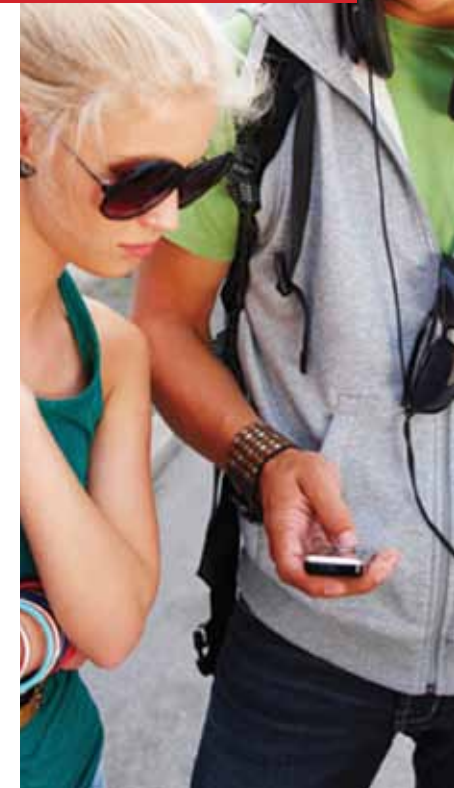
*The larger the centre, the higher the vacancy rate...*

*Source: Experian GOAD, Jones Lang LaSalle*



appropriate use classes for them, be that A3, retail service or residential. The residential option is the most interesting one – with housing shortages in many cities, surely it would make sense to convert redundant retail premises to homes? After all, many of these retail voids started out in this incarnation, before being converted to shops.

Above all, increasing vacancy underlines the need for the retail market to continue producing more modern floorspace, either through recycling existing stock or new development. In short, contrary to popular belief, vacancy does not preclude new development. >



# NEW DEVELOPMENT

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Funding constraints, rapidly fluctuating capital values and an uncertain occupier market have conspired to totally destabilise the retail delivery pipeline. In fact, the supply pipeline (or lack of) is one of the key issues currently facing the retail property market.

**Why does the retail market need new floor space? The simple answer is to grow; the more measured answer is to evolve.**

The development pipeline reached a 'high water mark' in 2008 when over 8.5 million sq ft of new shopping centre space was delivered to the market. This figure reduced dramatically in 2009 and 2010 when 2.7 million sq ft and 2.5 million sq ft of new space were developed respectively.

Only around 3 million sq ft of new shopping centre space is expected to open in 2011, but this figure is dominated by a single one - Westfield's Stratford City (1.6 million sq ft).



## *Parkway, Newbury*

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The market town of Newbury was identified as in need of new retail space due to an under provision in the town and competition from Basingstoke and Reading.

Determining the right scheme to be built was key: the development needed to be of the right size and scale to meet the demands of retailers and to provide an offer that matched the affluent demographic profile. At the same time, it had to be sympathetic to the existing environment and complementary to the current retail provision.

The scheme has focussed on bringing new retailers to the town but has also satisfied the space requirements for retailers already in the town that were undersized, due to the existing limited retail footprints, or off pitch. Without this development, some retailers may have exited the town completely.

Anchor deals were structured with **Debenhams** and **Marks & Spencer** and midway through the leasing campaign, the scheme was amended to satisfy the John Lewis at Home requirement, reinforcing the quality of the retail offer. The responsiveness to alter the scheme part way through the development to meet **John Lewis at Home's** new requirement is indicative of the flexibility required for successful new schemes. Parkway has been leased during exceptionally turbulent economic conditions and has proved resilient. Jones Lang LaSalle has been involved in Parkway Newbury from inception through to completion.

Parkway Newbury, the development by Standard Life Investments and Shearer Property Group is one of only 3 schemes to open in 2011 and totals 300,000 sq ft of retail space with 550 car parking spaces and 184 residential apartments. The scheme opens in October 2011 and recent deals include **Jigsaw**, **Hotel Chocolat**, **Fraser Hart**, **Paperchase**, **Superdry** and **Fat Face**.



## *Trinity, Leeds, a legacy for the city*

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Trinity will propel Leeds into third place in the top retail destinations in England. This exciting new development is set to become the only major shopping centre to open anywhere in the UK for two years. With the lack of development in the pipeline over the next few years, it is exceptional that with still 18 months until opening, the scheme is already 60% pre-let with negotiations ongoing with numerous other retailers.

