Lambert Smith Hampton

SHOPPING CENTRE FUTURES

PUTTING SHOPPING CENTRES AT THE HEART OF REGENERATION 2022

THE UK SHOPPING CENTRE VACANCY RATE IS 19%

20-40% OF RETAIL SPACE MAY NEED TO BE REPURPOSED

VALUES HAVE STABILISED AFTER DROPPING BY MORE THAN 50%

SHOPPING CENTRE INVESTMENT IMPROVED TO £850M IN H1 2022

WELCOME

DR STEVE NORRIS
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DIRECTOR - CAPITAL MARKETS

Welcome to *Shopping Centre Futures*. This report presents LSH's vision of the leading role that shopping centres will need to play in the regeneration of the UK's towns and cities.

The retail sector is facing unprecedented challenges, which have been both highlighted and exacerbated by the pandemic. Chief among these are the rise of online shopping, which continues to reshape consumer behaviour; and punitive business rates, which represent a major obstacle to the viability of bricks-and-mortar retail. As we emerge from COVID-19, the cost-of-living crisis has also reared its head as a new threat to the recovery of retail activity.

While all retail types are affected by these ongoing challenges, shopping centres have felt their impact most acutely. This is evidenced by consistently high vacancy rates and dramatic falls in capital values.

And yet, shopping centres also present the biggest opportunities for the creative and radical reimagining and reshaping of retail's role within towns and cities. As large assets usually under single ownership, they have the critical mass to enable strategic decisions to be made on how space is used, so that value is added to both the centre itself and the town it serves.

The repurposing of large volumes of shopping centre space is increasingly a key part of regeneration activity across the UK. Shopping centres need to be transformed into mixed-use locations with a wide range of commercial, residential and community space. This will enable centres to forge new roles as living, working places at the heart of communities.

LSH is taking a key part in many of the UK's most important shopping centre repurposing and regeneration projects. Our multi-disciplinary Planning, Regeneration + Infrastructure team is helping to deliver transformational schemes by providing expertise at all stages of the planning, design and development lifecycle.

In addition, our Capital Markets and Retail Agency experts are assisting investors and occupiers across the private and public sector to unlock opportunities being created by a rapidly changing retail landscape.

We hope you find this report of interest, and would be very happy to discuss any of the topics covered with you.

SHOPPING CENTRE CHALLENGES

The last two years have been a tumultuous period for the retail industry. The pandemic has accelerated changes in consumer behaviour and business models that were already reshaping the sector. This has put a renewed spotlight on the future of shopping centres.

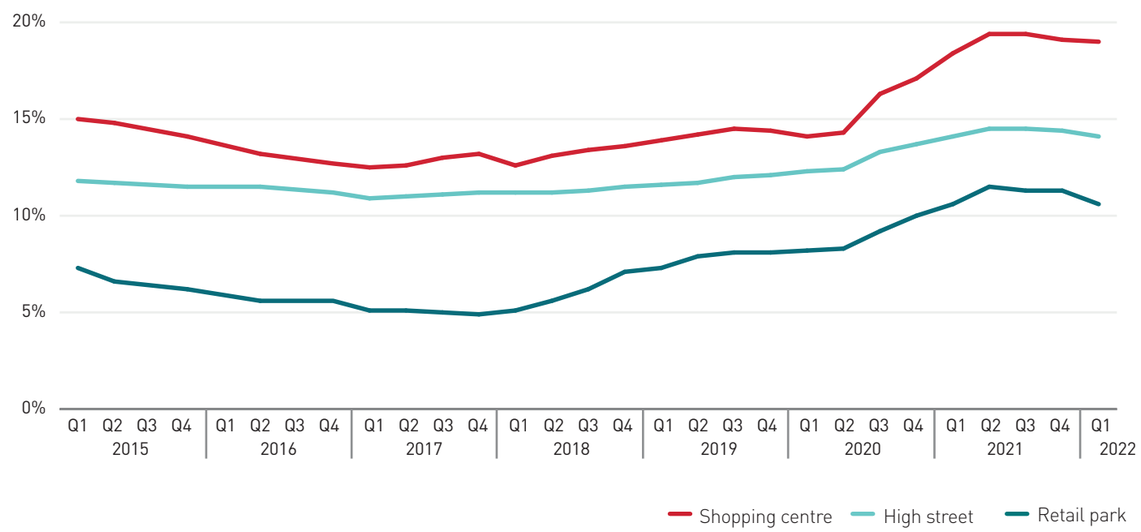
CHANGING SPACES

As the dust settles after the lockdowns of the last two years, green shoots are now appearing across the retail sector. Nonetheless, it is clearer than ever that the UK's towns and cities have more retail space than they need. Innovative ideas are needed to reimagine the country's shopping centres so that they are fit for the post-pandemic world, with significant volumes of space being repurposed to non-retail uses.

Vacancy rate trends illustrate the challenges that the retail sector faced during the pandemic. According to the Local Data Company (LDC), the overall retail and leisure vacancy rate jumped from 12.1% in Q4 2019 to a peak of 14.5% in Q2 and Q3 2021. The increase in shopping centre vacancies was particularly sharp, soaring by more than five percentage points to reach 19.4% in the middle of 2021.

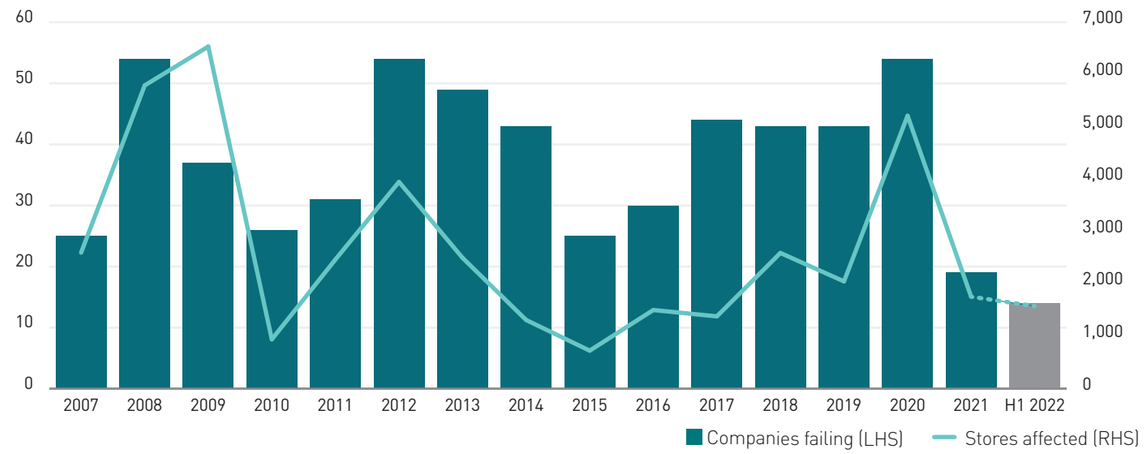
However, more positive signs have emerged since the final quarter of last year, when vacancy rates fell for the first time since 2018. The overall vacancy rate eased further to 14.1% in Q1 2022, while shopping centre vacancies edged down to 19.0%.

RETAIL VACANCY RATES (%)



Source: Local Data Company

MAJOR RETAIL FAILURES



Source: Centre for Retail Research

EMERGING FROM THE PANDEMIC

A host of other indicators suggest that the retail sector is slowly recovering after the *annus horribilis* of 2020. The Centre for Retail Research recorded just 19 major retail failures in 2021, a 15-year low, down from a joint-record 54 in the previous year. The most vulnerable retailers appear to have been casualties of the early days of the pandemic, leaving a smaller but hopefully more robust sector in their wake.

Nonetheless, there are a wide range of challenges facing retailers that survived the pandemic. Respondents to a survey recently conducted by LSH and REVO identified high business rates as the biggest single issue. The business rates system causes an uneven fiscal playing field for online and physical retailers, leading to growing calls for an online sales tax to redress the balance.

The impacts of changes in consumer behaviour, such as the growth of online shopping and increased homeworking, continue to play out in the physical retail sector. Meanwhile, new challenges have emerged, most notably the cost of living crisis, which appears to have burst the post-pandemic spending bubble as consumers rein in discretionary purchases.

