



Real Estate Insight

Leisure in the UK retail environment



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Executive summary

- ▶ Leisure is becoming an increasingly important part of the UK retail landscape as landlords seek to create an exciting space where consumers want to shop and spend. Research shows that the space allocated to leisure within shopping centres has increased significantly in recent years.
- ▶ From an investment perspective, we wanted to find out how much impact an increased leisure offering has on rental growth. We therefore carried out research covering both shopping centres and town centres.
- ▶ Our research showed income generated by leisure operators has risen, nearly doubling their contribution to overall shopping centre income in the past eight years. This was during a period when the net income growth of shopping centres declined overall.
- ▶ Prime shopping centre assets with higher leisure provision generated significantly better levels of rental value growth. For town centres, we found a positive relationship between the leisure offering and rental growth in most cases.
- ▶ Although not the only factor, our results suggest that having a significant leisure offering contributes to the attractiveness of a shopping destination or a town centre.

Recommendations

- ▶ The shape, style and experience of the leisure offering rests on 'knowing your customers', which places greater emphasis on social media and interaction with shoppers.
- ▶ A well-balanced leisure offering could positively contribute towards rental value growth for a retail destination, as it enhances the experience and can create an enjoyable space to suit different needs.
- ▶ For landlords, this brings the challenge of efficiently managing the income and covenant strength of their tenants in order to maintain or add long-term value.
- ▶ For less prime centres, or mature established centres, adding in or improving the leisure offering could be expensive, time consuming and an asset management challenge.

Introduction

As the digital era has made retailing more convenient for consumers, the need for retailers to deliver a unique physical shopping experience is increasingly important. Competition among UK retailers and shopping centres is therefore shifting from price and location to consumer relevancy and experience. The right offer increases customers' dwell time and enhances the overall shopping experience, which ultimately brings more spending. For example, a study by JP Morganⁱ suggested that the food court extension at WestQuay, Southampton, added four minutes to shopper dwell time, or one extra shop visit. This could potentially add extra sales worth £45 million or £4.5 million of rent. This is clearly something too valuable to ignore.

Leisure (defined as any form of food & beverage offering as well as cinemas and entertainment, as part of a retail offering) has a significant role to play in the ever-demanding retail landscape. Indeed, recent research from CBREⁱⁱ shows that over two-thirds of customers view the leisure offering in a shopping centre as either a very important or extremely important consideration in deciding where to visit. New shopping centres reflect the current trend, where the leisure offering has moved away from a cursory selection of canteen-style food towards the idea of a wide choice of dining experiences, as well as leisure activities to suit all needs.

In this paper, we examine the growth of the leisure offering within retail following the global financial crisis, when leisure operators have been more expansionary than retail players. We then seek to establish whether there is a clear link between an increased leisure offering and overall rental growth. In particular, we examine leisure's differing influence on prime and secondary shopping centre assets. Finally, we assess its impact on rental growth prospects for major town centres in the UK.

Integrating leisure into a retail environment

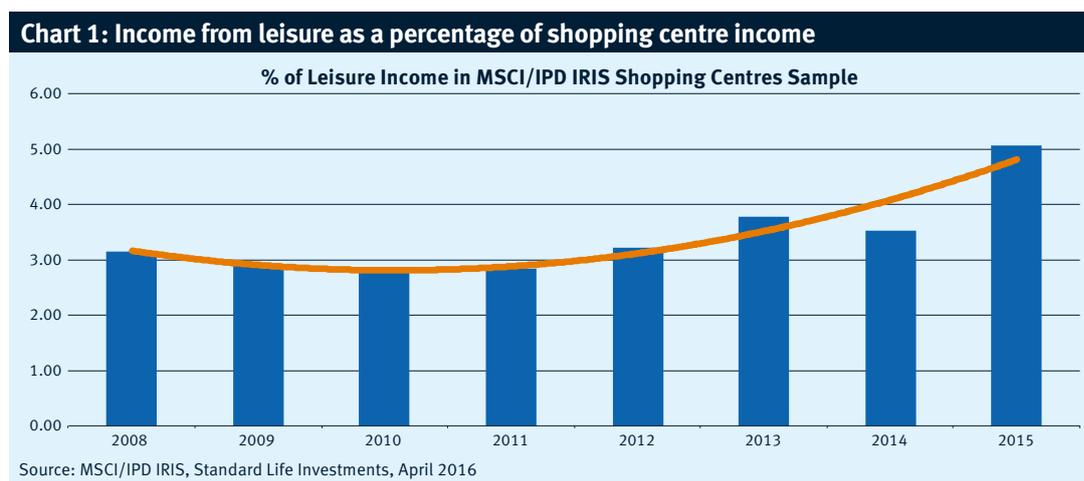
Restaurant and cinema operators have been at the forefront of integrating leisure into shopping centres. For example, the October 2013 launch of Trinity Kitchen in Leeds set a new benchmark for an indoor food offering. The 20,000 square feet (sq ft) food hall, equivalent to about 20% of overall floor space, provides shoppers with a diverse mix of street food vendors, pop-up market stalls and emerging high street food and drink brands. Similarly, Westfield Stratford City has dedicated over 20% of space to food and leisure. It has proven successful in creating an attractive space where consumers want to shop and spend.