The £350m development is progressing at pace and is due to open in Spring 2013. Jones Lang LaSalle has been involved in the project since its inception as trusted advisors to Land Securities throughout the development process.

Retailers are able to experience the magnitude of the development when visiting the Marketing Suite which is located in City Plaza overlooking the site. The imposing 100 ft domed roof is beginning to dominate the skyline showing the Leeds shopper that something very special is happening in the city centre. 1m sq ft and 120 units, Trinity will be anchored by Marks & Spencer and Primark, with other major fashion retailers including Next, H&M, Cult, Hollister, Top Shop and River Island. Jones Lang LaSalle are in the privileged position of being

in direct contact with the vast majority of operators in the UK market including international retailers that are keen to expand outside of London.

Trinity Leeds will open up to 19 hours a day and aims to boost the city's night time economy. Leisure operators including Giraffe, Carluccio's, Yo Sushi and Handmade Burger are taking space alongside a multi screen Everyman Cinema.

International restaurant operator D&D London has booked two places at Trinity Leeds, where it will have Conran-designed roof-top restaurants; linked from ground level with an external glass lift with views over the Grade I listed Holy Trinity Church.

Land Securities and everyone involved with Trinity are extremely proud to be involved with a shopping development that will allow the city to grow and become a positive legacy for the city.

Beyond this year, the pipeline is very dry. Only a handful of the schemes that were originally proposed in the late 2000s are now likely to reach fruition. Very few have current planning consent, even fewer are actually under construction, rendering 2012 an extremely barren year for new retail development. Why does the retail market need new floorspace? The simple answer is to grow, the more measured answer is to evolve. There is little disputing that new retail floorspace creates a virtuous circle amongst both retailers and consumers.

The latter benefit from a superior shopping environment and experience, whilst new floorspace is more able to respond to retailer demands and requirements. Note that retailer demands are constantly changing as retail markets evolve. New Look and Next are good examples of this. As both companies' business models have evolved, so have their respective floorspace requirements. Twenty years ago, both retailers had an average store size of less than 5,000 sq ft. These days, they seldom open a new store of less than 10,000 sq ft.



Much is made of the fact that retailers' expansion programmes have been curtailed by the constrained development pipeline. But we would argue that failure to hit expansion targets is not necessarily a catastrophe. There is little merit in a retailer expanding simply for the sake of meeting targets - and, indeed, nothing more perturbing than witnessing a struggling retailer trying to expand their way out of trouble. For retailers too, rather than expand haphazardly, the issue is also occupying the right space in the right place. These credentials will vary by retailer.

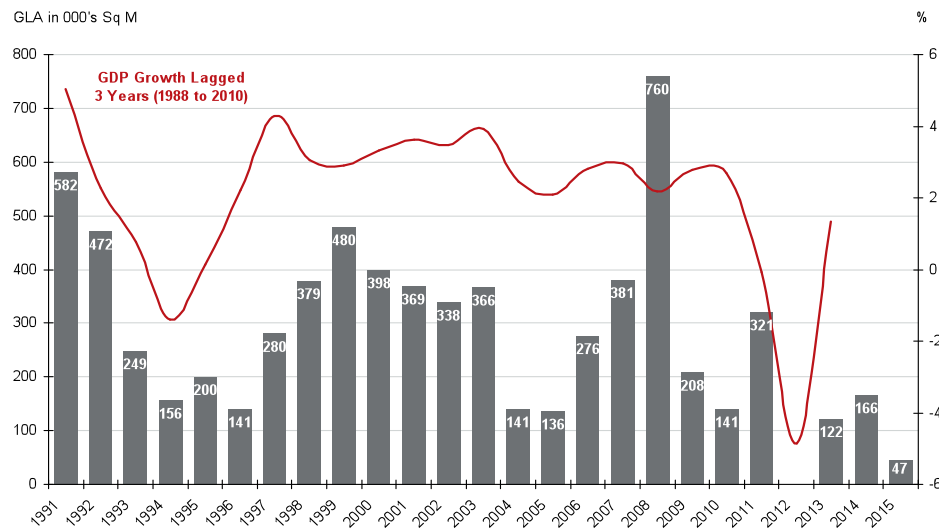
It is also worth stressing that from a retailer perspective, there are three sources of top line growth – like-for-like, inflation and new space. Of these, like-for-like is by far the most valuable, not least because it links most readily with profitability. Like-for-like sales growth is the lifeblood of any retailer.