EVOLVING SECTOR

An analysis of retail openings and closures shows that independent operators have led the sector's post-pandemic recovery. According to the LDC, chain stores experienced a net decline of 10,059 units in 2021, but independents recorded a net increase of 2,157 units.

This trend is part of the ongoing reshaping of the retail sector, as larger chains continue to rationalise their estates, while local and independent retailers find opportunities to meet changed consumer demand. Growth areas include health and beauty, convenience stores, restaurants and leisure operators; all of which provide services and experiences not easily replicated online.

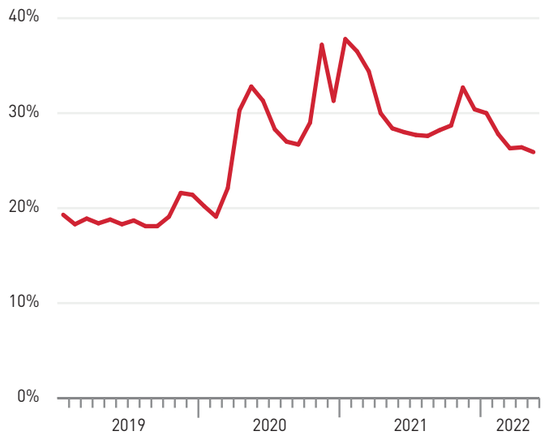
"Nearly one-fifth of the UK's shopping centre space currently stands vacant."

WINNING AND LOSING LOCATIONS

The geography of retail activity changed during the pandemic. Increased homeworking caused consumer demand to shift away from city centres to local neighbourhood locations. Consequently, vacancy rates held up much more strongly in commuter and market towns than in major cities. This trend was still evident in early 2022, with London being the only UK region to see its vacancy rate rise in Q1.

However, footfall figures show that city centre retail activity has greatly improved since the easing of lockdown restrictions in early 2022, as more people have returned to the office. Springboard data indicates that footfall trends in regional cities and market towns have been broadly similar in recent months, after towns outperformed during the pandemic.

INTERNET SALES AS A PERCENTAGE OF TOTAL RETAIL SALES (%)



Source: Office for National Statistics

Alongside improved footfall, a scaling back of online retail activity provides evidence that some of the trends negatively impacting shops over the last two years may now be being partly reversed. Online's share of total retail sales dropped to a two-year low of 25.9% in May 2022, albeit this is still significantly up on the pre-COVID peak of 21.6% recorded in November 2019.

While the growth of ecommerce has clearly been accelerated by the pandemic, there is evidently still strong demand for in-person retail and leisure experiences. Reports of the death of physical retail have certainly been exaggerated, but there is no doubt that towns, high streets and shopping centres are still facing significant once-in-a-generation challenges.

THE SCALE OF THE ISSUE

With close to one-fifth of shopping centre units standing vacant, there is plainly an oversupply of retail space in many UK locations. Retail property owners have increasingly recognised the need to repurpose or reposition the excess space, and this is driving investment and development decisions across the sector.

The general consensus is that somewhere between 20-40% of UK retail space may ultimately need to be redeveloped or repurposed. This is supported by the results of the recent LSH/REVO survey, with 62% of respondents putting the scale of the problem within this range.

Space that has been persistently vacant for long periods is likely to be most in need of radical repurposing solutions. LDC data shows that persistent long-term vacancies are a much bigger problem within shopping centres than in other parts of the retail market. In 2021, 6.1% of shopping centre space had been empty for at least three years, representing nearly a third of centres' total vacant space. This compares with persistent vacancy of 4.7% on the high street; and just 2.9% in retail parks.

HOW MUCH RETAIL SPACE NEEDS TO BE REDEVELOPED OR REPURPOSED? (%, SURVEY RESPONSES)

Source: LSH/REVO Survey 2022

PERSISTENT VACANCY - GREATER THAN 3 YEARS (%)

Source: Local Data Company

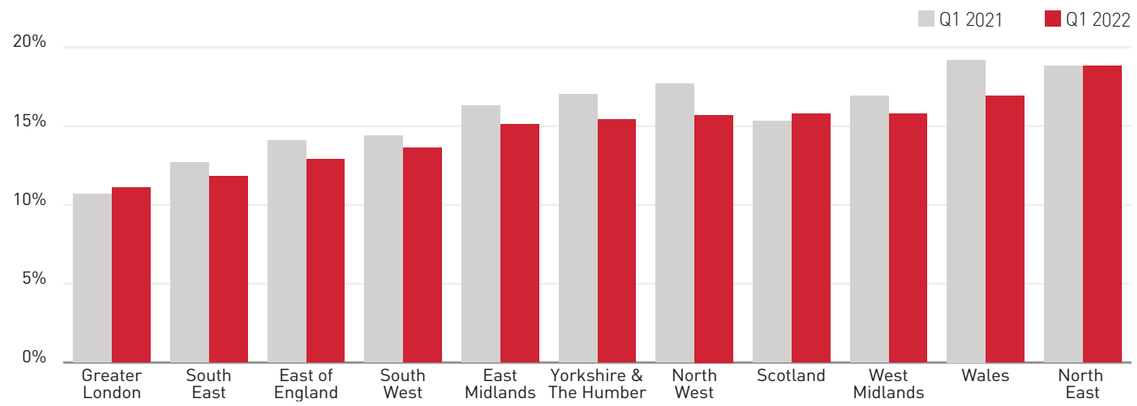
Relatively low persistent vacancy levels in retail parks demonstrate not just the relative strength of occupier demand in this segment, but also the adaptability of retail warehouse units, which can be spilt into different sized spaces or easily converted for alternative uses.

Shopping centre units are often less flexible, and persistent vacancy rates may increase further due to major retail failures during the pandemic. The collapse of retail groups such as Debenhams and Arcadia has left many centres without anchor tenants and with large, hard-to-fill empty units. A year after its demise, nearly 90% of vacated Debenhams stores remained empty.

The amount of space in need of repurposing or redevelopment varies greatly across the UK. Regional vacancy rates are significantly higher in the North East, Wales and the West Midlands than in Greater London, the South East and the East. MSCI data also shows that vacancy rates are generally higher in older shopping centres than more modern centres; as well as being higher in in-town rather than out-of-town centres.

As high as they are, national and regional vacancy rates underplay the scale of the problem faced in many secondary pitches where vacancy is endemic. There are shopping centres in the UK where a third or more of units are vacant, and these are the locations where the need for repurposing or redevelopment is most pressing.

REGIONAL RETAIL & LEISURE VACANCY RATES (%)



Source: Local Data Company

REPURPOSING SPACE

The need to repurpose retail space has become a hot topic within the sector in recent years. A wave of innovative repurposing projects are now in the pipeline, which reflect changing views on the role of retail centres within towns and communities.

KNOCK IT DOWN AND START AGAIN?

The most eye-catching examples of shopping centre repurposing projects in the UK include bold plans being led by local councils across the country, in locations such as Stockton-on-Tees, Nottingham and Shrewsbury, which involve the complete replacement of existing shopping centres with new urban developments.

Commercial developers also have ambitious plans, including Lochailort Investments at the Kennet Centre, Newbury; and Areli Real Estate at the Nicholsons Shopping Centre, Maidenhead and the Walnuts Shopping Centre, Orpington. All of these centres are proposed to be replaced by new mixed-use quarters.

Shopping centres lend themselves to this type of wholesale strategic redevelopment more than other types of retail, as they are large assets that are usually under single ownership and control. This contrasts with high streets, where units may be owned separately by multiple landlords.

However, the most radical form of repurposing – knocking down a shopping centre and completely replacing it – will not be the optimum solution in most cases. Widely varying degrees of redevelopment and repurposing activity will be suitable for different shopping centres. For most, the retention of a significant volume of retail space will be an important part of the creation of vibrant community-focused locations.

The goal for many landlords should be to transform shopping centres from single-use covered retail locations into diverse and open mixed-use places that are sustainable and provide people with more reasons to come to them and to stay for longer. Adding a wider range of residential, community and commercial uses will create a 'captive catchment' and generate footfall to ensure that properties are in use for longer periods of the day, including outside of normal retail hours.

