Which locations offer the best potential returns for UK retail investors?

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Abstract

This paper discusses the Cushman & Wakefield TopTowns model and summarises how, using a variety of inputs, the model attempts to gauge the real estate investment potential of 300 top retail locations in the UK. The model has been developed following a period of strong outperformance by property returns relative to other asset classes — and competition for the investment medium is increasingly evident, requiring a higher level of sophistication in the investment decision-making process to identify long-term targets.

The firm identified a need to determine how to predict investment potential at a local level within the UK, in order to deliver the best returns for clients. Drawing on in-house Researchers, retail leasing agents and investment agents, the firm was able to produce a model that would help in the investment decision-making process to identify long-term targets at a town level. The model is only one of the tools that should be used in stock selection, but it provides a rigorous corporate framework to improve the effectiveness of tactical and strategic selection.

Keywords:

retail investment analysis, town ranking model, past and future performance

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Figure 1: Total returns across asset classes on a per annum compound basis to December 2004

Source: IPD, Cushman & Wakefield

MODELLING INVESTMENT POTENTIAL

The property market has outperformed other asset classes over the last three, five and ten years, and as such is attracting interest from investors both inside and outside the UK, to some degree irrespective of the economic environment.

Whilst performance patterns have shifted somewhat in the last twelve months, 2004 in particular was an extremely good year for property, and saw total returns reaching an 11-year high of 18.3 per cent, compared to 6.6 per cent and 12.8 per cent for Gilts and equities respectively (Figure 1). Within the property sector, retail was the star-performer with a total return of approximately 20.5 per cent. The average return for retail over the past five or ten years, whilst somewhat less vigorous, has outperformed both property as a whole as well as other investment markets, a factor which has continued to attract investors into the market.

While it is clear that property holds appeal to both new and existing investors, there is little analysis that will help to pinpoint opportunities at, for example, town level, with most analysis focusing on returns either by sector or by region.

Against this backdrop, Cushman & Wakefield has developed a model designed to look at retail property on a town-by-town basis, in order to gauge those locations that will support the highest rents in the medium-term, say a ten-year horizon. The aim of the model is to consider the long-term structural potential of each market on a relative and risk-adjusted basis. Interpreting this in terms of current areas of opportunity will require a more detailed analysis of supply and current market pricing.

STATISTICAL ANALYSIS

Based on its experience of analysing retail investments and retailer requirements, the firm identified a number of variables which appeared to be responsible for determining future performance. These variables included the local economy, socio-demographic data, the local environment and property data (Figure 2).

A fundamental part of the process was the identification of those factors which impact on the local retail property market and thus act either to support or to diminish returns in the long run. Common sense suggests that certain variables, such as those specific to the macro

Figure 2: Integrated variables

Economic	Socio-demographic	Property	Environment
Current unemployment	Catchment population	Rental growth volatility	In-town accessibility
Historic unemployment	Catchment population growth	Recent rental growth	Out-of-town accessibility
Expenditure per person	Persons per multiple retailer	Current supply	Location rating
Current employment		Potential supply	Improving/static/declining
Regional employment forecast		Quality of stock	
Regional economic growth forecast		Investor demand	
		Retailer demand	
		Yield pricing	

economy or that are property related, eg historical rental growth, will have an impact on the market.

A wide range of variables from the four different categories were examined and their correlations with the locations' rental levels were revealed. A mix of both quantitative and qualitative data was used in order to combine both statistical data and specialised market knowledge to create meaningful, decision-enhancing results. As a result, a total of 21 variables were deemed to be most correlated with the retail market, as shown in Figure 2. Figure 3 shows the factors that were identified as having the highest correlations and therefore the greatest impact on potential performance. If the *t*-statistic is higher than 2, the variable is statistically proven to have an impact on the rental level.

Overall, the factors identified were considered to give a good range of both qualitative and quantitative variables spanning a variety of areas, which would then provide a realistic model that would be reflective of the retail-investment market.

KEY CRITERIA — IN MORE DEPTH...