In this respect, space-driven sales growth is vastly inferior to like-for-like sales growth. However, the reality is the two are – or should be – indelibly linked. New stores will obviously increase top-line growth. However, because the space is newer and configured more closely to that retailer's requirements, it should be much more productive. As it matures, it should be easier to leverage like-for-like sales growth from the new space. Thus, space-driven growth should ultimately morph into like-for-like growth. In instances where it doesn't, there are question marks as to whether it actually is the right space in the right place. >

### UK SHOPPING CENTRE OPENINGS

*Pipeline remains constrained and will lag economic recovery*

*Source: Jones Lang LaSalle, HIS Global Insight*



With evidence of new developments meeting the need for larger stores it will be a test for landlords of existing Centres, with an oversupply of small unit shops, to prove they are moving with the times. Seemingly the onslaught of US retailers arriving into the UK market is by no means over. Victoria's Secret will be opening next year and reports of Crate and Barrel closing in on a UK platform will fuel the need to provide the space for these players who traditionally operate large City Centre stores.

If Landlord's are going to offer greater choice for their increasingly financially strapped customers, by creating a more complete, more authentic retail offer, the evidence is compelling to create these larger, well planned retail units to accommodate the new retailers on the block.

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# RIGHT SPACE, & RIGHT PLACE WORKING HARDER

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What of all the floorspace inbetween? There is a preoccupation to focus on the two polarities of vacant floorspace and shiny new shopping centres. The mainstay of the UK retail market is, however, a 'silent majority' of over 80% of the nation's retail floorspace that is neither vacant nor new. It may not be the focus of attention, but it is the single most important part of the UK's retail fabric.

**The key to making existing floor space work hard is proactive asset management.**

The simple reality is that this floorspace also needs to work harder. Lease structures are such that retailers are inevitably saddled with stores that are no longer 'right space, right place'. Likewise, landlords in terms of the unit shops, shopping centres and retail warehouses they own and operate. To compensate for not necessarily being prime, they must aspire to being as close to 'right space, right place' as possible.

The key to making existing floorspace work hard is proactive asset management.

Generalisations in the retail market are rife - Prime outperforming Secondary and Tertiary, larger towns and cities growing at the expense of smaller ones, and London and the South East much stronger than the North, to cite the three most common.

There may be an element of truth in all three but generalisations of this kind are still dangerous. There are plenty of examples that fly in the face of these broad-brush assertions - flourishing smaller 'secondary' centres that successfully play to their convenience credentials, 'down at heel' northern centres that respond perfectly to the needs and aspirations of their catchment and supposedly affluent centres in the South East failing miserably with poor infrastructure, tired stock and spiralling vacancy rates.

Our 'right space, right place' mantra transcends all these generalisations. 'Right' is a deliberately relative term that will mean different things to different consumers, retailers, landlords and developers. 'Right' isn't necessarily big, prime, nor affluent. Relative it may be, but it is nevertheless measurable in that getting it 'right' will be reflected in the level of return. Understanding the relativities of 'right space, right place' in the context of a difficult and constantly changing retail market is the challenge faced by us all. >

**Understanding the relativities of 'right space, right place' in the context of a difficult and constantly changing retail market is the challenge faced by us all.**



# SIZE DOES REALLY MATTER?

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Over the last 10 years the globalisation of the retail market has seen demand for our core cities dominated by major international brands such as Hollister, Apple and Inditex, seeking large flagship stores. These international brands have followed a well trodden course, from London to major regional shopping malls and core UK cities.

To the consumer these brands feel like a natural part of our retail landscape - adopted as British - like Kellogg's, Heinz or Colgate. But these brands generally have a finite horizon, focused on the top 30-50 retail locations where they open large brand building stores producing 'super-turnovers'. So in reality they will only ever fuel the top echelons of our prime retail market.