MIXING USES

The recent LSH/REVO survey highlighted the variety of possible uses for town and shopping centre space. When asked to identify the optimum mix of uses, survey respondents most commonly selected food and beverage. The next three highest-ranked categories were all types of retail space, indicating that retail is still viewed as a fundamental part of the town centre mix.

Culture and heritage uses, street markets, meanwhile uses and new PRS/BtR homes also featured in the top ten answers to this question. These are all among the solutions that should be considered by landlords seeking to reposition their assets.

However, for the largest-scale regeneration projects, a very wide range of uses may be needed. If shopping centres are to be turned into vibrant urban quarters where people live, work and play, the new communities living in these places will also need to be supported by health, education and transport infrastructure.

WHAT IS MOST VITAL TO THE OPTIMUM MIX OF USES? (%, SURVEY RESPONSES)

1	FOOD & BEVERAGE	71%
2	NON-FOOD RETAIL	44%
3	FOOD / GROCERY STORES	34%
4	LOW COST / FLEXIBLE RETAIL SPACE	30%
5	CULTURE & HERITAGE	30%
6	PUBLIC REALM / OPEN SPACES / PARKS	29%
7	STREET MARKETS	29%
8	POP-UP SHOPS / MEANWHILE USES	21%
9	FREE TOWN CENTRE CAR PARKING	20%
10	NEW HOMES – PRS / BTR	20%
11	LOW COST/ FLEXIBLE WORKSPACE	20%
12	GYM / LEISURE CENTRES	18%
13	LIBRARY & CIVIC USES	17%
14	HEALTH CENTRES	15%
15	NEW HOMES – PRIVATE SECTOR	15%
16	CREATIVE INDUSTRIES	15%
17	MARKET HALLS / INDOOR MARKETS	14%
18	THEATRE / CONCERT VENUES	14%
19	CINEMA	12%
20	OFFICE SPACE	11%
21	NEW HOMES – PUBLIC SECTOR	8%
22	ELECTRIC VEHICLE CHARGING FACILITIES	7%
23	SCHOOLS / EDUCATION	6%
24	DEPARTMENT STORES	5%
25	CYCLE PARKING	3%

Source: LSH/REVO Survey 2022
Survey respondents were asked to select a maximum of five uses

VARIED OPPORTUNITIES

With planning policy becoming increasingly supportive of changes from retail, including via new permitted development rights and changes to the Use Classes Order, a broad variety of new uses are potentially available to shopping centre owners and developers.

Healthcare is a genuine growth area, as the pandemic has accelerated the NHS's drive to move medical services into communities. Multiple shopping centres have been used to house COVID-19 vaccination centres, in locations such as Cambridge, Hull, Preston and Croydon.

More recently, community diagnostics centres have opened at Beales department store in the Dolphin Centre, Poole, the Glass Works Shopping Centre in Barnsley and Wood Green Shopping Centre, London. With the NHS looking to roll out more services into town centres and being prepared to take long leases, this is a key opportunity for shopping centres owners.

Other growth areas within the UK property market may also present repurposing opportunities. With warehouse demand booming, conversions of retail space to urban logistics centres may seem attractive. However, this is likely to be easier for retail warehouses and superstores, rather than shopping centres, due both to the adaptability of units and their typical locations.

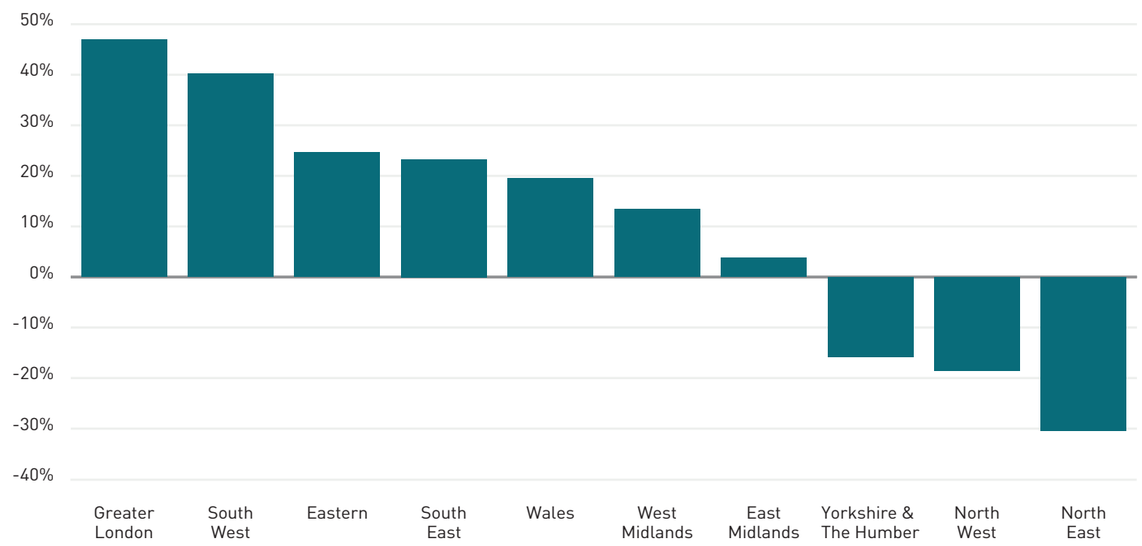
Life sciences is another bright spot within the property market, and the need for more space aimed at occupiers from this sector is encouraging developers to explore repurposing opportunities in science hotspots. Redevelopment plans for the Clarendon Centre in Oxford include 30,000 sq ft of lab space and offices, while a potential deal for the Grafton Centre in Cambridge could see it converted to life science uses.

VIABILITY CHALLENGES

The viability of alternative uses will impact development decisions. An increasingly compelling business case for retail-to-residential conversions has emerged in many parts of London and the South of England, as housing values have raced ahead of retail values. LSH research shows that average residential capital values are more than 40% higher than retail values in parts of the South.

However, average retail capital values remain higher than housing values in some Northern regions despite sharp falls in recent years. This makes residential redevelopment less viable in many of the locations most blighted by high retail vacancy rates. For this reason, public sector funding and leadership is needed to support projects that cannot purely be driven by commercial considerations. This reflects a wider challenge for the government's levelling up agenda and objectives.

DIFFERENCE BETWEEN RESIDENTIAL AND RETAIL AVERAGE CAPITAL VALUES (%)



Source: MSCI/LSH Research

REPLACE, REINVENT, REVITALISE

This report categorises the different approaches to repurposing needed by shopping centres as **Replace, Reinvent** and **Revitalise**.

