anderson wilde & harris

Property Guide

KEY COMPONENTS OF AN EXPERT SHOPPING CENTRE VALUATION

Shopping Centres are an important part of the UK's retail landscape. Unfortunately, strong headwinds have dampened what was once a high value asset class. Values have declined significantly over the last 10-20 years primarily as a result of the shift to online shopping, which has seen physical sales decline. More recent issues such as pandemic related struggles, staffing costs, record high inflation and economic uncertainty have exacerbated problems in the sector.

This has resulted in many UK and international retailers reducing the number of physical stores they have. As many prime Shopping Centre schemes in the UK have traditionally been anchored on department stores, many of which have been affected most strongly by the trend towards online shopping, some Shopping Centre Landlords have been left with large, vacant units and reduced foot footfall.

As a result of the above, opportunistic investors have entered the UK Shopping Centre market seeking discounted pricing, high income return as a percentage of purchase price, and medium to long term repurposing plays, whilst existing institutional investors remain at the prime and super-prime end of the market, albeit at reduced volumes.

One of the many areas of expertise our commercial valuation team have developed over the years are valuation of Shopping Centres and other retail outlets. In this article Robert Hughes MRICS presents us with just a few elements that a commercial valuation of this kind requires.

SHOPPING CENTRE CLASSIFICATIONS

It is important to determine the asset class within the sector as the yield gap can extend up to 850-900 basis points from the best assets to the least desirable. Our team determine there are four main categories of Shopping Centre, each with unique elements that affect valuation.

Category 1: Super-Prime Shopping Centres

Super-Prime Shopping Centres are the largest of shopping centres and are further distinguished by their location, falling into two distinct sub-categories.

Out of town regional shopping centres: These shopping centres are located on the outskirts of large urban areas. Primarily, this kind of shopping centre provides a retail offering consisting of fashion brands and comparison-goods. Examples of an out-of-town regional shopping centre are Bluewater in Kent, Lakeside in Essex and Meadowhall in South Yorkshire.

Dominant regional city centre schemes: This type of shopping centre, which sit within a city centre, tend to make up a significant proportion of the city centre's prime retail shopping. Very often the existence of a shopping centre this kind will have a strong influence on the prevailing rents in the rest of the city centre. Examples include The Bullring in Birmingham and West Quay in Southampton.

Super-Prime shopping centres will often have multiple Major Space Units (MSUs) and standard unit occupiers and may include other attractions, such as a cinema or other leisure activities. Yields for these centres are currently at 7.50% and with a weakened outlook.

Category 2: Prime Shopping Centres

There are two sub-categories within Prime shopping centres; non-dominant schemes within a major regional centres or dominant scheme if it is in larger subregional centres.

This type of shopping centre differentiates from the Super-Prime schemes in as much that they are often a strong 'second' shopping centre within the town. Alternatively, the shopping centre may simply not make up the entirety of the prime retailing area within the town, meaning that some of the prime retail area is outside of the shopping centre.

Shopping centres of this kind are often anchored by a department store which contains a mixture of fashion and comparison-goods. The scheme will likely have good representation from strong retail brands and will tend to provide a major part of the retail offering within the town.

Yields for these centres are currently at 8.75% and whilst having trending inwards during H1 2022, the outlook has weakened.

Category 3: Subregional schemes

The third type of shopping centre is known as a subregional scheme, which includes strong town centre dominant schemes. Such schemes would have a catchment limited to the region and would have competition from other schemes in towns with similar demographics. Such centres tend to be anchored by remaining department store operators, smaller variety stores or value-based retailers. Tenants will often be made up of a mixture of local, regional and national covenants.

Category 4: District Shopping Centres

The fourth category of shopping centre are generally the smallest. These are known as District Shopping Centres and serve a much more localised catchment area. Within this bracket other definitions include secondary town centre, community or convenience, or the more generalised definition of secondary-tertiary. National retailers on display would be the mass-market, value-based retailers. The remainder would be made up by a higher proportion of local and regional businesses. Metrics by which a shopping centre is measured will be weakest in these centres but conversely repurposing plays are potentially the strongest.