This trend for space has been equally prevalent in the value and convenience sector. The deep discounters, single price retailers and supermarkets have all been acquisitive, spotting the opportunity to grow rapidly, acquiring market share with the demise of historic retail stalwarts like Woolworths and a flight to value by nervous consumers. Their size and location strategy

has evolved rapidly with requirements for bigger stores in prime higher profile locations, as they try and capture the minds of middle class shoppers. So at the moment Big, really is Beautiful.

But what does all this mean for smaller shops and middle ranking retail locations? Generally small units now equate to a problem as they do not match modern requirements. Whilst there remains demand for smaller units from premium and upscale operators in the top 30 - 50 locations, outside of these major centres and cities, the water becomes very choppy.

For years this market was fuelled by the expansion of mobile phone stores, coffee shops and card retailers but these retailers now have mature estates. Overlaying this is a trend for retailers to rationalise their store portfolios. The days of retailers needing 1,500 sq ft stores in every town are gone. The modern consumer is much more likely to travel for their main shopping and top-up for convenience in the interim. Retailers are aware of this change and are adapting their estate, rental and location horizons accordingly.

**Investors  
can still  
deliver real  
performance  
and additional  
income if  
they focus on  
centres that  
offer the 'right  
space in the  
right place.'**

**Big**  
really is Beautiful.

For the shopping centre market, solutions to this problem are essential. A large proportion of existing shopping centre space was designed in the 1980s, physically providing for the needs of multiple retailers looking for 1,500 sq ft stores. Whilst asset management initiatives will seek to create larger stores by extension or amalgamation, this quite often is economically difficult or physically impossible. Coupled with retailer risk averse strategies outside their core expansion territory, this creates a difficult set of circumstances.

Undoubtedly as an industry we need to encourage regional and independent retailers to expand into this territory - often with flexible leasing arrangements and offset rental deals that can allow new concepts to be nurtured and developed. Some of these retailers will become the multiples and power brands of the future.

As the market battles with the structural changes caused by recession, cost price inflation and lower retail sales growth, how centres adapt and respond to these changing circumstances will be key. Understanding the market positioning of your scheme, your consumer and their aspirations are vital. Marketing to these customers will have to become more sophisticated as competition is fierce. Painful decisions will need to be taken over direction and deals, in order to address these structural changes.

Centres across the spectrum can be successful if they adopt the right strategies to position their centres today. Investors can still deliver real performance and additional income if they focus on centres that offer the 'right space in the right place.' >

# DEVELOPMENT VOID

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Retail is a huge employer - it is one of the top three providers of employment across the UK. Not delivering an urban regeneration programme will have a wider ripple effect on the market. With the loss of development skills and the time it takes to deliver complex developments, the ability to turn the tap back on is going to be challenging.

Considering the status of the development pipeline and the lack of activity, we are sitting on a huge void of schemes not being progressed. With the continued focus on de-risking development by taking out costs and waiting for the market conditions to be right, it will take some time before the pipeline starts to flow. Developers are constantly looking at opportunities where they can best engineer returns and work with proactive Councils in delivering viable development.

In addition, we need to find new funding mechanisms in both the private and public sector which help kick-start the analysis. The Local Authority has a major role to play by actively encouraging development with cross party support, from creating the right environment, to actively participating in the scheme by introducing land on a cost effective basis.



The implications of a future undersupply in retail development in the UK - why urban regeneration is so important and what actions need to be taken to ensure that the sector continues to thrive.

As an industry, we need to endorse the implementation of developer led Tax Increment Financing (TIF) and Local Tax Re Investment Programmes (LTRIP). Adopting these or other financing vehicles will help inject early finance into the process.

In time, the market will find itself as demand is out there. It is simply a matter of creating the right space and environment, and recognising technology and

multichannel retail offers which are with us to stay. To create something sustainable, the focus should be on a mix of uses including leisure, where there is flexibility to cut and carve units to satisfy requirements.

Traditional anchor stores like Debenhams, House of Fraser and John Lewis, are being more flexible on the type and size of space they are willing to take. Redevelopment and rejuvenation of just one building can kick-start the redevelopment of a whole area. A thriving town centre is somewhere where people want to go to, therefore having very few retail voids. There are however many centres that carry a high proportion of void space and it is in these situations that alternative uses need to be found.