REPLACE

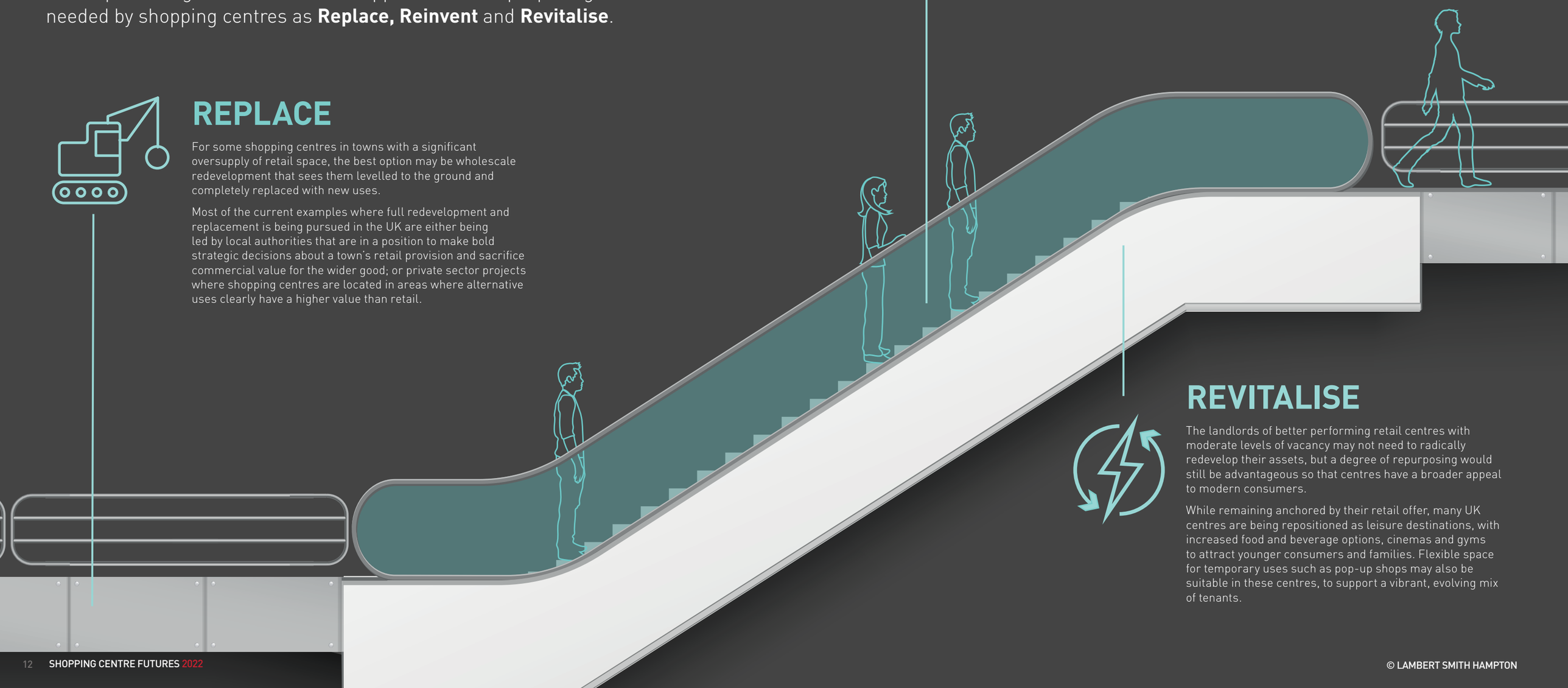
For some shopping centres in towns with a significant oversupply of retail space, the best option may be wholescale redevelopment that sees them levelled to the ground and completely replaced with new uses.

Most of the current examples where full redevelopment and replacement is being pursued in the UK are either being led by local authorities that are in a position to make bold strategic decisions about a town's retail provision and sacrifice commercial value for the wider good; or private sector projects where shopping centres are located in areas where alternative uses clearly have a higher value than retail.

REINVENT

Many shopping centres, particularly those with relatively high vacancy rates, would benefit from significant changes to non-retail uses, while stopping short of being fully repurposed. A condensed retail offer might be supplemented by a varied range of other uses including leisure, residential, workplace, healthcare, education and community uses.

This scale of reinvention is likely to require significant redevelopment or regeneration activity and capital expenditure, with varying degrees of private and public sector involvement. A wide range of innovative mixed-use projects are currently in the pipeline at shopping centres across the UK, which seek to transform them into more diverse modern destinations.



REVITALISE

The landlords of better performing retail centres with moderate levels of vacancy may not need to radically redevelop their assets, but a degree of repurposing would still be advantageous so that centres have a broader appeal to modern consumers.

While remaining anchored by their retail offer, many UK centres are being repositioned as leisure destinations, with increased food and beverage options, cinemas and gyms to attract younger consumers and families. Flexible space for temporary uses such as pop-up shops may also be suitable in these centres, to support a vibrant, evolving mix of tenants.

REPLACE

STOCKTON-ON-TEES
CASTLEGATE SHOPPING CENTRE

Stockton-on-Tees is home to arguably the UK's most radical plan for shopping centre repurposing. The Castlegate Shopping Centre is being demolished along with a multi-storey car park and the Swallow Hotel, to make way for the new Stockton Waterfront project. This will create a large new riverside park including open, flexible space for community use, markets and large-scale events. The plans include a land bridge connecting the town centre with the River Tees, which forms an informal amphitheatre facing the waterfront.

Many of Castlegate's tenants have been relocated to the nearby Wellington Square Shopping Centre. The aim is to consolidate the town's retail space into a more compact core in Wellington Square and the northern section of the High Street. The need to reduce Stockton's retail space is made clear by planning documents supporting the Waterfront redevelopment, which put the town centre's vacancy rate at 34%, and the Castlegate Centre at 44%, in March 2021.

The old shopping centre was an unloved piece of 1970s planning which effectively blocked views and restricted access to the river. The new plans attempt to comprehensively remodel the town centre so that it is refocused on the waterfront. While retail space will be reduced, Stockton town centre should ultimately become a much more attractive shopping destination.

This type of blue-sky redevelopment, which forgoes commercial space in the pursuit of community goals can only really be led by local councils, and not the private sector, because it involves the deliberate removal of commercial value. The progress of the Stockton project will provide an important litmus test for some of the more radical ideas currently being explored around town centre placemaking and regeneration.


STOCKTON-ON-TEES WATERSIDE (CGI)

NOTTINGHAM
BROADMARSH CENTRE

Nottingham's derelict Broadmarsh Centre is the subject of one the UK's most ambitious projects to reimagine the future role of a failing retail centre.

Previously owned by Intu, the centre was part-demolished as part of redevelopment plans that were halted in 2020 when Intu went into administration. The centre is now owned and controlled by the council.

A new concept for the site, led by the celebrated designer Thomas Heatherwick, was unveiled in December 2021. The vision includes the retention of much of the structural frame of the old centre, with new spaces created within it to host leisure and other uses. A wildlife-rich green space is conceived, which will permeate the whole site and weave in and out of the frame. The proposal also includes 750 new homes, new commercial and mixed-use buildings and a hotel.


NOTTINGHAM – BROADMARSH CENTRE REDEVELOPMENT (VISION)

SHREWSBURY
RIVERSIDE, PRIDE HILL AND DARWIN SHOPPING CENTRES


SHREWSBURY – RIVERSIDE AREA REDEVELOPMENT (VISION)

Shropshire County Council purchased Shrewsbury's three main shopping centres – the Darwin, Pride Hill and Riverside – in January 2018.

The acquisition was made so that the council could bring the sites under its ownership and enable future town centre regeneration. The council has since decided to make the Darwin Centre the town's main shopping centre. The Pride Hill Shopping Centre has already been closed, with several of its retailers relocated to the Darwin Centre.

The council's current vision, unveiled in February 2022, envisages a leisure-focused mixed-use development replacing the Pride Hill and Riverside centres, as well as the Ravens Meadow car park and the bus station. The new development will potentially include a cinema, restaurants and bars, a transport hub, council offices, workplaces, hotels and up to 270 homes.

There are still significant obstacles to be overcome before the vision becomes reality, and the council's purchase of the shopping centres has attracted local criticism, as it bought them for c. £51m, and their value has since plummeted by more than 75%. However, by bringing multiple retail sites under its control, the council has given itself an opportunity to radically and strategically reshape Shrewsbury town centre as a more attractive leisure destination.

REINVENT

EDINBURGH
OCEAN TERMINAL

OCEAN TERMINAL (CGI)

Ocean Terminal is a 420,000 sq ft shopping centre with a prominent location on Leith waterfront, but it has faced challenges in recent years, with two of its anchor tenants – Debenhams and BHS – going out of business.

Its owner, the Ambassador Group, has recognised the need to reposition the asset and to make more of its waterside position. It is seeking to part-demolish and remodel the centre, replacing the old Debenhams unit and a multistorey car park with a mixed-use development comprising housing, commercial units and new public realm that will open up the waterfront. A planning application covering phase one of the project was submitted in March 2022.

OXFORD
TEMPLARS SQUARE

Templars Square in Cowley, Oxford is a tired first-generation covered 1960s shopping centre which was acquired by Redevco, on behalf of a client, in late 2021. The property was purchased with a view to transforming it into a landmark residential-led mixed-use scheme, and pre-existing planning consent is in place.

The existing consent covers 226 residential units, a hotel, restaurants and public realm improvements. A multistorey car park and bridge will be demolished to clear space for flats, but existing retail will be retained.


OXFORD – TEMPLARS SQUARE (CGI)

BURGESS HILL
THE MARTLETS

BURGESS HILL - THE MARTLETS (CGI)

The Martlets Shopping Centre in Burgess Hill has been the subject of regeneration plans for several years. Its owner NewRiver was first granted planning permission to redevelop the centre in 2016, but a revised application was approved in 2020.