For landlords, this brings the challenge of attracting a suitable selection of leisure operators while efficiently maintaining a balance of rental value and covenant strength. They also need to consider the right type of leisure space a shopping centre needs, either destination or convenience, and how they can implement this in a cost-effective manner in an era of lower growth.

When it comes to the 'ideal' level of food and leisure space in shopping centres, factors to consider include location, type of centre and the social demographic background of each destination. In addition, diners are increasingly demanding different types of dining experiences to suit different occasions. These can range from a quick bite to pre-activity meal and, of course, the family meal, as well as leisurely catch-ups and that special romantic dinner. It is important to distinguish customers' requirements and build a mix that addresses their demands. Each occasion is different. For a quick bite outlet, speed of service and convenient location are vital but familiarity, reliability and product quality also play a significant role. By contrast, a family meal can be more complex, as the essential ingredients include a child-friendly environment, a wide menu range, friendly yet efficient service and child entertainment such as a soft play area, if space permits.

Analysing leisure's impact

While leisure has become increasingly integrated into the retail environment over recent years, there is little information on how it has contributed to rental growth. Therefore, we commissioned research using a dataset of 130 shopping centres held from 2008 to 2015.



In line with the growing integration of leisure operators, we found a trend of rising income generated from leisure since 2008, except in 2014. At the end of 2015, over 5% of rental income came from leisure tenants, compared with 2.8% in 2010. While this is not substantial in absolute terms, the contribution to overall income has nearly doubled over the past eight years in an environment where net income growth for shopping centres had declined. However, would a high proportion of leisure space in shopping centres necessarily translate to higher rental growth?

Shopping centre rental growth

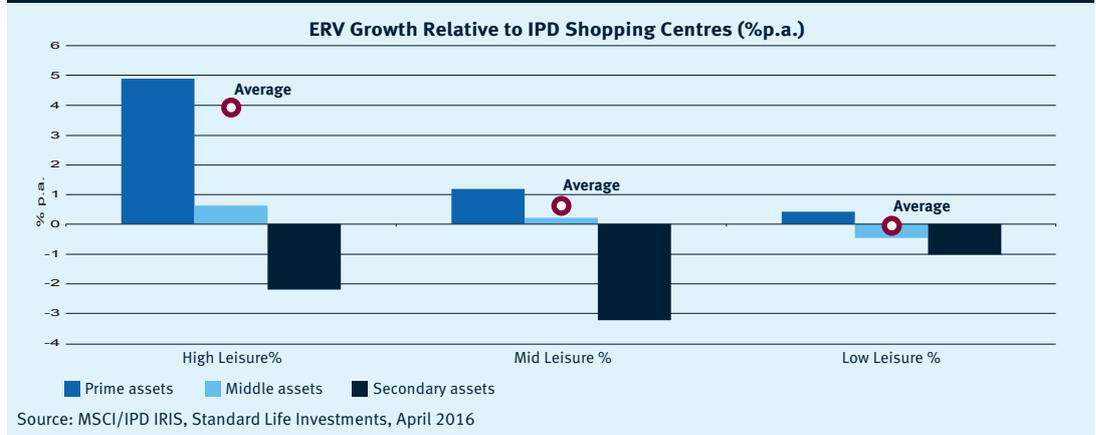
We are yet to appreciate fully the impact on rental growth of increasing leisure operator space, as much of the analysis to date focuses on floor space data. For example, research commissioned by the British Council of Shopping Centres (BCSC)ⁱⁱⁱ in 2012 on Savills' managed portfolios showed that around 8% of units within shopping centres are allocated to leisure usage. This rises to 15% for larger destination centres. Overall, from a net total floor space of 16.7 million sq ft, 1.38 million sq ft (8.3%) was apportioned to leisure.

