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Hammerson's profit: turning point or false dawn for retail?

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Embattled investors may be finally turning a profit, but are growing consumer clouds going to hamper progress?

Hammerson's first profit in five years feels like a landmark moment for the UK retail market – a sign that, even in the embattled shopping centre sector, values and rents are finally bottoming out.

But with rising debt costs putting outward pressure on yields and retail sales falling, could it prove to be a false dawn?

So far, there is little in the real estate data that raises alarm bells. Figures from the Local Data Company last week showed that vacancy rates continued to fall in the second quarter, albeit by a modest 0.1 percentage points to 14%.

The recovery in leasing activity is having a positive impact on rents, particularly in the retail park sector where vacancy rates are getting on for half what they are in shopping centres.

And even in the shopping centre market, Hammerson's numbers were encouraging. It reported that on new leasing deals in the first six months of the year, headline rent was 31% ahead of previous passing rent and net effective rents were “marginally up on ERV”.

This is not quite as positive as it sounds because Hammerson only includes so-called “principal” deals in this calculation, ignoring temporary deals which account for just 30% of deal numbers. The company did not break down how temporary deals compared, but in 2021 they came in 44% below previous passing and 61% below ERV.

That caveat aside, the figures are undeniably more positive than they have been for a long time, and point to some degree of leasing tension returning at the prime end of the shopping centre market.

Reasons to be cheerful

If the current momentum were to continue, there are reasons to be optimistic about the outlook for the investment market. The sector is not immune to the impact of rising debt costs and wider financial market volatility, as illustrated by last week’s news that two of the UK’s biggest retail park deals had hit the buffers.

However, in theory, rising rates are not as much of an issue for the retail sector as they are for other parts of the market, as the valuation impact of the same outward yield shift on a low-yielding property is significantly more painful than it is for a high-yielding asset.

As Panmure Gordon analyst Miranda Cockburn notes: “With low-yielding assets under pressure given the rising interest rate environment, the retail property sector (where yields are at highs and rents appear to have reached an affordable level) might finally have its day.”

The ongoing sale of Union Square in Aberdeen for around £140m shows there's money for shopping centres

Anecdotal evidence from agents would support this. Sales processes in the retail parks sector, including for the bulk of Mike Ashley's £320m portfolio, are still progressing and agents claim that the gap between seller and buyer expectations is narrower than in other sectors. As for the shopping centre market, where debt availability was thin even before recent turmoil, the fact that Brookfield Asset Management is closing in on a deal to buy Union Square in Aberdeen for around £140m shows that the market remains active.

"The lack of debt available for retail purchases is partly its saviour. People have been buying with cash, so debt costs are not so much of a focus," says Mark Garmon-Jones, head of shopping centre and retail investment at Savills.

"The investment market will be challenging for some of the larger lot sizes, but we've also seen new buyers emerge for the £20m-£40m assets, such as Adhan, BYM Capital, and family office money which looks at things a bit differently and are not so reliant on debt."

Consumer clouds

That all being said, the outlook for the sector will only remain positive if the occupational market holds up. Feedback from agents would suggest that there is little to worry about in the short-term.

Paul Souber, head of UK and EMEA retail at Colliers, says the consultancy has had the highest level of new enquiries from potential London occupiers in July than for the past five years.

However, it is impossible to ignore just how bleak the latest figures are on consumer behaviour.

Deloitte's consumer confidence tracker hit an all-time low a fortnight ago and the latest retail sales data shows people are already cutting back.

In the second quarter, non-food retail sales fell by 4.2% on a like-for-like basis compared to the same period last year, according to data from KPMG and the British Retail Consortium. Given that the figures are not adjusted for inflation, the trade body said they masked a steeper decline.

Some of the usual suspects are already showing signs of strain. Ted Baker is in the spotlight after credit insurers have reportedly pulled cover and other fashion retailers are also struggling. Joules, for example, recently drafted in KPMG to advise on options to bolster its finances.

Power shift

But the mix of occupiers that are in the danger zone is somewhat different to what it was during the pandemic. Some of the big pandemic winners could quickly turn into losers.