The current plans seek to reduce the retail footprint and add 142 residential units, a Travelodge hotel, Cineworld cinema, bowling alley, gym and a new public library. NewRiver is working with Mid Sussex District Council to bring the development forward, but progress may be dependent on securing central government funding.

REVITALISE

HAMMERSMITH
LIVAT HAMMERSMITH

The former Kings Mall was purchased by Ingka Centres, the IKEA-affiliated shopping centre owner, in 2020. It was relaunched as Livat Hammersmith in February 2022, and is anchored by IKEA's first small-format high street store in the UK.

The Hammersmith centre is the first in Europe to bear the Livat brand, which is being rolled out globally. Meaning 'lively gathering' in Swedish, the Livat concept seeks to reposition shopping centres as 'meeting places' where communities can meet, eat and socialise.

Initiatives aimed at creating a community-focused centre include a programme of events and pop-up outlets; as well as some retail space that is bookable by the hour, giving local businesses an opportunity to set up shop themselves.

HAMMERSMITH – LIVAT HAMMERSMITH

NORWICH
CASTLE QUARTER

NORWICH – CASTLE QUARTER

The former Castle Mall was rebranded as the Castle Quarter in 2019, with asset manager RivingtonHark seeking to reposition it from retail-led centre to a mixed-use family destination, with an enhanced leisure and entertainment offer. The centre now has a Leisure Quarter which features a cinema, bowling alley and gym alongside other entertainment options.

The next phase of the repositioning is Castle Social, a new food market incorporating five street food kitchens, a live performance space and a programme of regular events.

SOUTHEND-ON-SEA
VICTORIA SHOPPING CENTRE

SOUTHEND-ON-SEA – VICTORIA SHOPPING CENTRE

Southend-on-Sea Borough Council bought the Victoria Shopping Centre for £10m in late 2020, and has since sought to fill vacant spaces with a more diverse range of occupiers. An indoor climbing centre and an art gallery are among recently-secured tenants.

While these are bringing new life to the centre in the short term, the council's ownership of the centre will give it scope to develop longer-term plans as part of its wider regeneration aims; and the idea of moving council offices to the centre has also been mooted.

VALUE AND OPPORTUNITIES

Although the recovery in retail investment volumes is being led by retail warehouses, the stabilisation of the shopping centre sector is also encouraging investors to explore opportunities, particularly where there are strong repurposing angles.

VOLUMES PICK UP

Retail investment activity was on the wane even before the pandemic, with investors showing caution due to changing consumer behaviour, high vacancy rates and falling capital values. Retail volume dropped to a 20-year low of £4.2bn in 2020, but it recovered to a three-year high of £6.6bn in 2021, primarily driven by the retail warehouse sector. This segment has continued to drive activity, fuelling further improvements in volume in H1 2022.

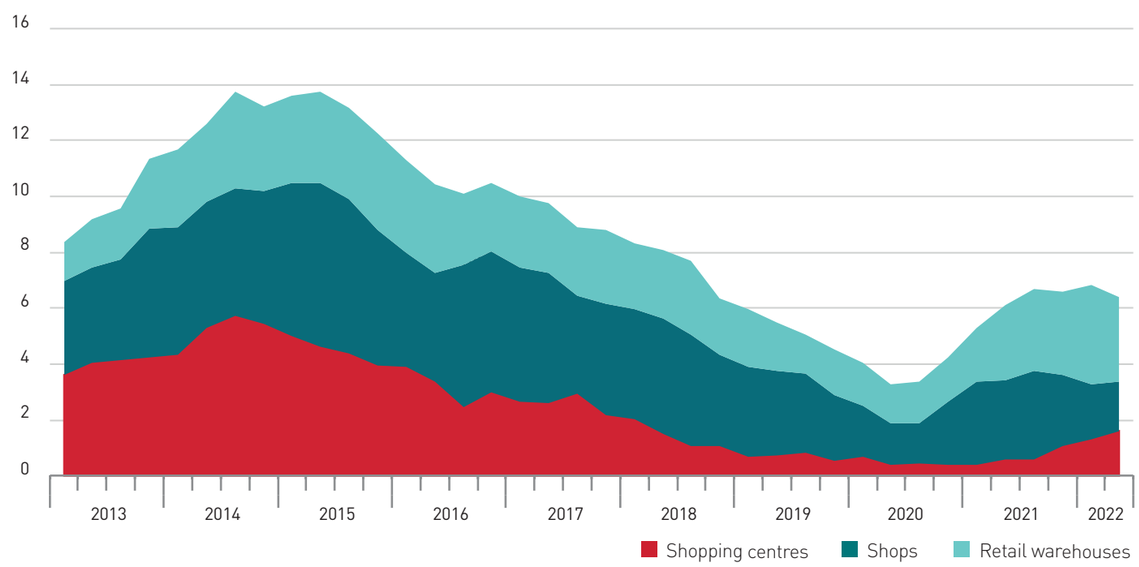
Shopping centre volume has increased after slumping to just £410m in 2020. Approximately £1.1bn was invested in the segment in 2021, with a further £850m transacted in H1 2022 as investor interest gathered momentum. However, accounting for just 20% of total retail volume since the start of 2021, shopping centres' share of the overall retail investment market has remained very low by historical standards.

Nonetheless, recent quarters have provided signs that investors are more prepared to commit to shopping centre deals, encouraged by the stabilisation of capital values. Shopping centre values have diverged from other sectors over the last five years, more than halving between 2016 and 2021, but MSCI data shows that values finally started to edge upwards in the first half of 2022.

The widespread rebasing of rents has also given more certainty to investors, by ensuring that they have been able to purchase assets whose tenants are paying sustainable market rents and reducing the risk of acquiring overrented properties.

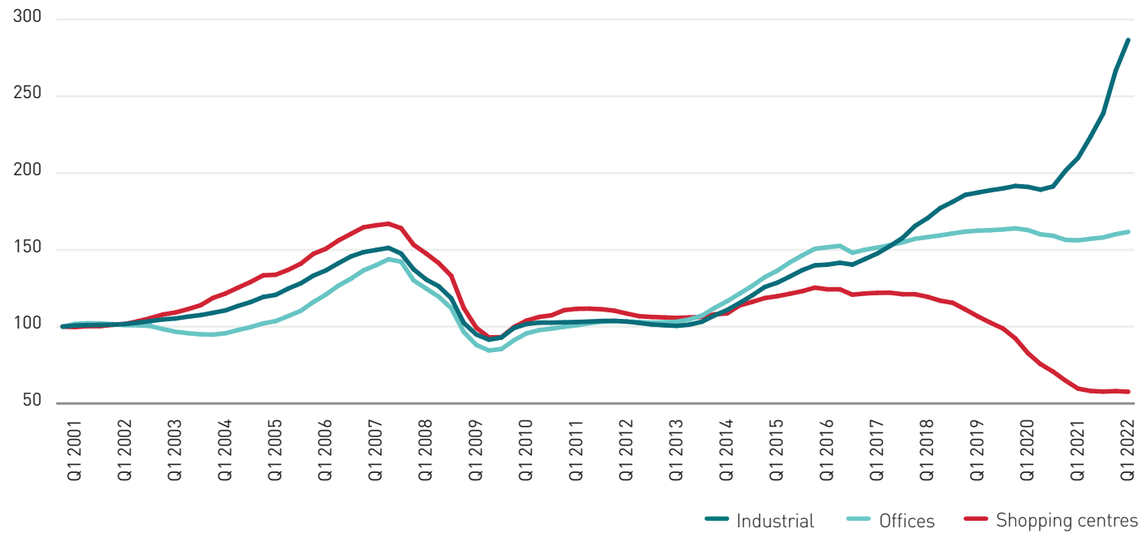
Repurposing, redevelopment and regeneration angles have been major drivers of recent shopping centre transactions. LSH has analysed every deal since the start of 2020 and found that repurposing opportunities are present in almost every case. However, centres requiring complete replacement are only a small minority. Using the typology outlined earlier in this report, more than 90% of shopping centres purchased in this period fall into either the Reinvent or Revitalise categories.

