Regional trends

The Central London retail property market: A fresh perspective

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Abstract

This paper seeks to determine the current state of the Central London retail property market. The challenges of poor primary data are overcome through the employment of real, market-tested insights into the three key areas of market performance: supply (availability of new units), demand (from retailers) and performance (achieved rental levels).

Central London is a large, diverse retail centre. As a consequence, and to test the belief that it is indeed a heterogeneous entity, nine distinct sub-markets were demarcated.

The main conclusion of this paper is that the Central London retail market is in a healthy, robust state. The research confirms that retailers are continuing to seek out new stores, while at the same time incumbent retailers are reluctant to give up existing space. This is a solid indication as to the capital's vitality.

Intrinsic to any retail assessment of Central London is an evaluation of the capital's current provision. In this regard, the retail attraction of Central London was assessed relative to two leading regional retail centres in the UK — Birmingham and Manchester — and two leading regional shopping centres — Bluewater and the Trafford Centre. This paper confirms that Central London has a diametrically superior offer to any of its UK rivals in terms of the depth, breadth and all-round quality of its retail provision.

Keywords:

London, West End, retail, retail attraction, retailer demand, shop availability, rents, property ownership

INTRODUCTION

London has a multitude of retail locations serving local, national and international functions, as befits a true 'global' city. There is a

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huge range in the quality and scale of shopping destinations within London. This retail provision caters to a large, disparate catchment consisting of three core constituents — residents, workers and tourists.

The primary objective of this research has been to determine the current state of the Central London retail market — whether it is in dire straits and suffering, as has been suggested by many commentators in the media, or whether it is actually in a robust state of health. A secondary objective was to verify the belief that the Central London market is not a single homogeneous entity and that in reality its various parts are subject to a host of unique drivers.

London has a total resident population of some 7.4 million people, ranking it the 15th largest city in the world and the largest in the European Union. Contrary to trends in other parts of the UK, the capital experienced significant population growth from the late 1980s onwards. Indeed, it is estimated that London's population has grown by around 600,000 people since 1989 (a total comparable to the population of the city of Sheffield). Moreover, it is predicted that London's population will rise by a further 800,000 between 2001 and 2016. Inward migration from overseas drives the overall population growth.

The number of people employed in London is 4.45 million, representing 15 per cent of the UK total and 700,000 higher than in the early 1990s. Forecasts suggest a further 200,000 jobs will be created in London by 2008, with employment growth averaging 1.4 per cent a year over the next three years.

In contrast to the increasing relevance of the other two elements of the London catchment, visitor numbers to London peaked in 1999/2000 at around 30 million people, and have broadly fallen slowly since that time at a constant rate. Around 27 million domestic and overseas visitors came to London in 2004, generating some £9.4bn for the local economy. Half of all overseas visitors spend time in London, with three out of four at least passing through the capital.

This paper focuses on Central London — an area that is broadly consistent with that covered by Zone 1 of the London Underground. To establish its heterogeneity nine distinct sub-markets were demarcated for detailed analysis — Bond Street, Covent Garden, Kensington High Street, King's Road, Knightsbridge, Oxford Street (east), Oxford Street (west), Regent Street and Victoria. The definition of London's West End covers Oxford Street (east and west), Bond Street, Regent Street and Covent Garden.

The nine sub-markets are shown in Table 1, together with an estimate of total retail floorspace within each area and a summary assessment of the average market positioning of retailers within its boundary. This latter appraisal is based on a scoring system ranging from 1 (lower market) through to 5 (upper market). It is a qualitative assessment used to define the market position of a

Table I: Retail provision for the nine Central London sub-markets

Central London sub-market	Total retail floorspace ('000 sq ft)	Average market positioning (maximum 5)
Bond Street	636	4.4
Covent Garden	769	3.4
Kensington High Street	739	3.3
King's Road	788	3.7
Knightsbridge	1,704	4.5
Oxford Street (east)	1,061	3.0
Oxford Street (west)	3,307	3.7
Regent Street	1,127	3.7
Victoria	534	3.4

retailer based upon both the quality and price positioning of the goods it sells and the status of the retailer itself. This headline analysis confirms the diverse nature of the nine sub-markets in terms of both their size and their retail market focus.