Whilst the majority of the factors that have been utilised within the model are self-explanatory, some of the key property criteria may require further clarification. These variables also tend to show a higher correlation with the rental level, suggesting that they are of relatively higher importance to the overall model.

- Current supply: Rates the current supply of prime retail units in the central area of the given location. This factor is designed to determine whether the town is over- or under-supplied at the present time.
- Potential supply: Looks at the potential for further supply of prime units in the central area of the location. It is also important to examine whether the location is able to support an increased supply of retail units in the medium term.
- Improving/static/declining: This factor examines the perception of the town within the UK's retailing hierarchy. Local initiatives, for example increased funding from the government or regeneration of

Figure 3: Rental level correlations: Top five

Variable	Correlation (%)	t-statistic
Location rating	81	23.29
Quality of stock	79	22.00
Investor demand	74	18.67
Yield pricing	68	17.22
Persons per multiple retailer	61	16.01

certain areas, that are designed to improve the perceptions of the location are also taken into account within the rating.

- Yield pricing: Examines the current yield level and looks at whether yields in the location are either at their correct level or are mispriced given current conditions. The factor takes into account whether there is scope for further hardening or softening of the yield level in the short term.
- Investor demand: Looks at the current level of interest within the location from investors.
- Retailer demand: Examines the current level of interest within the location for prime units/space from retailers.

THE CREATION OF THE MODEL

Once the relevant factors had been discovered, the modelling process could begin. The first step was to weight each factor in terms of the expected impact on the investment potential of a location. The weighting reflects an amalgamation of the correlations that resulted from the testing process and general theory according to market knowledge. Once finalised, the weighting bands were as set out in Figure 4.

The majority of the variables, as would be expected, have been included in the middle category and cover each of the four areas shown. Several of these, however, are economy-specific variables, reflecting the significant impact that economic drivers have on the rental level in general. Perhaps surprisingly, both unemployment variables were discovered to be rather less significant than the other factors, therefore justifying only low weightings in the overall model. This, however, is true

Figure 4: Model weightings

Low	Medium	High
Current unemployment	Regional economic growth forecast	Catchment population
Historic unemployment	Catchment population growth	Persons per multiple retailer
	Current employment	Yield pricing
	Regional employment forecast	Location rating
	Expenditure per person	Quality of stock
	In-town accessibility score	Investor demand
	In-Town accessibility score	Retailer demand
	Rental growth volatility	
	Recent rental growth	
	Improving/static/declining	
	Current supply	
	Potential supply	

of rental forecasting models in general, with employment levels, rather than unemployment itself, acting to drive rental growth across the sectors.

Once the variables had been weighted, the foundation of the model had to be laid. The underlying basis of the model, was, however, relatively straightforward.

In order to bring some form of consistency to the data, a standardisation technique was used. This involved turning the data into a value akin to a z-score (which normalises data by measuring its distance from the mean in standard deviations) and then into a percentage. These figures were then weighted as shown and subsequently aggregated in order to produce a final score for each of the locations from which the final ranking was created.

MODEL OUTPUT

The modelling process was applied to a total of 300 retail locations in the UK, comprising of 287 towns and a further 13 prominent malls. It was therefore considered prudent to maintain two lists, with one that would focus on towns and another on the malls. As well as highlighting the overall rankings, the output also focuses on where each location falls in terms of each factor area, showing, for example, the location's percentage of the best attainable score for economics.

The second part of the output focuses on the individual locations themselves in significantly more depth. Initially, the location is examined on a factor-by-factor basis in order to enable an investor to decide whether or not the site meets the required parameters. The location itself is also placed into both a regional and national context, showing how each factor performs relative to these areas, before picking out the location's best and worst features.

The final part of the analysis allows for a comparison with the location's local competition and then examines historical rental growth and yield movements at a local, regional and national level. Figure 5a and b shows an example of the output page for Lincoln, ranked 82nd in the analysis.

UPTOWN TOP RANKING...