It is imperative to continue pushing the development agenda forward. Without this, we will lose valuable efficiencies within the retail market. Not all schemes are going to be viable, however those that are well thought out, have the occupational interest and ability to raise finance, should be the focus of development whether it be for mixed use urban regeneration projects, or extensions and reconfiguration of existing retail space. ›

# RETAIL DEMAND IN THE RIGHT LOCATION AT THE RIGHT TIME

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## ON THE HIGH STREET

Polarisation is a symptom of current market conditions, where retailers continue to complain of tight margins and difficult trading conditions. Although retail sales volumes are not yet falling significantly, some retailers are saying that they would be happy if like for like performance is less than 5% down on 2010. It is clear that consumer spending is flat and not expected to change this side of Christmas. Consumer confidence has dropped with the cost of living rising faster than income growth. The pressure on household spending has been exacerbated by Public Sector cuts and unemployment.

The gulf between Prime and Secondary has undoubtedly increased due to the following factors:

- 1 WEAKENED OCCUPATIONAL DEMAND**
- 2 RETAILER ADMINISTRATIONS**
- 3 WIDESPREAD DOWNSIZING**

Retailers continue to narrow their focus on the larger prime trading locations, where footfall remains high and consumer spending remains resilient. These locations include London of course, major regional centres and large towns. Regional Malls and Cities are strengthening their position as the most desirable shopping destinations. The good news is that in these prime locations, vacancy rates are reducing justifying higher rents being paid.

The bad news comes from the increasing view that more retailers need to urgently rationalise their store portfolios and exit under performing units. These stores tend to be in secondary high streets resulting in increased vacancy rates. Some locations are nearing saturation point in terms of the comparison between retail floorspace and available consumer spend.

Our Retail clients are increasingly looking at ways of reducing property costs. Portfolio strategies are more focused on the lease renewal profile over forthcoming years in terms of the opportunity to either exit stores or aggressively exploit market conditions to secure reductions against current rents.

With the size of retailers portfolios continually under review, we work closely with clients on the segmentation of core versus non core properties. With increased levels of E-tailing and retailers' focus in multichannel infrastructure, there is no longer the need for the same number of stores to achieve market penetration. Mobile online traffic is forecast to multiply 40 times over the next 5 years, continuing to shift power to the consumer.



## *Rightsizing the portfolio*

Following O2 Telefonica's internal review to 'rightsized' their property portfolio, Retail property specialists Jones Lang LaSalle were brought in to dispose of 40 stores throughout the UK. The primary goal was to focus capital investment in refitting core units or invest in new markets. The disposal programme has sent a clear message to the market of their intention to walk away from non-core stores unless attractive terms can be achieved at lease renewal both in terms of short term flexibility and discounted rents. On core stores where O2 want to reinvest in refitting units, Jones Lang LaSalle continues to explore opportunities to regear leases with long term commitments in return for attractive incentive packages.

## Flagship stores in London

Central London can be viewed as a completely separate market to the UK, given demand for retail space continues to be high. Demand for space has continued to be fuelled by international retailers, mainly from Europe and USA, however we are also seeing leading UK retailers investing more to fight for prime position flagship store locations. A recent example of such a case is the UK fashion retailer SuperGroup, who have acquired the 55,000 sq ft Austin Reed store on Regent Street. SuperGroup are looking to expand the number of stores in the UK from their current portfolio of 60 across the nation. Jones Lang LaSalle, who act on their behalf, understand their ambition to grow and expand with an ever increasing product range.

### WHEN LESS IS NO LONGER, MORE

The extent of High Street voids across the UK has been well documented, the supply of 'standard sized units' continues to increase as a result of a number of recent tenant failures including Jane Norman, Homeform, Officers Club and Fenchurch. Rationalisation programmes including Game/Gamestation, Mothercare, O2, Curry's and Julian Graves has added to these number at a time when the demand for small retail units is limited. In the past, the size of units on offer would have been sought after by a combination of mobile phone, card and coffee shop retailers. The acquisition campaigns of these operators has been more curtailed over recent times, indeed we suspect that there may be a further consolidation of the mobile phone market with the merger of T Mobile and Orange trading as Everything Everywhere.

In difficult market conditions, clients with disposal campaigns want to be assured that their property agents have sufficient resource, experience and market coverage to ensure that their surplus stores receive full and focused attention.