RESEARCH METHODOLOGY

The approach to this research has been based on a philosophy of utilising original, quality primary data wherever possible. The UK retail property market has many imperfections that render a purely academic research pursuit impossible. Of central relevance to this imperfect state is the paucity of any real reliability in terms of data regarding the fundamental market drivers of supply and demand. There is also a distinct lack of sophistication in the market assessment of the attractiveness (and strength) of retail centres in the first place.

In the retail market the key pricing issue for any landlord is of course the desirability of a given location — ie how strong a retail centre is. An important secondary consideration is the availability of alternative accommodation for any aspiring tenant. Quantifying the level of retailer interest (or retailer demand) is absolutely crucial in objectively assessing the health of any single retail property market. Finally, a simple proxy for the health of any given retail location is its rental performance. This market variable was therefore selected for final scrutiny.

Determining the level of availability of shop units is a good deal more complicated than simply counting the number of 'vacant' stores in a retail audit area. In many instances a unit seemingly 'unoccupied' has in fact already been let to a retailer which, for whatever reason, has yet to take up accommodation. In contrast, a unit seemingly occupied with an operator in residence is sometimes in fact being actively marketed around the retail property industry and is actually 'available' for almost immediate occupation.

A final element in the equation is the necessary consideration of those units being traded by a retailer that 'could be bought' and acquired with relative ease given that the retailer is none too

enamoured by the unit's performance. This latter category is the most difficult to determine accurately given the obvious reluctance of a retailer to admit to poor trading performance.

Retailer demand is also difficult to determine accurately. A 'call centre' approach is the norm in the UK retail property market, whereby an independent data-supply firm contacts retailers and their agents on a periodic basis simply to enquire as to the subject retailer's expansion programme.

This approach is fundamentally flawed, in that the UK retail property market works on the basis of exclusivity of knowledge. The nuances of a retailer's expansion programme are typically highly confidential. It is therefore most unlikely that an unsolicited approach from an unconnected data provider will yield a meaningful response. Rather more likely is one of two responses — a crude affirmation that the subject retailer simply wants to trade in every possible location currently bereft of its presence (ignoring all commercial logic in that it would be impossible to expedite such a desire in a single financial year), or secondly the more likely impartation of a bare minimum response (or complete lack thereof).

Instead this research project has required active agency teams to map actual, identifiable sources of retailer interest in a theoretically available unit in a given location. In addition, these aspiring tenants had to be of good covenant strength and ready and willing to submit a competitive offer.

Finally, the output of interest here — retail rental levels — is also clouded with complexity in Central London. Many landlords are especially driven here by a desire to maintain confidentiality, whether they be private investors, UK institutions or City livery companies.

Many tenants treat London uniquely on the basis that a shop is often a major flagship store founded on a sometimes intangible desire to secure a presence. This often leads to retailers being especially unwilling to disclose the amount paid for a given unit.

Finally, the valuing approach for retail space varies across Central London. Most sub-markets are assessed with a premium placed on the first 30ft zone upon entering from the street. Three sub-markets (Covent Garden, King's Road and Knightsbridge), however, are assessed primarily only on the first 20ft zone. This 'zoning' phenomenon renders direct comparison impossible in the absence of an appropriate conversion factor.

The challenges of deriving quality primary data to cover availability, retailer demand and rental performance are not inconsiderable. Fortunately the retail agency teams working on this project have a significant market share in Central London and excellent contacts, which enable the accurate measurement of availability, demand and rental levels. In addition, a customised, relatively sophisticated assessment of retail strength was employed to measure Central London's retail 'attractiveness'.