RETAIL INVESTMENT VOLUMES (£BN, ROLLING 12-MONTH TOTALS)



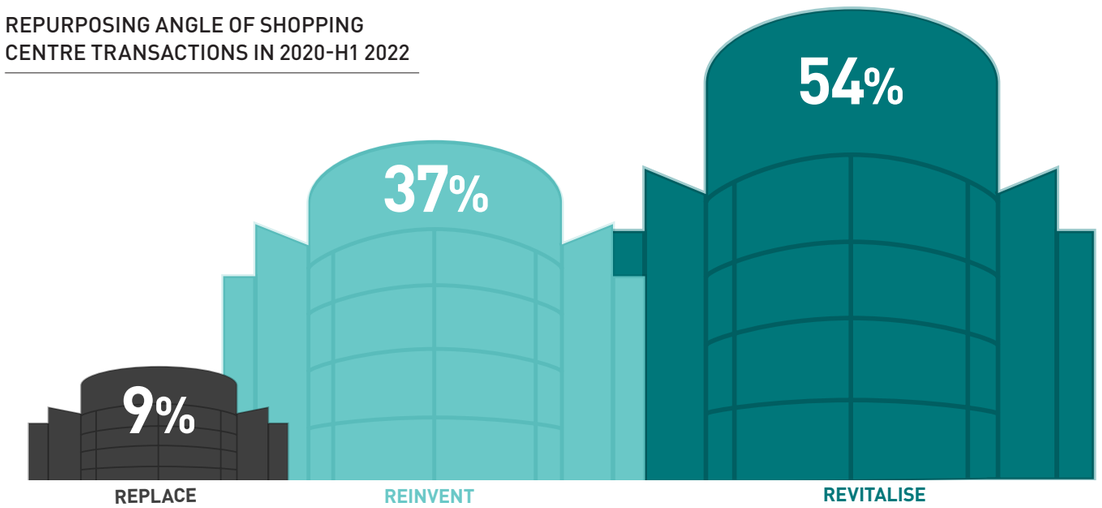
Source: LSH Research

ASSET VALUE GROWTH INDEX (Q4 2000=100)



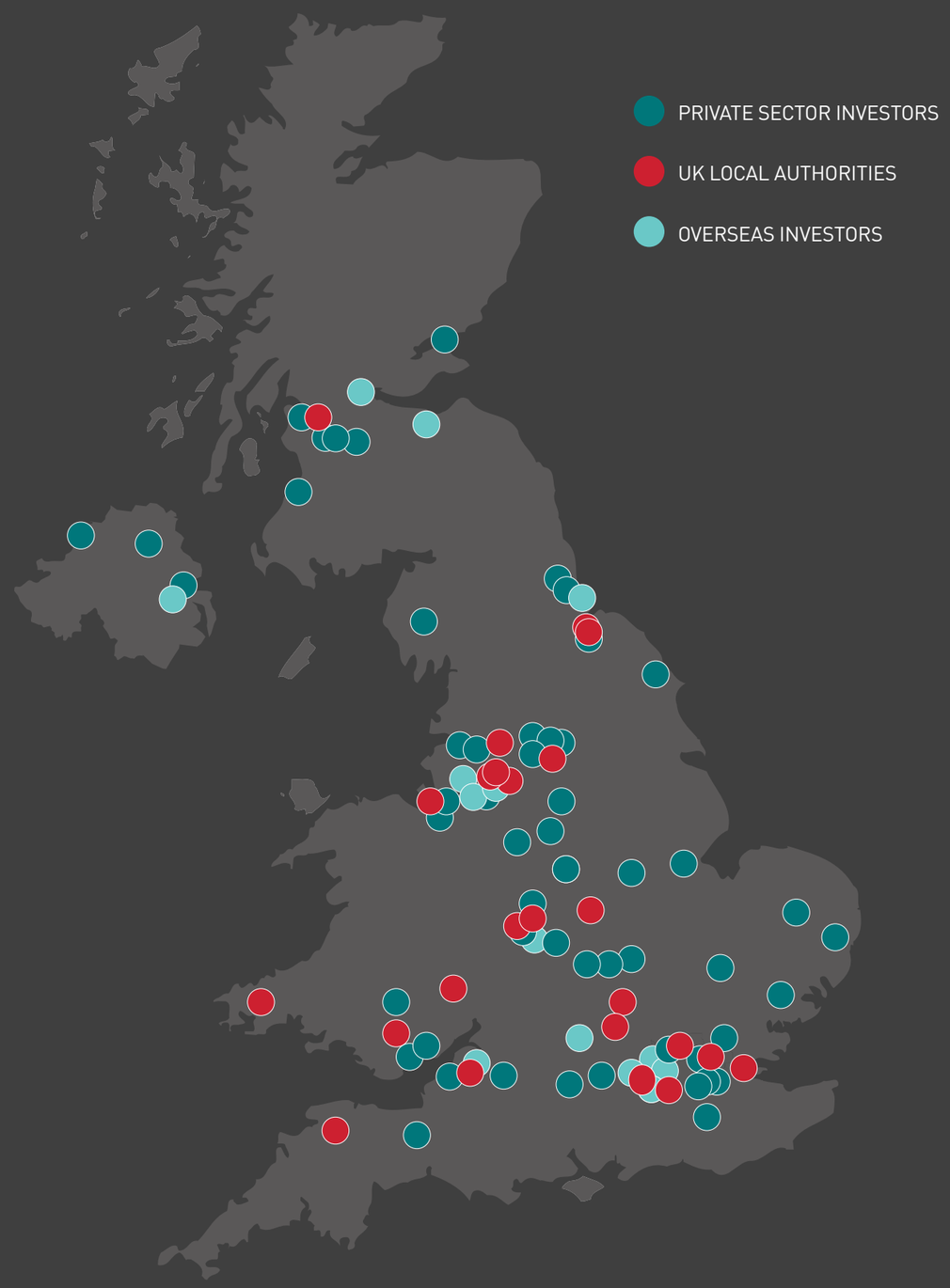
Source: MSCI

REPURPOSING ANGLE OF SHOPPING CENTRE TRANSACTIONS IN 2020-H1 2022



Source: LSH Research

UK SHOPPING CENTRE TRANSACTIONS
BY PURCHASER TYPE, 2020-H1 2022



CHANGING DEMAND

The make-up of shopping centre buyers and sellers has changed, both recently and over the long term. During the 1990s and into the 2000s, shopping centres were core investments and development projects for many UK institutions, but the global financial crisis of 2007/08 was a turning point. The popularity of shopping centres among institutional investors has since been in long-term decline, with asset values and construction activity never recovering to pre-crisis levels.

Many shopping centres built by UK institutions subsequently ended up in the hands of overseas investors primarily motivated by income, rather than having long-term strategic plans to improve centres. Many of these international investors have more recently retreated from the sector, to be replaced by a new breed of retail investors.

SELLERS TAKE A HIT

Over the past two years, several UK investors familiar to the retail sector including Hammerson and Aberdeen Standard, and major international investors such as Patrizia Immobilien and Columbia Threadneedle have all made multiple shopping centre disposals.

Nearly every seller has had to accept sales prices significantly below the price that they paid for the asset. LSH analysis shows that, on average, centres sold over the last two years were transacted at 58% below their previous purchase prices. In the most extreme cases, a handful of transactions saw discounts in excess of 90% on the previous price paid.

BUYERS SEEK OPPORTUNITIES

On the buyer side, a range of private sector investors mainly on the opportunistic and value-add end of the spectrum have been active, making shopping centre purchases with an eye on the potential to drive gains through repurposing and repositioning. Investors making multiple recent purchases include Signal Capital Partners, Evolve Estates, Redical and London & Cambridge.