The obvious question, of course, is what did the final analysis suggest — where are the best places to invest over the next ten years based on the current climate? Figure 6 shows the top thirty towns in terms of retail-investment potential in Great Britain, according to the TopTowns model.

Most of the top 30, and the top 15 in particular, are not really surprising choices, with large and historically important retailer towns remaining high in the list, suggesting continued long-term potential. Oxford Street, as one of the major shopping streets in London, also makes an anticipated appearance, although its position at only number seven in the list underlines the need for investment in the local area.

Reading, ranked first out of all 300 locations, scored exceptionally highly in the majority of categories: it is expected to see healthy economic growth combined with a flourishing labour market, while being

TopTowns Model: Oct-2005

Lincoln 58th

The following is an assessment of the relative strength and standing of the above as a retail investment centre in the UK in the long-term. The information is derived from Cushman & Wakefield Healey & Baker's TopTowns Model, which compares retail locations based on a wide range of economic, socio-demographic and property data. The model weights all of the variables under consideration to arrive at a ranking of UK centres for investment potential.

The analysis below is based on 2004 data. It shows the data used for each variable and the percentage score awarded, along with the relationships to regional and national average figures for the centres in the database. The scoring reflects the relative spread of values recorded for the 300 centres analysed in the database, placing each centre in context with the sample for each data item. The data is derived from a wide range of sources and is supplied on a confidential basis. Data is sourced from Cushman & Wakefield Healey & Baker, CACI, Experian Business Strategies, GOAD and the ONS.

Further information can be obtained from the European Research Group of Cushman & Wakefield Healey & Baker.

Long Term Assessment

Lincoln is currently ranked in the top 30% of retail investment locations by the Cushman & Wakefield Healey & Baker TopTowns Model. As such, it may see above average investment returns over the long term.

Short/Medium Term Assessment

The current assessment of Lincoln is based on 29 years of data. Retail prospects are currently expected to be average in the short/medium term, whilst investment prospects are expected to be very good.

Assessment Factors		Lincoln		East Midlands		Great Britain
	Factor Weightings	Data Input	Score	Average Data Input	Average Score	Average Data Input
Regional Economic Growth Forecast	Medium	1.62%	37.1%	2.22%	46%	2.47%
Catchment Population Size	High	118,678	49.5%	126,952	46%	133,889
Catchment Growth (5 year)	Medium	8.76%	63.7%	6.07%	55%	4.58%
Current Unemployment	Low	1.90%	58.1%	1.91%	31%	2.29%
Number Employed	Medium	148,381	38.3%	199,399	100%	419,532
Regional Employment Forecast	Medium	0.05%	43.2%	0.35%	60%	0.50%
Historic Unemployment	Low	2.00%	57.4%	2.01%	36%	2.42%
Comparison Gds per Person	Medium	5,591.7	39.5%	5,589.4	83%	6,128.9
Persons per Multiple Retailer (Goat)	High	479	48.3%	623	45%	669
In-Town Accessibility Score	Medium	5 out of 10	26.8%	7 out of 10	40%	7 out of 10
Out of Town Accessibility Score	Medium	5 out of 10	33.7%	7 out of 10	34%	6 out of 10
Rental Growth Volatility	Medium	7.79%	49.1%	6.02%	46%	7.11%
Recent Rental Growth	Medium	4.62%	45.3%	2.93%	27%	3.74%
Yield Pricing	High	7 out of 10	78.3%	6 out of 10	51%	6 out of 10
Location Rating	High	7 out of 10	70.2%	5 out of 10	45%	5 out of 10
Quality of Stock	High	6 out of 10	59.2%	5 out of 10	45%	5 out of 10
Investor Demand Rating	High	8 out of 10	77.8%	5 out of 10	44%	5 out of 10
Improving/Static/Declining	Medium	4 out of 5	61.1%	3 out of 5	52%	3 out of 5
Current Supply	Medium	1 out of 5	81.0%	2 out of 5	54%	3 out of 5
Retailer Demand Rating	High	9 out of 10	85.1%	6 out of 10	50%	6 out of 10
Potential Supply	Medium	5 out of 5	0.0%	3 out of 5	41%	3 out of 5
Comparative Ranking		58th	55.8%	175th	48%	150