Bulky goods retailers, which did a roaring trade last year, are vulnerable as under-pressure consumers are likely to cut back on big-ticket purchases. The abrupt change in sentiment has sent shares in DFS tumbling more than 40% so far this year.

DFS has a healthy balance sheet but others in the sector could run into trouble. Matalan, in particular, is in focus after the highly geared fashion and homewares retailer acknowledged earlier this summer that it may not be able to continuing trading if it fails to refinance a £350m tranche of debt by January.

As consumers seek out bargains, discount retailers like Aldi, Lidl, and B&M look well placed to continue trading well.

Jonathan de Mello of JDM Retail says: "There is a polarising of the market. Value players are doing well and continue to expand. Lidl and Poundland are growing, and as a counterpoint retailers with a big wholesale or e-commerce component want to be visible in high traffic areas to build brand equity such as Regent Street and Bond Street.

“The losers from the end of the pandemic, are online pureplays. Physical retailers invested heavily during Covid, and have become more competitive with streamlined logistics processes compared to the likes of Boohoo who are now passing the costs on to customers by charging for returns.”

High street losses mean retail park gains

The tougher times for bulky goods retailers are bad news for retail parks. However, the likelihood of difficult trading conditions ahead for furniture, DIY and carpet stores has to be counterbalanced against the more positive outlook for other retail park stalwarts.

The retail park sector particularly stands to benefit from the ongoing trend popularity of budget retailers as well as big-name retailers like Next and M&S who are shifting the mix of their store estates in favour of parks.

John Maddison, head of asset management at Quadrant Estates, says: “Covid created a life support machine for struggling retailers so I wouldn’t be surprised to see more failures now that the government support has been lifted and retail sales are falling.

“But in the retail park sector, tenant credit is the best it has been for many years. The strength of the retailers that now dominate gives me confidence that the sector will remain largely resilient.”

Amid the recent market wobble, Royal London has withdrawn from the £250m purchase of Crown Estate retail parks, including Banbury Gateway

As for shopping centres, those packed with retailers reliant on discretionary spend look most at risk.

Some of the first signs of distress could emerge in the casual dining sector, which is particularly exposed to higher cost inflation and vulnerable to weaker consumer spending.

“From a restructuring perspective, it’s been really quiet since the government support kicked in during the first summer of Covid, but I’d expect the next six to 12 months to be busier,” says Will Wright, restructuring partner at Interpath.

“I think the casual dining side is going to bite more quickly than the retail side because we’re already starting to hear of situations where there is genuine concern around what’s going to happen.”

> *“The bonfire of the mediocres has already happened”*
>
> MARK WILLIAMS, RIVINGTONHARK

It has been suggested that rents have now rebased to a level where company voluntary arrangements will be not be as worthwhile for occupiers to pursue as they have been over the past five years. This may be true, but faced with the prospect of business failure, many are still likely to explore every avenue available to them to stay in business. Whereas in the past the focus of CVAs has been to seek rent cuts, future CVAs may be more focused on exiting unprofitable stores.

When the strong remain

It is important to keep this in perspective. There are weak occupiers out there who survived Covid thanks to government support and will now struggle, but equally many of the weakest players have already gone. The list of big names that look like they may need to resort to a CVA or enter administration if the trading environment gets tougher is shorter than it once was.

“You could argue the oversupply of retailers, the bonfire of the mediocres, has already happened,” says RivingtonHark executive director Mark Williams. “It’s the stronger retailers remaining, brands like H&M, River Island and Zara who are doing really well.”

Many of these stronger retailers have also come to recognise the value of their stores more and the positive impact they have on their online businesses.

“Brands get a halo effect by opening the right kind of store – the right location will benefit the online business, sometimes seeing a 30% increase in online purchases within the catchment of that store,” says Colliers’ Souber.

The worst may well be over for the retail sector, but there is no getting away from the fact that the outlook for retail spending is as bad as it’s ever been and that any emerging leasing tension could quickly evaporate.