WHAT WE LOOK FOR DURING A VALUATION

By their very nature, the valuation of a Shopping Centre requires analysis of a wide ranging degree of inputs and metrics, not limited to the size, condition and location. There are several aspects that need to be taken into consideration, some of which are unique to Shopping Centres and require careful consideration.

Here are a few examples of some of the items that our Commercial Valuation team take into account.

Anchor tenants: Anchor tenants are those retailers who take up a large amount of space at a focal point in a scheme. As such, anchor tenants often contribute the highest single proportion of rental income. They will often be large department stores, food stores or other well-known retail brands, for example Marks & Spencer, John Lewis/Waitrose, Wilko, Primark.

Location: The location of the Shopping Centre will be of initial consideration in determining its category. Town or City location, in-town or out-of-town, size of town and demographics, catchment area, competition, degree of prime retail area contained within the scheme as opposed to traditional high street. All of these factors will have an impact on the final valuation.

Access possibilities: This covers everything from whether the Shopping Centre has its own car park – or has good access from other local car parks – quality and easy of transport links or whether it is in a prime high street location.
Shoppers tend to prefer surface parking, both for ease of access as well as safety. While multi-storey car parks offer the ability to provide increased parking options on a smaller footprint, they require higher maintenance costs.
Consideration to other, competing car parks, is required. Nearby car parks might benefit the scheme, but could also limit income available from on-site car parking. If car parking is deemed as logistically difficult this would negatively impact the centre.

Tenant mix: The variety of tenants within the shopping centre needs to reflect the target audience, which will often be determined by the size and location of the scheme. Moving away from core retail and providing a “multi-themed” centre is increasingly important for the success of any scheme. For that reason, our chartered Valuers will always assess the Tenants leasing units within the scheme, reporting on their diversity, financial stability as well as how much footfall they are expected to generate for the shopping centre. The proportion of large store space when compared to standard units also needs to be considered, as well as how much space there is for kiosks within the scheme.

Net Operating Income (NOI): The net operating income is an extremely important consideration and when assessed against gross income is essentially a numerical reflection of the shopping centre in question. Landlords’ shortfalls have grown over the years as the retail landscape has deteriorated and as such, net operating income as a portion of gross income has declined. The best performing centres have less divergence between NOI and gross income.

WAULT: The Weighted Average Unexpired Lease Term (WAULT) is also an extremely important consideration at is represents a balanced interpretation of unexpired term across a shopping centre as a whole. Longer WAULT represents longer income stream and therefore the more attractive the asset. It is not uncommon at present to find subregional and district shopping centres with WAULTs to earliest break of only 3 years.

Voids: Both of the above require careful interpretation in order to effectively assess the market value of the asset as both offer an indication as to inherent income risk. Potential for large voids needs to be considered in an environment where it is difficult to let large stores. Assessment is also required to determine the likelihood of a significantly reducing NOI in the short term as a result of a short WAULT and potential for large voids.

Flexible Lease Terms: As the retail landscape has deteriorated many Asset Managers have resorted to granting flexible lease terms to Tenants in order to fill large voids thus reducing Landlord's shortfalls and protecting net operating income. Most common examples include:

- zero rent, occupational costs covered by Tenants;
- base rent plus turnover top-up, turnover rent only basis;
- rolling Tenant break option.

Repurposing potential: A high proportion of the UK Shopping Centre stock now has repurposing potential as its primary investment consideration, alongside short-medium term income. This has become more apparent in the south-east where repurposing plays are more profitable. The degree as such has been that it is becoming more common that Shopping Centres are purchased on a capital value £ per sq ft basis, rather than net initial yield. Opportunistic investors and local authorities have been purchasing town centre stock over recent years with the primary view to undertake regeneration of important town-centre stock. Redevelopment most commonly includes incorporating flatted residential blocks with a reduced degree of commercial space.