Best Features

Retailer Demand • Current Retail Supply • Catchment Growth Prospects • Yield Pricing • Investor Demand

Above Average Features

Structural Change to Centre • Location Rating • Recent Rental Growth • Catchment Population Size • Quality of Stock • Historic Unemployment • Current Unemployment

Average Features

Below Average Features

Persons per Multiple Retailer • Rental Growth Volatility • Local Labourforce • Expenditure per Capita

Poor Features

Regional Employment Growth • Out of Town Accessibility • Regional Economic Growth • In-Town Accessibility • Potential Retail Supply

Competing Centres	Current Rent	Current Yield	Ranking	Distance	Attraction / Multiples	Shoppers per Multiple
Lincoln	£165.00	4.75%	58th	n/a	401 / 268	479
Nottingham	£250.00	4.50%	12th	38 miles	1,026 / 585	1,210
Sheffield	£200.00	5.25%	80th	47 miles	609 / 431	1,618
Peterborough	£210.00	5.00%	57th	51 miles	501 / 263	721
Doncaster	£130.00	5.25%	145th	42 miles	457 / 255	601
Scunthorpe	£70.00	5.50%	281st	30 miles	253 / 157	426
Grantham	£60.00	5.75%	239th	33 miles	200 / 128	447
Grimsby	£120.00	5.50%	232nd	39 miles	397 / 267	872
Newark	---	---	n/a	19 miles	---	---
Meadowhall	£420.00	5.00%	5th	43 miles	612 / 258	2,286
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Figure 5a: Top Towns model summary page: Please note that the analysis was undertaken prior to the rebranding of C&W/H&B to Cashman & Wakefield

TopTowns Model: Oct-2005

Figure 5b: (continued)

Figure 6: Top 30 locations — Towns-only ranking

Rank	Location	Region
1	Reading	South East South
2	Kingston upon Thames	Suburban London
3	Guildford	South East South
4	Cardiff	Wales
5	Brighton	South East South
6	Cambridge	East Anglia
7	Oxford Street W1	London West End
8	Glasgow	Scotland
9	Manchester	North West
10	Birmingham	West Midlands
11	Newcastle upon Tyne	North
12	Nottingham	East Midlands
13	Leeds	Yorkshire & Humberside
14	Leicester	East Midlands
15	Covent Garden WC2	London West End
16	Norwich	East Anglia
17	Cheltenham	South West
18	Brompton Road SW3	London West End
19	Belfast	Northern Ireland
20	Milton Keynes	South East North
21	Chelmsford	South East North
22	Bath	South West
23	Oxford	South East North
24	Bristol	South West
25	Newbury	South East South
26	Richmond	Suburban London
27	Southampton	South East South
28	Kings Road SW3	London West End
29	Chester	North West
30	Bournemouth	South West

Figure 7: Individual factor scores for Reading in a regional setting (Great Britain = 50 per cent)

able to attract a large catchment population as a result of its now highly developed retail property market, as shown in Figure 7.

Graphically, it is easy to see why Reading has achieved the top ranking. The town has scored extremely well in the investment-based factors that were weighted most highly, such as the location rating, yield pricing and the general perception of the town ('improving/static/declining'), while also scoring above the Great British average in all but one of the other areas. One of the major factors that will boost potential in the medium term is that there is in fact little perception of oversupply.

This will therefore act to encourage both investors and occupiers into the market.

When the current and expected perceptions of the town's retail market across all factor areas are taken in account, therefore, this combines to suggest that there is still significant medium- and long-term potential for both occupiers and investors within the Reading market.

REGIONAL DISPARITIES

When the list is examined at a regional level, it is clear to see that, again, as would be anticipated, the most favoured region will continue to be the South East/London area (Figure 8). This is logical given the region's nature as the commercial hub of the country, with ever-increasing numbers of people looking to locate in the area, for both work and leisure, suggesting the necessity and availability of a much more developed market. But while 14 of the top 30 towns belong to this area, there is still a relatively good level of diversification amongst regions, with contenders from Wales to Yorkshire and Humberside and Scotland also gaining high positions in the ranking.