We are also tending to see the polarisation in demand for large units, whether it is from major fashion retailers, convenience stores or discount operators. Market conditions are allowing some retailers to expand portfolios and the rebasing of rents in some city and town centres is allowing operators to secure representation in prime pitch on a cost effective basis whereas previously, they would have proved too expensive.

Fashion retailers including the likes of Superdry, Next, H&M, Topshop and Zara are all looking to expand at a time when the supply of large units has been restricted with a reduction in the

## Polarisation reinforces the very simple message that there is retail demand for the right product, in the Right Place at the Right Time.

development pipeline. Over the next 2 years the UK will see the lowest level of shopping centre completions during the last 50 years.

Demand from international retailers such as Forever 21, Hollister, Apple and Desigual are also fuelling demand for large space. In addition to Superdry, Hollister have secured representation on Regent Street acquiring the National Geographic store.

Forever 21 have recently opened a flagship store on Oxford Street, London, to add to their existing representation in the Bullring in Birmingham. Jones Lang LaSalle acted for Forever 21 in Liverpool, securing a 42,000 sq ft store on Church St, at the junction with Paradise St. The new store is due to open in 2013.

Jones Lang LaSalle's previous advisory role for Woolworths and current instruction from The Co-operative to dispose of 70 surplus stores has allowed us to gain first hand knowledge of the extensive demand from both convenience supermarket operators and value retailers to expand their portfolios. The Co-operative Group instructed Jones Lang LaSalle to implement a selective disposal programme to dispose of surplus stores following the acquisition of Somerfield. We have been successful in agreeing package transactions with a large number of value retailers including Wilkinson, B&M Poundland and the 99p Store.



Food retailers are generally performing well with Aldi and Lidl the winners, with double digit growth. Morrisons have established themselves at fourth behind Tesco, Sainsbury's and Asda.

Demand for space in the South East, and particularly London, as a retail powerhouse, continues to be high. Zone A rates for the West End continue to reach record levels. Demand for space fuelled by international retailers has resulted in substantial premiums being paid alongside record rents. London continues to be one of the leading tourist destinations, demonstrated by the fact that the amount spent in the capital is greater than LA, Milan, Berlin, Rome and Madrid combined. Retail spend has obviously benefited from the current exchange rate.

This contrasts with the North, where the most significant rental falls have been in the East & West Midlands, North East and Wales. In summary, polarisation of the market exists in terms of prime versus secondary, large versus small and North versus South. >

# RETAIL WAREHOUSING HAS BOUNCED BACK TOO QUICKLY BUT HASN'T EVERYTHING?

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Prime retail warehouse yields currently stand at 5.0%, ahead of the long term average yield for the sector of 5.55%.

The last time yields came in beyond the long term average was at the height of the market in mid 2007, when yields peaked at 4.0%. However, rental growth rates in mid 2007 stood at 1.8% per annum versus the current, more modest figure of 0.5% per annum.

Since mid 2009 we've seen yield compression of over 200 basis points, against a back drop of continued economic uncertainty and limited rental growth, so you could be forgiven for thinking the sector has bounced back too quickly.

However a look at the other retail sectors reveals the situation is not just limited to retail warehousing. Prime shopping centre yields currently stand at 5.5% versus a long term average of 6.2% and, like retail warehousing, rental growth has dropped from 1.8% per annum in mid 2007 to a current level of 0.6% per annum.

At 4.75%, whilst yields on the high street remain outside the long term average of 4.65% the sector has seen the most marked drop in rental growth from 2.5% per annum in 2007 to a lowly 0.2% in 2011.

## SO WHY BUY RETAIL WAREHOUSING?

As well as strong covenants, long leases and economic rents, a comparison of the occupational situation with shopping centres and the high street paints a very positive picture.

In mid-2009, retail warehouse vacancy rates stood at circa 12%. However, despite headlines being dominated by news of retailers closing stores and going into administration, that figure has dropped to circa 9%.

Conversely, over the same period, shopping centre and high street vacancy rates have been rising, from circa 12% in 2009 to the current level of circa 15%. >

In mid-2009, retail warehouse vacancy rates stood at circa 12%. Despite headlines being dominated by news of retailers closing stores and going into administration, that figure has dropped to circa 9%.



