ST BRIDE'S MANAGERS

Bull and Bear

Raving About Retail Warehousing

Bull and Bear are discussing drive-thrus and retail parks, and look to dissect the UK's broader retail warehouse sector. With strong occupier demand and a changing consumer landscape generating rental growth, they are struggling to see why investors aren't piling in.

Bull: Morning Bear. What's with your two-toned T-shirt?

Bear: What do you mean? This is the same shirt I wear every Sunday. You know I'm not really one to push the boat out when it comes to fashion.

Bull: I know, Bear. I was referring to the giant coffee stain on your chest!

Bear: Ah, yes. I'm afraid that's the result of a slight mishap outside the Starbucks drive-thru that has just opened on my way here.

Bull: I hope it didn't burn you too much. Although I confess, I didn't have you down as a '***Venti*** from Starbucks' kind-of-bear.

Bear: Well, it ended up being more like a '***Grande*** from Starbucks'… but it did get me thinking about a good topic for today's discussion.

Bull: Oh, yes? Like the frightening rise in global obesity levels? Or, how people should be sure to walk their 10,000 steps a day rather than guzzling coffee from their car seat? Did you read last week's WHO report? They reckon that 28.3% of women and 26.9% of men in the UK are now obese! It's all a bit scary.

Bear: No, Bull. I mean drive-thrus! And on the obesity front, you know very well that I limit myself to just one cup a day. But this new Starbucks is certainly a welcome addition to my grinding commute. Not only can I now get my morning caffeine dose without leaving the confines of my car, but I no longer have to put up with the barista spelling my name incorrectly on my cup!

Bull: I'm pleased to hear it, Bear. However, it doesn't look like you've mastered the art of coffee-drinking and driving yet!

Bear: I'll admit the timing of this morning's accident was unfortunate. But I tell you what, the drive-thru property market, rather like my coffee this morning, is HOT right now! Seriously hot.

Bull: Really? I'd never thought of drive-thrus as being a standalone sub-market. To me they've always been blended into retail and leisure parks, with the same old Food and Beverage (F&B) operators.

Bear: Most of them are. But in the wake of the pandemic and the increasing drive (excuse the pun) for consumer convenience, their popularity has really kicked off. According to a Savills report, recent demand from F&B operators for space has been at a 10-year high. They are regularly featuring nowadays in the top 20 most acquisitive brands in the UK retail warehouse market. It appears that drive-thrus now make up 33% of new F&B openings, up from 27% in 2022.

Bull: Interesting. And there was me thinking that they were there just so that we Bulls could pick up a snack on our way home as a sneaky little appetizer to the shepherd's pie being prepared for tea! But now you're telling me that we can get our morning coffee there too?

Bear: Yep. In fact, Costa and Starbucks are two of the more acquisitive brands at present. Don't worry though, stalwarts like McDonalds, Burger King and KFC are still active, having consistently acquired space over the last five years. But lots of other big-name brands are in the market as well.

The UK's first drive-thru opened in Fallowfield, Manchester, in 1986. There are now over 2,000 drive-thru's in the UK, 938 of which are operated by McDonalds.

Source: BBC, Group 1 Automotive

Bull: Such as?

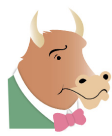
Bear: Tim Hortons, Taco Bell and Greggs, to name but three.

Bull: Okay, so clearly there is lots of demand for drive-thru space. But putting my property horns on … is that translating into rental growth and performance?

Bear: You bet it is. The competition between operators means that rents have been shooting up and are showing no signs of slowing down. Savills reported that average headline rents towards the end of 2023 reached just under £55 psf. That's a whopping 25.9% increase on 2022. And in the last month or so, I've even heard of some deals in prime locations being negotiated at upwards of £80 psf.

Bull: Wow! That is incredible.

Bear: Yes, it is. And on top of that, well-established F&B operators are also taking long leases, upwards of 15 to 20 years in some cases. You know what the combination of rental growth and long leases from strong covenants means, don't you?



Bull: Yep. Investors will want to get their sticky mitts on them. I have to say, Bear, it's nice to hear a bit of positivity from you for once.

But what I want to know, is whether these dynamics have been reciprocated across the wider retail warehouse market too?