ESTABLISHING THE RETAIL ATTRACTION OF CENTRAL LONDON

The assessment of retail attraction is based on a scoring system that takes account of:

- the quantity of available retail floorspace
- the quality and market draw of incumbent retailers
- the breadth of market positioning among constituent retailers
- the external aesthetics of each individual retail store
- the internal functionality of each individual retail store
- the sense of ‘retail theatre’ offered by each individual retailer.

Central London was compared with two leading regional retail cities in the UK, Birmingham and Manchester, and two leading regional shopping centres in the UK, Bluewater and the Trafford Centre (Table 2).

Determining the supply/demand balance of Central London’s retail property market

The assessment of this crucial supply/demand balance is based on:

- supply: the number of available units covering all three categories of genuinely unoccupied, openly marketed and ‘could be bought’
- demand: the real market assessment of retailer demand levels based on identifiable levels of interest from quality operators willing and able to make competitive offers for the subject unit.

Determining rental performance in each of Central London’s retail property sub-markets

The assessment of this crucial output is based on achieved rental levels — rents actually, and verifiably, paid in the open market, taking into account all relevant incentives offered to the retailer by the landlord. Note that the decision was taken to denote ‘achieved’ rental levels as opposed to ‘achievable’ rental levels. This latter information has been documented, however, and can be requested from the author.

Table 2: Retail provision for Central London and its principal UK rivals

Location	Total floorspace (million sq ft)	Overall retail attraction score
Central London (nine sub-markets)	10.7	2,290
London’s West End	6.9	1,590
Birmingham	3.2	687
Manchester	3.2	647
Bluewater	1.6	419
Trafford Centre	1.4	306

RESEARCH FINDINGS

The retail attraction of Central London

London has missed out on the retail development boom of the last decade. Both the nominated regional shopping centres, Bluewater and the Trafford Centre, opened in this period while both Birmingham and Manchester witnessed substantial retail-led regeneration over the period. Upon initial inspection there is clearly a danger that London's USP could be eroded by these developments.

But the conclusion is that the capital has a diametrically better retail offer than each of these four centres. None of the aforementioned destinations comes close in terms of quality or breadth of retail offer.

The supply/demand balance of Central London's retail property market

In terms of availability, the market was broken down into a series of size bands, and then further into a grading of each location. For prime units in the most sought-after locations — those with rents within 20 per cent of the local peak — the level of availability was found to be very modest indeed. For most size bands there were barely more than ten units available (Figure 1). In particular, availability was scarce for larger units in prime locations. In aggregate, across Central London less than 2 per cent of prime units were available at the time of this survey.

Adding in secondary and tertiary units of course increases the total, but even so the overall figure is still less than 4 per cent of total floorspace. Moreover, pockets of availability were identified that account for a large proportion of these units. In some

Figure 1: Total number of available units against average prime demand for the nine Central London sub-markets

instances, for example, units are available only on short-term leases pending a landlord's proposal to redevelop the building in which the unit is situated.

In terms of retailer demand for prime units a score of 50 on the right-hand axis in Figure 1 represents the belief that, for a given unit, five willing and able retailers would submit competitive offers for that space. As can be seen in Figure 1, this strong level of retailer demand is quite consistent across all unit size categories.

It was decided to concentrate on prime retailer demand within this research. Quantifying actual demand for secondary and tertiary retail space is particularly problematic. In many instances, where prime demand exceeds prime availability, demand will 'spill over' into more affordable areas (if the whole market is deemed strong, attractive and robust). But in some instances retailers will not compromise on their desired prime location. Consequently, direct comparisons should only be made with prime availability levels, although broader inferences can still be gleaned on the whole market.

There are significant variances between different sub-markets. For example, Kensington High Street has suffered somewhat in recent years with 'overrenting'. This was caused by deals in 2001 to H&M Hennes and Gap for large units as part of a redevelopment of a former Bhs unit.