This research also analysed rental information based on a sample of 645 leases. It took the leased area and calculated the cost per sq ft for each occupier, and then compared retail occupiers with leisure operators within a particular shopping centre. The research found that in the majority of shopping centres, average rents for leisure operators were at parity or below the levels paid by retailers in similar-sized spaces.

Overall, a lack of transparent rental data for the leisure sector was a major obstacle for us. We therefore carried out further analysis on our database as detailed below.

- ▶ We filtered data within the MSCI/IPD Annual Digest for shopping centres held between 2008 and 2015.
- ▶ We classified shopping centres with more than 5% of income from leisure as high, 1-5% as medium, and less than 1% as low.
- ▶ We then further divided shopping centres into prime, medium and secondary using equivalent yields as thresholds to distinguish the quality of the asset within each group.

Chart 2: Shopping centre estimated rental value growth



The results (see Chart 2) demonstrated a clear link between an increased allocation to leisure and subsequent rental growth. However, there were pronounced differences among the three categories in terms of quality of assets. In particular, the prime assets of all groupings displayed constant outperformance. Arguably, the top-quality assets in the high leisure income category are dominated by large lot size shopping centres, which have likely attracted leisure operators over time. Prime shopping centres with a leisure component of over 5% by their open market rental value generated rental growth of nearly 5% per annum relative to the IPD Shopping Centres segment.

Furthermore, the difference in rental growth between each band is substantial, with medium-quality assets almost in line with rental growth from the IPD sample. On the other hand, secondary assets underperformed regardless of the amount of leisure offering. A very similar trend emerged among middle and low leisure income assets, although the rental value growth differences among the prime and secondary groups have narrowed, with rental growth for top-quality assets in those two categories less pronounced.

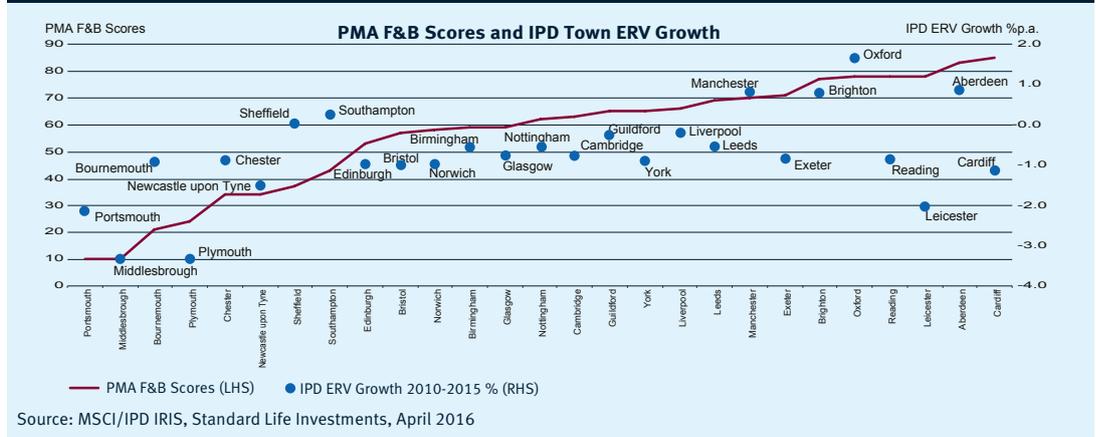
Overall, within the 130 assets in the MSCI/IPD sample, we can conclude that prime assets with higher leisure income generated the highest levels of rental growth. As a whole, high leisure income assets outperformed the market as well as their medium and low income equivalents. For less prime centres, increasing leisure provision did not fundamentally improve prospects for rental growth.