When the average scores for the region across all locations are examined, this trend of southern dominance in terms of investment potential holds true. The majority of sub-regions that achieve above-average scores are from the south, with the West End clearly expected to have the potential to achieve returns in advance of any other region over the next ten years, averaging a score of 59.4 per cent, compared to the GB average of 50.0 per cent.

When the traditional areas of London, the West End and the City, are compared, there is a clear disparity between the two. The West End, which is possibly the most popular retail location in the country, is clearly expected to outperform the City, the capital's office heartland, by a significant margin in terms of retail potential over the medium term. Clearly, however, local issues of sub-market supply and current market pricing will determine to what extent actual performance matches potential.

Figure 8: Average score by region (Great Britain = 50 per cent) Source: Cushman & Wakefield European Research Group

The north-south divide that exists in the top 30 locations is maintained throughout the list. This is explained by both weaker property fundamentals and a relatively lacklustre labour market that continues to suffer from a skills mismatch.

THE IMPACT OF CENTRE FORMAT

A clear trend also results when the top 30 locations are examined by type of centre. Those locations which are deemed to show the most investment potential are largely defined as 'primary centres', a definition which encompasses the largest retail centres such as major cities that have a significant impact at a national and regional level. In fact, 15 of the top 30 belong to this grouping, suggesting that this format is becoming preferred, by both retailers and investors alike, over smaller, mid-market-focused shopping formats. The remaining 15 locations also belong to the larger-style groupings, such as major centres (large towns or 'secondary' regional cities that possess sizeable retail markets), and this trend is reflected throughout the complete list in general.

When the total list of locations is examined in terms of the type of format of the retail market, there is a clear movement away from the small, localised, town-centre format for comparison stopping, with the more dominant sub-regional cities instead likely to outperform. Out-of-town regional malls are expected to see the most potential in the long term, as shown in Figure 9, albeit, of course, that this is already reflected in their investment pricing. This is a largely anticipated result given the increasing importance of regional malls, such as Bluewater and Lakeside, as preferred shopping destinations. These regional malls have a tendency to score well owing to strong underlying property fundamentals, such as accessibility and quality of stock, as well as their notably higher catchment populations and number of shoppers in general. Furthermore, planning restrictions placed on some major town centres ultimately enhance the attractiveness of the existing out-of-town destinations.

Those towns without identity or those that are less independently economically viable, for example as a tourist destination, will tend to lag in terms of investment potential. While some of these other rural and

Figure 9: Average score by centre type (All centres = 50 per cent) Source: CACI, Cushman & Wakefield European Research Group

typically smaller local centres have a propensity to record healthy economic activity combined with a reasonable demographic profile over the next ten years, they are hindered by both limited structural potential within the property market and the relatively poor shopping environment.

Instead, the much larger, centralised primary centres will continue to expect to record higher growth and demand. The ability of larger centres to attract a significantly greater catchment population, for example, will continue to enable such centres to excel.

It is clear that, when considered by centre type, the economic outlook, while important, is of less importance than other features. Instead, a combination of strong property fundamentals, a healthy demographic profile and a positive environment tends to give the best profile in terms of long-run investment potential.

ONE YEAR ON — THE MODEL REVISITED

An update to the model was completed in autumn 2005, giving an ideal opportunity to see how locations in the list had changed over time, alongside changing perceptions of the market. Figure 10 shows the new ordering for the top 30.