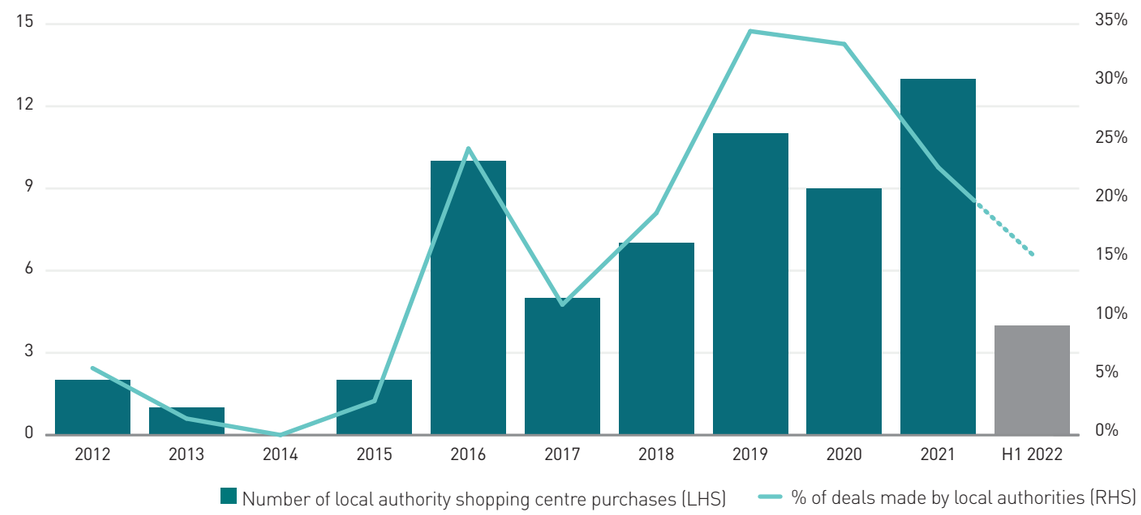
However, a major gap in the investment market is the relative absence of private sector patient capital prepared to invest in shopping centres for the very long term. An increase in this type of investment could be crucial to support the future of the sector.

LOCAL AUTHORITIES STEP IN

Local councils making shopping centre purchases within their boroughs for regeneration purposes have also been a key buyer group in recent years. During 2021, there were a record 13 such transactions in locations as diverse as Sutton, Leicester, Burnley and Merthyr Tydfil. Since 2016, local authorities have been behind more than one in five shopping centre purchases in the UK.

The acquisition of shopping centres by local authorities is not without controversy, and some councils have seen the value of their assets fall significantly since making purchases. However, councils are able to take a long-term view and, as planning authorities, they are in a position to push forward the repurposing and regeneration activity that is sorely needed in many locations.

SHOPPING CENTRE PURCHASES MADE BY LOCAL AUTHORITIES



Source: : LSH Research

FUNDING & FINANCING

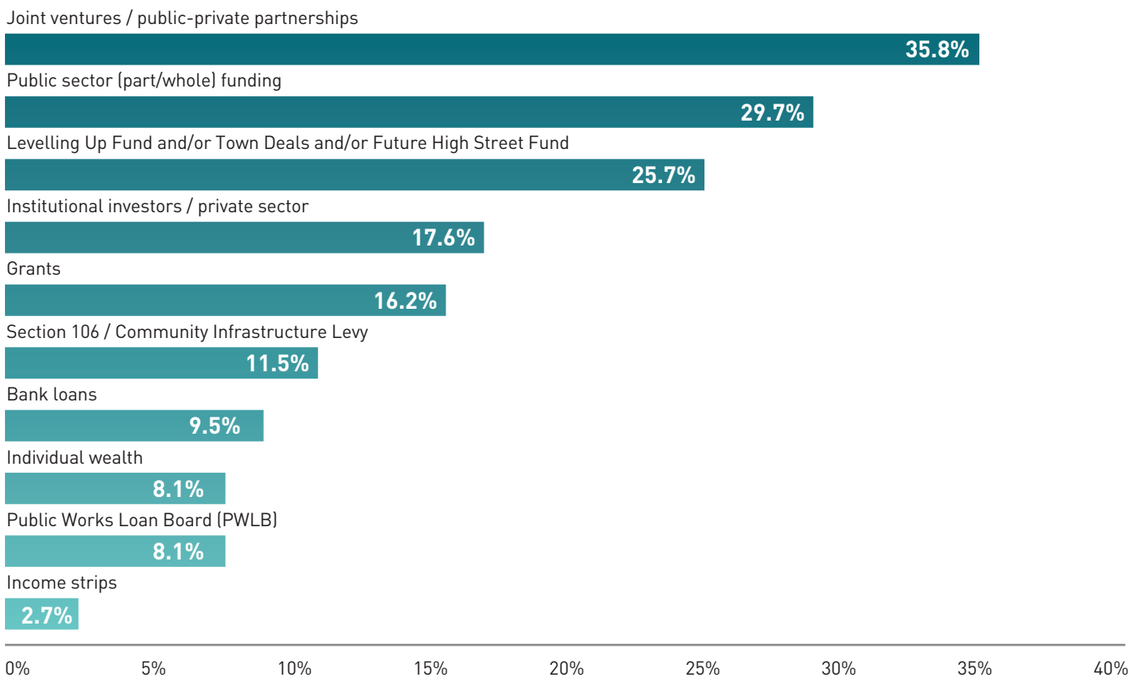
Public sector interventions and funding will be needed in many locations where the commercial viability of shopping centre repurposing projects is challenging.

PUBLIC SECTOR VITAL

The importance of public sector funding is illustrated by the LSH/REVO survey, which asked public and private sector respondents involved with regeneration and development projects how they intend to finance them over the next five years.

The most common response was public-private partnerships and joint ventures, while the next two most popular answers also involve central or local government money. Key sources of funding include some that have been explicitly designed to give local authorities capital support in the delivery of government policy around levelling up and town centre regeneration.

PREFERRED FUNDING METHODS (%, SURVEY RESPONSES)



Source: LSH/REVO Survey 2022
Survey respondents were asked to select all funding methods intended for key projects in the next five years

St Nicholas Shopping Centre, Sutton
Purchased by the London Borough of Sutton for £26m in 2021. LSH acted on behalf of the council to provide extensive due diligence, analysis and research in preparation for the purchase. The advice extended to liaison with architects and engineers to arrive at a future strategy for regeneration and redevelopment.

GOVERNMENT FUNDS

A myriad of government funds have been launched in recent years, some of which have already helped to finance local authority purchases of shopping centres, while other allocated money will be used in town centre regeneration projects involving the repurposing of retail space.

Among the largest funds is the £3.6bn **Towns Fund**, which includes two strands: **Town Deals** and the **Future High Streets Fund**. Most of the funds have been allocated, with 101 towns in England selected to develop Town Deals in 2019; while 72 locations were awarded capital from the Future High Streets Fund in 2020 and 2021. The ambitious regeneration plans in Stockton-on-Tees are among those that will benefit from the Future High Streets Fund.

The £4.8bn **Levelling Up Fund** was launched in 2021, to provide investment for town centre and high street regeneration, local transport projects and cultural and heritage assets. The first round of successful bidders was announced in October 2021; while round two is open until 2nd August 2022. Projects receiving round one funding included the demolition and redevelopment of the Artizan Shopping Centre, Dumbarton.

The **UK Shared Prosperity Fund** was announced in April 2022, as a central pillar of the government's levelling up agenda. Other funds created in recent years include some that were specifically targeted to provide support for the post-COVID recovery, including the **Getting Building Fund**, **Welcome Back Fund** and **UK Community Renewal Fund**. This has created a complex funding environment for local authorities to negotiate.

While the Towns Fund and Levelling Up Fund have already awarded billions of pounds, the projects that they are funding will only be developed over the coming years. For many projects, the securing of central government funds was the first important step; allowing local authorities to acquire and demolish sites, before taking the development phase forward with private sector partners.

PUBLIC WORKS LOAN BOARD

The **Public Works Loan Board (PWLB)** is a well-established source of public funding whose origins trace back to 1875. However, the LSH/REVO survey shows that its popularity has waned; only 8% of respondents mentioned it as an intended source of funding in 2021, compared with 22% in 2019.

This is largely due to tightened restrictions on the use of PWLB loans. Following a wave of controversial out-of-borough commercial property acquisitions made by local authorities, new guidance was issued in 2020 stating that PWLB loans could no longer be used to support the acquisition of investment assets bought primarily for yield.

However, PWLB loans can still be used for regeneration purposes. Recent shopping centre acquisitions supported by PWLB funds include North Devon Council's purchase of Green Lanes Shopping Centre in Barnstaple in 2021.