Town centre rental growth

Having examined the link between leisure and shopping centre rental growth, we then turned our attention to its impact on town centres. Geographically, the expansion in leisure has focused on London, although historic market towns are now experiencing an influx of aspirational brands. The BCSC research we highlighted previously, which showed the amount of space apportioned to leisure operators has risen dramatically, covered 450,000 retail occupiers across approximately 3,000 town centres or shopping destinations. It concluded that leisure certainly has a role to play in the reinvigoration/regeneration of urban centres, although it is not the answer in isolation. An increase in the leisure offering on the high street is likely to be a by-product of how attractive a place is to live and work, and the impact has been felt in large and small town centres.

For secondary locations, a small yet well-selected food and beverage (F&B) offering tailored to the type of shopping trip and visitor shows greater potential for success. A different shopper profile means that convenience and speed are far more important than a luxury product offering in those locations. To integrate with the evening/night as retail activity declines, there is significant anecdotal evidence that leisure has a role to play too. In this case, a cinema would act as an attraction to complement F&B trading. Nevertheless, sustaining footfall into the evening and keeping down the costs of later opening hours needs to be constantly balanced.

Chart 3: Café/restaurant scores and rental growth



We examined the F&B ranking for various towns and cities (see Chart 3), and generally found a positive relationship between a high F&B score and rental growth, with a few exceptions. Traditional high street retailing has faced many headwinds in recent years, with the majority of centres in our dataset experiencing static or declining rental growth since 2010. However, there are bright spots such as Oxford, Manchester, Brighton and Aberdeen, where higher F&B scores are associated with better rental growth.

On the other hand, some town centres, such as Cardiff, Reading and Leicester, continue to suffer from rental decline despite high F&B scores. In Cardiff's case, its F&B scores have significantly increased since 2010 following the opening of the extension to St David's shopping centre and the consequential improvement in the retail offer. However, high street retailing has become a competitor to the newly opened shopping centre and it has struggled to maintain any meaningful rental growth momentum.

At the other end of the spectrum, high streets with low F&B scores, such as Middlesbrough, Plymouth and Portsmouth, have suffered substantial rental declines. However, most centres with average F&B scores also demonstrated very modest positive or negative changes to rental growth. While the F&B score alone cannot explain the nature of each centre's retail profile, the results suggest that a good leisure offering does contribute to the overall attractiveness of either a shopping destination or a town centre. In turn, this contributes towards rental value growth.

Conclusion

The expansion of leisure within a retailing environment has been a great thrust in shopping centre development and town centre regeneration. It brings more footfall to shopping destinations, prolongs dwell times and increases spending. In turn, it then improves rental income, which both landlords and investors desire in a competitive marketplace. Despite recent peaks and troughs, spending on leisure services has increased. This spending should grow further as the popularity of dining out grows and the desire for a shopping experience becomes increasingly prevalent.

In our research, we investigated the significance of leisure on the income of shopping centres. We found income generated by leisure operators has risen, almost doubling their contribution to overall shopping centre income in the past eight years. Importantly, this occurred at a time when net income growth for overall shopping centres has declined.

We further categorised shopping centres into high, medium and low leisure provision and found pronounced results. There was a distinguishable difference in rental growth among each category, with the high leisure income shopping centres demonstrating substantial rental growth as opposed to a decline in low leisure income equivalents. Within the same category, diversity remained considerable as the rental growth profiles of less prime assets were in negative territory. We acknowledge that there will be other factors at play, including the dominance of large-size shopping centres.

Finally, we selected major town centres and linked rental value growth with F&B scores. The results suggested that there is a positive relationship between the F&B scores and rental growth in most town centres, with a few exceptions.

In summary, the leisure component of a scheme is essential to creating a retail destination. Using a sizeable data sample, we identified that the proportion of leisure has an impact on the rental growth of a shopping centre. A well-balanced leisure exposure generally makes a positive contribution to rental value growth for a retail destination, as leisure offers an enhanced experience. We also established the benefit of a leisure offering in terms of the income stream. The shape, style and experience of the leisure offering rests on 'knowing your customers' by making use of social media and shopper interaction.

i) JP Morgan: Property Dining out on European Retail, 2014

ii) CBRE Food and Beverage in a Shopping Centre: http://www.cbre.be/be_en/news_events/news_detail?p_id=18402

iii) BCSC Food and Beverage: a solution for shopping centres?

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