The rents achieved on Kensington High Street (circa £330psf in Zone A) have largely proved unsustainable and are perhaps above and beyond what might reasonably be expected for a centre with Kensington's retail status and positioning. In addition there are local issues at play in this sub-market, with House of Fraser recently deciding to close a department store here and the spectre of a new shopping centre being built at White City two miles away (opening in 2008). Kensington High Street is still a strong location with an estimated £445m worth of comparison goods expenditure available to its retailers, but top rental levels have outpaced the true retail standing of the market.

As a consequence of the above, availability of prime units is more substantial than the norm seen elsewhere across Central London and prime retailer demand is more muted, particularly for large units (Figure 2).

By comparison, the King's Road sub-market has steadily built up momentum over the last decade, earning for itself a sought-after reputation among a strong, local catchment. As a consequence, retailer demand is currently dramatically in excess of availability for all size categories — but especially larger ones, where demand for prime space is at acute levels and there is an absolute paucity of availability (Figure 3).

Indeed, even within a single sub-market, such as Bond Street, there is substantial variance depending on the micro-location of a pitch. At the northern end of New Bond Street there is a challenging market, with retailer casualties and a relatively plentiful

Figure 2: Total number of available units against prime demand for the Kensington High Street sub-market

Figure 3: Total number of available units against prime demand for the King's Road sub-market

supply of available units despite rental levels being in the order of only £200psf in Zone A. Further south along the mile-long street there is an acute paucity of availability, striking retailer demand and rents of £650psf in Zone A in the 'Jewellery Quarter'. The pitches in-between are witness to somewhat lesser levels of market dynamics, but still keen retailer demand.

Understanding the nuances of Central London is very much about understanding its sub-markets. Indeed, while at the outset of this project nine such individual areas were demarcated, in reality there are likely to be close to 90.

Rental levels

Rental levels within Central London are generally high, as Table 3 demonstrates. With the exception of Kensington High Street, all of the sub-markets' 'achieved' top rental zones are being challenged by current market sentiment. Indeed, in a number of locations (Bond

Table 3: Rental levels for Central London’s nine sub-markets

Standardised rank	Location	End 2005 Zone A rent per square foot
1	Bond Street	£650
2	Oxford Street (west)	£525
3	Regent Street	£435
4	Covent Garden	£560*
5	Oxford Street (east)	£400
6	Knightsbridge	£525*
7	Kensington High Street	£330
8	King’s Road	£360*
9	Victoria	£230

* Denotes locations with smaller rental zones

Figure 4: Prime rental history: Average prime Zone A rents (£psf) for the nine Central London sub-markets, against annual prime rental change

Street, Regent Street, Covent Garden and King’s Road) prime rental levels have moved on and improved in the last 12 months.

On average, prime rents have increased across Central London by 5 per cent over the last year (Figure 4). This figure is broadly consistent with 2004, although down on the double-digit growth recorded in 1996, 1997 and 2001.

CONCLUSION

It is generally accepted that the UK is entering a quite challenging environment for retailers, with operating margins under increasing pressure. Competition is fierce between retailers and also from the internet and supermarkets. Consumer spending patterns are threatened by concerns over personal debt ratios, the impact of stealth taxes, a possible correction in the housing market and rising unemployment. In this environment, retailers can ill afford costly property mistakes.

In addition, the capital faces a number of intrinsic challenges. Despite contributing a disproportionately high amount to UK public finances (in the order of £12.1bn each year), the city's basic physical fabric is often tired and the capital's public transport system has seen chronic underinvestment in recent times.

There are also significant challenges on the horizon for Central London in terms of major new sources of competition — White City and Stratford City will together consume nearly £2bn of retail expenditure when these new shopping centres open in 2008 and 2010, respectively. Further retail development is planned across Greater London.

Despite this multitude of reasons to be negative, the principal finding is that the majority of the Central London retail property markets are in excellent health, with retailer demand and rental growth momentum in fine harmony. In addition, supply is constrained by generally low levels of availability. There are exceptions, and areas such as Kensington High Street which have lost focus over recent years have suffered as a result.