OTHER OPTIONS

The **UK Municipal Bonds Agency (UKMBA)** is an alternative source of finance for local authorities, issuing bonds on their behalf to raise funds for capital expenditure and projects. However, councils have been slow to take up municipal bonds since the UKMBA was established in 2014 and alternative bonds are available from the institutional investor market. The London Borough of Sutton has issued a £250m bond using the European Primary Placement Facility (EPPF) to finance projects within its approved capital programme.

A further £22bn of financing is available from the government-owned **UK Infrastructure Bank (UKIB)**, which was launched in 2021, to replace the functions of the European Investment Bank. The new bank will provide infrastructure finance and partnering with the private sector and local government for projects that drive economic growth and support green objectives.

Income strip deals, now increasingly referred to as 'regeneration leases', are another financing option. Essentially, this type of deal allows a public sector tenant to obtain forward funding for a major development project in exchange for a long lease of 30-50 years, with the option to acquire the freehold for £1 at the end.

To date, this source of finance has most commonly been used to develop Build to Rent (BtR) schemes, but it could become a key mechanism for unlocking patient private sector investment into shopping centre regeneration projects. Rochdale Riverside, which opened in 2020, is an example of a retail and leisure development where this approach has been taken, with M&G providing £80m for the delivery of the scheme, with the council paying this back over a 35-year period.

A range of solutions will be appropriate for different shopping centre repurposing and regeneration projects. Ultimately, blends of public and private sector capital and expertise will be needed to drive forward the delivery of most high quality mixed-use developments.

FUNDING VEHICLE	TOTAL FUNDING	TYPICAL FUNDING SIZE	GEOGRAPHY	TYPE OF FUNDING	FUNDING RECIPIENTS	PURPOSE	STATUS OF FUNDING FACILITY	EXAMPLE OF SHOPPING CENTRE FUNDING
Levelling Up Fund	£4.8bn	Up to £20m (larger bids of £20-£50m accepted for transport projects only)	UK-wide (with specific minimum allocations to Scotland, Wales and Northern Ireland)	Direct funding from central government	Local authorities. Bids will be accepted by other applicants, including businesses, in Northern Ireland.	To invest in local infrastructure that improves everyday life. Funding is prioritised for local authority areas assessed to have the greatest needs, with each area put into one of three priority categories.	The first round of successful bidders was announced in October 2021. Applications for round two funding must be submitted by 2nd August 2022. The fund will run until 2024/25.	Funding to West Dunbartonshire Council for the purchase and demolition of Artizan Shopping Centre, Dumbarton.
Town Deals (part of Towns Fund)	£2.4bn offered to date	Up to £25m (more in exceptional cases)	England	Co-funding and matched preferred	101 towns were pre-selected to develop funding proposals. An additional competitive allocation of funding has been promised for towns not initially selected.	To increase economic growth with a focus on regeneration, improved transport, better broadband connectivity, skills and culture.	Offers totalling £2.4bn have been announced for all 101 pre-selected towns. No announcement yet on the competitive allocation of funding for other towns.	Funding for Bournemouth planned to be used in the replacement of Sovereign Shopping Centre, Boscombe, with a mixed use neighbourhood.
Future High Streets Fund (part of Towns Fund)	£830m awarded	Up to £25m	England	Co-funding towards capital projects	Local authorities.	To renew and reshape town centres and high streets in a way that drives growth, improves experience and ensures future sustainability.	Launched in 2018. After bidding, 72 towns were awarded a total of £830m in 2020-21.	Funding for demolition and replacement with an urban park of Castlegate Shopping Centre, Stockton-on-Tees.
Public Works Loan Board	£7.9bn lent in 2021	Average loan size of £12.8m in 2021	England, Wales, Scotland	Low interest loans	Local authorities (including town and parish councils) and other specified bodies.	Lending facility operated by the UK Debt Management Office providing loans for capital projects.	Ongoing source of funds since 1875.	Funding for the purchase of Green Lanes Shopping Centre, Barnstaple by North Devon Council.
UK Infrastructure Bank	£22bn of financial capacity	Initial loans have ranged from £10m to £250m	UK	Loans and other financing tools available	Private sector and local authorities.	Investment in infrastructure assets that drive regional and local economic growth or support tackling climate change.	Launched in June 2021 as a replacement for European Investment Bank activity.	None to date.
UK Shared Prosperity Fund	£2.6bn	Core allocations range from £1m to £144m	UK	Direct funding from central government	Local authorities. Funding allocated using formulas rather than a competition. Local authorities will have to submit investment plans before allocations can be unlocked.	To reduce inequalities between communities, as part of the government's levelling up agenda.	Fund launched in April 2022. The first payments are expected from October 2022, with the funding period lasting to March 2025.	None to date.
Getting Building Fund	£900m	Allocations range from £7.5m to £85m	England	Direct funding from central government	Local Enterprise Partnerships and Mayoral Combined Authority areas.	To support the post-COVID recovery with funds for shovel-ready local infrastructure projects.	Funding allocated in 2020.	Funding to the West Yorkshire Combined Authority for the repair, refurbishment and reconfiguration of Dewsbury Arcade.

THE CENTRE OF THE FUTURE

The shopping centre as we think of it now may not exist in the future. Retail-only centres will need to evolve into mixed-use locations, serving a wide range of community needs. These may no longer be thought of as shopping centres, but simply as town centres. While every location will have to respond differently to the needs of its local community, some key characteristics of successful future centres can be proposed.

MIXED

Leisure, food and beverage, flexible offices, residential, healthcare, education and other uses may all sit alongside retail in future centres. The greater the range of commercial, residential and community uses offered by a centre, the more reasons that people will have to come to them and to stay for longer.

Finding the right combination of mixed uses will generate a 'halo effect', with consumers' positive experiences in one area making it more likely that they will use others, improving footfall and revenues across the centre.

LIVING

Mixed-use centres with residential space will need to be integrated into the communities that live in and around them. Future centres will not survive if they are only places where people go to shop and then leave; instead they need to be locations where communities live, work, play and socialise.

By becoming living places with a resident population, demand will be created for a wide range of community services, including healthcare, education, libraries and sports facilities. The mixed-use centre of the future may essentially need to function as a town centre in itself, serving a broad range of public needs.

24/7

Across all commercial property sectors, one of the key post-pandemic challenges is finding ways to utilise and generate value from space for longer periods of the day and week. For shopping centres, this means adding uses that ensure they do not become dead spaces outside of retail hours.

Introducing residential space could be key, as it creates an on-site population generating 24/7 demand for services. Community, cultural and leisure uses will also bring life to centres at times when shops are quiet or closed.

FLEXIBLE

Flexible space and leases will be needed to ensure that centres can attract a broad range of occupiers across sectors. Landlords will need to be flexible on terms, by offering short leases or turnover rents, or even setting aside some space that can be rented on an hourly or daily basis to support new and local businesses.

Flexible units that are easily divisible and adaptable to different tenant needs will also be required. Future centres may ultimately need to offer ultra-flexible space that breaks conventional sector distinctions and can be used as retail, leisure, work or community space; and occupied by different tenants depending on the time of day, or the day of the week.

SUSTAINABLE

With ESG considerations continuing to rise up the agendas of investors, occupiers and consumers, there will be an increasing onus on centres to make positive environmental and social impacts. The shopping centre of the near future will need to be carbon neutral, and designed or retrofitted with features that reduce energy consumption and water usage.

Better integration with public transport and cycling links will help to reduce the emissions caused by travel to shopping centres. This will also be supported by the move towards mixed-use centres, as the addition of residential units will lessen the travel requirements of those living in these new homes.

EXPERIENTIAL

The key advantage that physical retail and leisure operators have in an increasingly online world is their ability to provide in-person experiences that go beyond simply browsing and buying products. Shopping centres will increasingly need to cater to consumer demand for personalised, immersive retail experiences, and the human desire for social and face-to-face interactions.

An increased focus on experiences will see centres giving greater volumes of space to leisure and food and beverage uses, as well as providing flexible and pop-up retail spaces suited to local, artisan and boutique businesses.

While unprecedented challenges abound, shopping centres still have important roles to play within towns and cities. However, they may need to take on radically different forms in order to survive and flourish. Repurposing activity is key to securing the future of centres, but it must be carefully planned and implemented so that it supports bold new visions of their long-term roles at the heart of communities.

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