Rent and service charge collection rates: During the course of the pandemic rent and service charge collection rates were lower than usual, with some landlord's required to grant COVID-19 related relief. As the economy emerged from the pandemic rent and service charge collection rates have mostly returned to normal levels with aged debt also being addressed. Collection rates are another indicator of perceived risk in relation to future income.

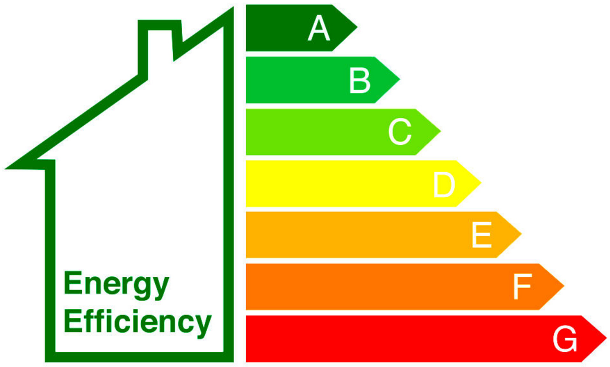
A FEW MORE THINGS TO CONSIDER

In addition to the above, some of the other factors that need to be taken into account are whether there are any special conditions in place, such as rent-free periods and void assumptions. Whether a rent review is due will also play a part and it is becoming increasingly common to see scheme owners agreeing a base rent with clauses relating to a supplemental turnover rent top-up.

Assessing the physical condition of the shopping centre of course plays a major role in completing the valuation. Knowing whether the scheme is in need of modernisation or refurbishment – which in some cases requires cash injection so as to not make the scheme uncompetitive by high service charge – is a vital piece of information for any potential investor.

There are also a range of environmental factors that could affect the value of the property. As well as looking at the property's general Energy Performance Certificate (EPC) rating, our Valuers will investigate and account for elements such as:

- the possibility of site contamination, for example from on-site or local petrol stations;
- the risk of flooding;
- the existence of any asbestos within the building;
- the possibility of the scheme being affected by Radon gas.



Further elements that may have an effect on the value of a shopping centre include statutory, town planning or highway matters, as well as Section 106 planning obligation agreements with the relevant local authority. All of these are thoroughly investigated by our Valuation team as they can affect things such as;

- opening hours;
- car-parking charges;
- security;
- the provision of 'shopmobility' facilities;

and more.

Approved or progressing planning applications for competing retail schemes also need to be taken into account, especially if they are in relatively close proximity to the scheme being valued.

A FEW EDUCATED ASSUMPTIONS

Of course, it is not always possible to get fully accurate information about all of these details, for example the current, actual financial stability of tenants. However, the experience they have gathered over the years allows our chartered Valuers to make certain educated assumptions that they include with any valuation report.

An example of such an assumption could be whether a Tenant is likely to exercise their break clause and what void this would result it in, or if not, could the Tenant re-negotiate terms for not exercising their break.

Another example could be whether a 12 month reletting period will be required, or whether a 12-18 month rent-free period could be utilised to in order to attract new tenants.

Their dedication and passion for the job means they work tirelessly to provide a detailed and thorough report the client can use to make educated financial decisions on.

SPEAK TO THE EXPERTS

As you can see, a lot of careful investigation and research goes into specialist valuations of this kind. The above is just a snapshot of some of the aspects included in a specialist commercial valuation.

Our Valuation team have worked with clients on shopping centres schemes of all the described types over the years, gaining a wealth of experience and expertise in this field.

To find out more, speak to Robert Hughes or another member of our Commercial Valuation team on **0800 071 5517** or email **admin@awh.co.uk**.

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anderson wilde & harris

EXPERTS IN PROPERTY

Phone: 0800 071 5517

Email: admin@awh.co.uk

Head office: 12, Dorrington Street, London, EC1N 7TB