## BULKY GOODS

# SURVIVAL OF THE FITTEST

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The bulky goods market is much maligned, but there is still growth to be found on prime schemes. New entrants to the market such as Oak Furniture Land, Think Furniture and CSL in the South have given landlords new options and have increased demand. Coupled with new acquisition programs from Next Home, Harveys and Wren, and continued demand from Pets at Home, the market could be seen to be in good health.

At the start of 2011, vacancy rates on bulky goods schemes, or schemes with restricted consents had dropped from a 12 month high of circa 13% to 10%. Good levels of rent were achieved for the prime furniture parks in strong catchments, such as at Solartron Retail Park in Farnborough where Dreams paid a headline rent of £42 per sq ft for a 7,767 sq ft unit with minimal rent free.

There remains however a major and widening divide between prime and secondary. This can be seen in the handling of two recent administrations, Focus and Easy Living. In both cases package deals were agreed for the best units, and latent demand enabled landlord's to take other units back on strong schemes to enable asset management. In both instances approximately 30% of the vacant space was taken in the first stages of the administrations, with premiums being paid to secure the prime units.

For the secondary units however it is a different story. Following the initial cherry picked packages from the Focus portfolio, there remained approximately 3.4m sq ft vacant and unaccounted for, equating to approximately 2% of the total retail warehouse market. It is difficult to see some of these units being let at their passing rents in the short to mid term.



**It is survival of the fittest in the market, both amongst retailers, and when looking at properties themselves. The strongest retailers will gain market share and enhance their reputation whilst their competitors struggle.**

The over supply of secondary bulky consented accommodation is further established when looking at retailers' disposal packages. For instance; Comet are currently marketing circa 640,000 sq ft, or approximately 23% of their portfolio. Carpetright recently announced 19 disposals, and the potential for circa 90 closures at lease expiries in the coming years, should regears not be agreed.

Due to the competition for prime schemes and the lack of development in recent years, landlords of such schemes will be able to increase rents and capital values accordingly. It is in the secondary areas of the market where there will be very tough times ahead. ›

# BUDGET GYMS INCREASINGLY FLEXING THEIR MUSCLES

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After many years of dormant activity within the health and fitness sector, where funding for new acquisitions effectively dried up, the last three years has seen a dramatic rise in the number of affordable “no frills” health clubs which are opening across the UK.

The “budget” health club sector which is well established in the USA and mainland Europe, has continued to erode the mid-market offering in the UK. With the average gym membership in the UK costing £37 per month and consumers becoming ever more cost conscious, the UK market is now being flooded by market leaders Pure Gym and Gym Group who collectively have over 40 clubs in the UK, with a plethora of others, such as Gym Box, Gym For All and Xercise 4 Less amongst others opening facilities at a rapid rate.

The last three years has seen a dramatic rise in the number of affordable “no frills” health clubs opening across the UK.



## THE RISE OF THE “BUDGET” HEALTH CLUB

The rise of the “budget” health club is compelling

- › Extended opening hours, the vast majority of which are open 24 hours
- › Flexible contracts on month to month basis at very competitive rates
- › Subs of £20 per month and in some cases only £12.50 per month
- › The emphasis on quality of equipment over quality of fit out

These incentives to keep gym membership a budget item and no longer solely a luxury commodity make them an irresistible proposition for a significant proportion of those wanting to keep fit.

The top end racket and spa clubs, such as David Lloyd Leisure for example, appear to be maintaining their market share and it will be interesting to see how Virgin Active, following the purchase of the Esporta business, reacts to the increasing number of budget health clubs opening in towns and cities across the UK.

With the continual high level of inflation and the ever increasing pressure on consumers disposable income, the mid sector gyms will have to respond by adopting changes to their business model before it is too late. >

# BLOCKBUSTER RESULTS DESPITE MARKET SLOW DOWN



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UK cinemas have traded well during the downturn. 2010 saw UK and Ireland box office ticket sales rise 2% to £1.76 billion, achieved on top of a stellar 11% increase in 2009.

Admissions in 2009 rose 6% to 173.5 million whereas 2010 figures were down slightly at 2.5%. However, 169.2 million admissions still represent the 3rd highest admissions over the last seven years. The increase in value of the box office in 2010 was delivered by higher ticket prices for 3D movies and 3D glasses sales, in addition to the technical improvements including most operators converting to digital projection.