By and large, the top locations have remained the same, with only five new entrants to the list, all of which are in the second part of the list. Reading has remained top, with its underlying fundamentals still in advance of all other towns. Indeed the property-related variables in the

Figure 10: Top 30 locations — Towns-only ranking — 2005 update

Rank	Location	Region
1	Reading	South East South
2	Guildford	South East South
3	Cambridge	East Anglia
4	Newcastle-upon-Tyne	North
5	Kingston-upon-Thames	Suburban London
6	Manchester	North West
7	Brighton	South East South
8	Nottingham	East Midlands
9	Glasgow	Scotland
10	Oxford Street W1	London West End
11	Leeds	Yorkshire & Humberside
12	Cardiff	Wales
13	Milton Keynes	South East North
14	Leicester	East Midlands
15	Birmingham	West Midlands
16	Covent Garden WC2	London West End
17	Southampton	South East South
18	Chester	North West
19	Belfast	Northern Ireland
20	Brompton Road SW3	London West End
21	Richmond	Suburban London
22	Kings Road SW3	London West End
23	York	Yorkshire & Humberside
24	Canterbury	South East South
25	Tunbridge Wells	South East South
26	Chelmsford	South East North
27	Croydon	Suburban London
28	Oxford	South East North
29	Marylebone High Street	London West End
30	Bath	South West

town have shown a relative improvement over the year compared to the other locations in the list.

There has, however, been notable movement within this top grouping itself due to the movements of locations such as Oxford Street, which has been surpassed by other locations in terms of its relative standing in the views of the retail and investment markets. This has, to some extent, been due to the terrorist bombings of July 2005 and the impact of these on tourism in particular; but other issues, such as congestion charging and the Street's competitive offer versus newer schemes and other London thoroughfares, are also acting to affect the attractiveness of the location.

The most improved town now in the top 30 is Tunbridge Wells, which has risen from last year's position of 60 to reach number 25. While there has been some improvement in terms of the perceptions of the local property market, much of this progress has been the result of more positive expectations for the economy. Ten-year GDP and employment growth forecasts in particular, saved from experience, have been upgraded significantly, which has had the knock-on effect of improving local consumer spending expectations. Consequently, the retail outlook for the town has become much more optimistic.

Outside of the top 30, there has also been significant change within the list as a whole. The most notable shift, although somewhat expected, has been the movement of Stratford in London from number 243 to a much-improved 114. This, of course, is predominantly due to the awarding of the 2012 Olympics to London, which is expected to accelerate the redevelopment of the East London area in general, and Stratford, the planned location for the Olympic Park, in particular. As a result, expectations of improved transport links, increased employment and increased economic growth have lifted the perceptions of the town from all perspectives and, most notably, in terms of the local property market.

CONCLUSION

In summary, the model suggests that outperformance will be achieved by those towns which are known to be major retail locations, having a solid demographic base, healthy economies and already-strong property fundamentals, both from a retail and an investment perspective, including Reading, Kingston-upon-Thames and Guildford.

At a regional level, locations with the most potential tended to be located in the south of the country and, in particular, in London. Northern regions were expected to lag, especially in terms of economic and property-related factors.

At centre-type level, there was also an obvious trend of a movement away from smaller, more localised locations to regional urban centres. The most potential over the next ten years will result from the regional mall format, a logical prospect given their recent expansion and robust rental growth rates.

According to the model, therefore, those locations which are likely to boast the greatest returns over the next ten years or so tend to be focused on specific areas and centre types, with the south in general, and London in particular, continuing to present greater investment opportunities on a

regional basis, while larger regional centres, including out-of-town shopping malls, will yield healthier returns by centre type.

The model also, however, helps to demonstrate what factors smaller centres must address if they are to win a healthier position in the retail hierarchy and highlights some markets with clear potential to do this. Indeed, when compared with an analysis of current market pricing, it is often mid-sized centres rather than well-supported local markets which are at most risk of future underperformance.

The model raises some interesting results, but the conclusions that can be drawn should not be restrictive. This forms a starting point in identifying new targets in the UK retail market, but the importance of careful stock selection remains paramount in making the best investment decision, especially in the current buoyant property market. Good value is increasingly difficult to find, and with the emphasis now turning to longer-term investment gains, as short-term uncertainties are on the up, models such as C&W TopTowns enable longer term fundamentals that drive investment performance to be identified and serve as a tool to assist in making careful investment decisions.