This research suggests that retailers in Central London are actually very content with their current performance and future prospects. The detailed assessments of market availability and demand would detect any genuine retailer concerns, and this is not the case. Retailers are not fools and would not commit to expensive new space if they had serious concerns as to its viability. Similarly, retailers would not retain a store presence in an area if they had any real doubts over its ability to yield appropriate sales and profit contributions.

It is the author's belief that many commentators fundamentally misunderstand Central London. Good retailers, in the right accommodation, turn over astonishing volumes in the capital. The author's firm has access to information from a number of retailers, and their sales densities in Central London are typically way in excess of regional efforts. Occupational costs are of course higher, but, even allowing for this, profit contributions from Central London stores are typically very substantial.

Moreover, above and beyond profit contribution, retailers also yield a less tangible return from their Central London stores by virtue of these being flagship showcases for new goods and services. In addition, high sales volumes greatly assist cash flow and buying power.

This research also confirms that Central London has a vast amount to offer the consumer as a retail destination. The quality and scale of the retail offer is without parallel in the UK.

The key challenge is for such a large and varied entity to market itself successfully as a single destination and detail the range of offer that is actually available. For while this study has taken care to define a series of distinct sub-markets within Central London, the reality is that many consumers take advantage of the close proximity of several sub-markets to shop in during a single trip.

Figure 5: Proportion of retail property ownership for the nine Central London sub-markets (excludes Harrods, Selfridges, John Lewis and Marks & Spencer stores)

The recent creation of formal business improvement districts (BIDs) and Transport for London's £10bn investment over the next five years to improve and expand London's transport network are likely to pay real dividends. The creation of the New West End Company in particular as a formal BID is hugely significant above and beyond its most visible manifestations of street cleaners and security patrols. The long-term value of the BID lies in it acting as a focus for the single advancement of the West End of London. It will act as a conduit for 'joined-up thinking' and provide a necessary strategic backcloth for development plans.

A challenging setting nationally is intensified in Central London with its much higher occupational costs and corporate expectations. This is where many retailers often take a conservative stance and compromise on their ideal location or unit specification to meet a predefined budget. Additionally, many retailers incorrectly identify their metropolitan customer base or the dynamics of their chosen retail pitch. This can be a recipe for disaster.

There is so much choice in Central London that the consumer here is particularly demanding, and so any half-hearted effort will fail. Retailers must be on top of their game if they are to succeed in the capital. They must deliver on all aspects of their proposition, from merchandising through to staffing. Similarly, retailers must make maximum use of the space they are paying for to justify their high occupational costs. River Island and Mexx on Oxford Street (west) are two examples of retailers succeeding in this endeavour.

Central London has a largely untapped resource on its doorstep to counteract any possible fall in tourist numbers should recent

trends continue and/or be increased by any additional security fears. Some 1 million people are employed in close proximity to Central London. On average, these workers spend only a modest amount each year in the capital. These people can and should be tempted to spend more (at the expense of their poorer, largely suburban, centres of residence).

Finally, the unit-by-unit analysis of Central London also yielded interesting insights into property ownerships across the capital. These are the landlords currently facing the challenges and opportunities outlined in this paper. One can confirm the extent to which aggressive private investors have utilised the availability of low interest rates and succeeded in securing prime sections of retail property in London (Figure 5). Private buyers own 15 per cent of property within the defined sub-markets, with private Irish investors, in particular, owning half of this amount.

If one ignores the disproportionate effect of a handful of major department stores, UK institutions and property companies own nearly 70 per cent of all retail stock. It is interesting that, despite removing Harrods, Selfridges, John Lewis and Marks & Spencer from the equation, retailers still own over half a million square feet of retail space. This is surely food for thought for any hungry investors keen to take such weighty holdings off retailers' balance sheets.

This research makes it clear that both retailers and landlords can yield high returns in the capital if they are fully aware of the nuances of the local market and invest appropriately.