Operators have benefitted from conversion to digital projection, delivering more programming flexibility, 3D projection, alternative content (Opera, Live Sport) and cost savings.



Source: CAA/Rentrak EDI/CEA 2011

## GROWTH IN IMAX / OVERSIZED SCREENS

There has also been growth in IMAX / oversized screens as well as boutique and full service auditoria.

- › Cinema openings have naturally slowed as property development has stalled
- › 2010 saw five cinemas open delivering 46 screens
- › 2001 saw 25 openings and 284 screens
- › In terms of films, the blockbuster releases still dominate the cinema earnings tables. The top 20 films accounted for 45% of sales
- › 3D films share of the market is significant, representing 24% of market share in 2010
- › UK audience, the 15 – 24 year old cohort has traditionally been the heaviest cinema-going group averaging 6.2 visits per year, but visits by this age group are now outnumbered by those of the over-35's

*Dodona Research / CAA 2011*

## PROSPECTS GOING FORWARD

Dodona research forecast in April 2011 the following:

- › Admissions growth of 8.8 million to 178 million by 2015. This represents a conservative 5.2% increase over the next five years
- › Average ticket prices are however forecast to grow more steadily from £5.84 to £7.10 over the same period, which represents a 21.5% increase
- › Total cinema revenue (including advertising, concessions etc) are forecast to growth 22% over the period to £1.488 million ›

# INTERNATIONAL RETAILERS MAKE A BEELINE FOR LONDON

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Overpaid, oversexed and over here. The tongue-in-cheek moniker first derived to describe American Servicemen during WWII could equally be applied to the growing band of US retailers currently blazing a trail across the Atlantic. But only the harshest cynic would deny that the likes of Abercrombie & Fitch, Hollister, Forever 21, Guess, Victoria's Secret and Williams Sonoma, are very welcome additions to high streets and shopping centres across Europe.

The UK and London in particular, is proving 'the first port of call' for many of these transatlantic trailblazers. Indeed, new research from Jones Lang LaSalle analysing the presence of 150 key cross-border retailers from across the world highlights London as the most 'International' retail destination in Europe.

The UK capital boasts 73% more key cross-border retailers than average, across 54 major European cities. These retailers include both established international brands such as Zara, H&M and Timberland, and the 'new breed' such as Superdry and The Sting. London is just ahead of Paris in the ranking and less predictably, Moscow, which is immature in retailing terms, muscles in ahead of both Milan and Madrid.

Why is the UK such a popular haven, particularly for internationalising US retailers? In part, the reasons are economic, despite current difficulties. The UK retail market has an uncanny knack of being able to defy weakness in the wider economy. The UK, unlike other European markets, has an unparalleled track record of retail sales growth with forecasts of future growth similarly robust. On a more general front, the consumer environment in the UK is a very favourable one: progressive, with an appetite for change and 'new blood'. Adding a favourable exchange rate and a common language to the mix, it is not difficult to see the appeal of the UK to an aspiring transatlantic retailer. But the UK is by no means the final frontier. On the contrary, it is increasingly seen as a bridgehead into Continental Europe.

**The UK has an unparalleled track record of retail sales growth with forecasts of future growth similarly robust.**

There is no 'one size fits all' strategy to international expansion, but many retailers are increasingly taking the 'flagship breadth' over 'dredger depth' option; opening large, brand-showcase, flagship stores in capital cities

across a large number of countries, rather than a network of stores in any given country. The latter option is the higher risk one, but if executed strategically and effectively, will ultimately produce the greater reward.

On a note of caution, international success is by no means a foregone conclusion, even for the strongest retail brands. Retail history is unfortunately littered with failed and abortive internationalisation strategies, with failure to tailor domestic models to the demands and idiosyncrasies of international markets the most common denominator. Whatever route to market international retailers take, the old retail truism of 'thinking global but acting local' resonates just as loudly now as it ever did. >

**The UK capital boasts 73% more key cross-border retailers than average, across 54 major European cities.**

## CITY RANKING & INTERNATIONAL ATTRACTIVENESS INDEX:

Source: Jones Lang LaSalle 'International Attractiveness Index' is calculated on the basis of a matrix of 150 leading international retailers and their presence across 54 European cities.



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Don't hesitate to contact our specialist Retail team who are happy to discuss your views and provide any further Retail *Intelligence*

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