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Bear: Well, as you know, retail parks have been one of the hottest plays for both domestic and overseas investors in recent years, particularly if they are anchored by a front-line supermarket, like an Aldi or Lidl. But investment in property generally has been so thin lately, it's hard to know exactly where retail warehouse yields currently stand.

Current Retail Warehouse Investment Yields

Out of Town Retail - Sector	Yield
Open A1 Parks	6.00%
Good Secondary Open A1 Parks	7.50%
Bulky Goods Parks	6.00%
Solus Open A1 (15 year income)	5.75% - 6.00%
Solus Bulky (15 year income)	5.75% - 6.00%

Source: Knight Frank, February 2024

Bull: Well, I can tell you that regardless of where yields currently stand, I am still very much a fan of the sector.

Bear: I know. I am too. Over the past decade, retail parks have been much more resilient than the High Street and Shopping Centres. It comes down to the changing consumer landscape. It's all about convenience.

Bull: Yep. And, perhaps most importantly, car parking. Did you know that English councils generated £962m from car parking last year? No wonder people are taking the cheaper option. Everyone is crying out for town centres to be revitalised but until car parking costs are taken out of the equation, town centres are going nowhere … other than backwards.

Bear: Not only that, but retail warehouses are cheaper to occupy than in-town units. Remember, most of the sector's 'over-rentedness' has now been recalibrated and with business rates being revalued downwards last year too, it is little surprise that tenant demand for out-of-town space has picked up again.

Bull: Yeah! And as we both know well, where consumers go, retailers go too. Retail park stalwarts like B&M and Dunelm are expanding their exposure, plus traditional high street brands like M&S and Next are increasingly taking the out-of-town option. And even businesses likes dentists have jumped on the bandwagon.

Bear: Exactly. And if we need any hard evidence to prove it, British Land, who are the UK's largest owner and operator of retail parks, has recently reported that their retail warehouse portfolio is running at 99% occupancy, with ERVs growing at 4% per annum.

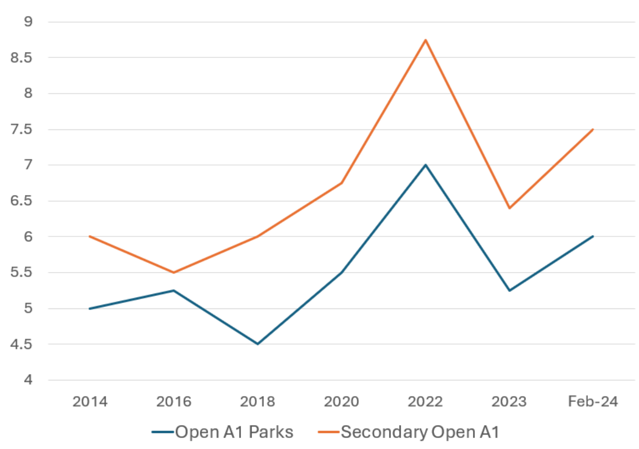
Bull: Wow! But I bet British Land's retail parks have some of the best quality kit going. What is the broader UK market vacancy rate looking like for the sector?

Bear: It's still only at 4%. That tells me that the wider retail warehousing market remains pretty healthy. Which begs the question why the investment market is so out of sync with the occupational market.

Bull: And a very good question that is too!

Bear: Thank you, Bull! It's very strange. At the peak of the market, back in 2018/19, retail warehouse yields were as low as 4.50%. They then went up, then down and now they are back up again. According to Knight Frank, prime yields currently stand at 6.00% and are trending upwards. It has been like a blooming yo-yo for the sector.

Retail Warehouse Investment Yields - Last 10 Years



Source: Knight Frank

Bull: More upward yield movement?! Let me get this straight … retail warehouse occupancy rates are at 96%, with good occupiers taking long leases, and you can buy them at 6.00%? With bond yields at 4.20% and interest rates expected to come down this year, what's going on?

Bear: I don't really know, not least because Knight Frank are predicting that in 2024, retail warehouses will deliver a total return of +8.80% for the year. It will be largely driven by income, but it is expected to deliver +2.5% capital growth too.

Bull: +8.80%? That's spectacular. Come on Bear, what are we waiting for? We should be piling in.

Bear: I know. But before that, what's for lunch today? I'm starving.

Bull: Erm, when I left this morning I heard murmurings of the leftovers from last night's fish pie. Hmm … on reflection, I might be making a quick pit-stop on my way home.