Retail Renaissance 2025

Lesson #3: Understanding / managing / avoiding obsolescence and oversupply

2025

The third of six papers exploring what other real estate sectors can learn from Retail's fall and unlikely rise again

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Repurposing not necessarily the default option.

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3 KEY LESSONS:

- Denial is a dangerous option. Oversupply and obsolescence need to be first acknowledged, then addressed. Or better still, avoided altogether.
- Obsolescence is more palatable if proactively managed, rather than addressed reactively and retrospectively – prevention is better than cure.
- Repurposing is a highly complex undertaking requiring bespoke solutions. There is no manual or blueprint – and it needn't be the primary course of action.

Oversupply + obsolescence = repurposing. The real estate equivalent of $E = mc^2$? Or does 2 + 2 = 5? Oversupply is complex. So is obsolescence. Add them together and the product is something infinitely more complex.

Oversupply and obsolescence are both industry buzzwords, often bracketed together as interwoven twins of real estate evil. The reality is that they are separate forces that act as often in isolation as they do in unison and both come in many guises.

Repurposing the only equation-balancing solution? Unquestionably oversupplied as a market, with more than its fair share of obsolescent stock, retail was involuntarily put forward as the ultimate guinea pig in the great repurposing experiment. There have been a few positive test results that went beyond control procedures. But few definitive cures and certainly no panaceas. And not nearly as much activity as the noise that encircled every endeavour.

Indeed, we have now turned full circle. An increasing number of proposed retail repurposing projects are now finding a future in....retail. More relevant retail than before. But retail nonetheless.

OBSOLESCENCE – IN ALL ITS MANY GUISES

Old fashioned. Out of date. No longer of use. In property terms, obsolescence is when a building no longer meets current needs – legally, physically, functionally or financially. It comes in many forms. Our *'Sustainability Series' ('Meeting the Commercial Property Retrofit Challenge – Part 1: Defining a Strategy')*, categorises these risks under four main headers:

1. Regulatory
The risk of not meeting regulatory or legal requirements. In the UK, the Minimum Energy Efficiency Standards (MEES) require commercial buildings to have a minimum Energy Performance Certificate (EPC) rating of E to be lettable from 1 April 2023. There are proposals to raise this minimum to a C rating by 2027 and a B rating by 2030 – although timelines and implementation are far from set in stone.

2. Functional
Spanning two areas: sustainability and economic. The former relates to the shift in tenant preferences and the risk that a building no longer meets occupiers' ESG needs. The latter relates to the change in the economic makeup influencing the occupiers e.g. for offices, a shift from financial occupiers to life sciences – which require different types of space and possibly change of use.

3. Physical
These are largely climate change-driven impacts and may either be classed as 'Acute' (event-driven e.g. heatwaves, hurricanes, or droughts) or 'Chronic' (long-term climate shifts, such as temperature changes, sea level rise, or soil erosion).

4. Financial
Relating to access and cost of insurance and financing. With rising physical risk, the cost of insuring buildings is increasing, and, in some locations, the availability of finance is limited or indeed absent.

DECODING OBSOLESCENCE IN RETAIL

Many (but importantly, not all) of these roads to obsolescence are ESG-related. One of the underlying themes of this series of research papers is that retail is ahead of the curve in its evolution – more at the bleeding than cutting edge – and that other property sectors can learn from retail's often uncomfortable journey.

> “Rightly or wrongly, ESG does not dominate the narrative in retail to anything like the extent it does in offices.”

ESG is something of an exception or outlier to this general theme – retail is definitely a laggard when it comes to many aspects of ESG. Rightly or wrongly, ESG does not dominate the narrative in retail to anything like the extent it does in offices. Yet it is as big an issue in retail real estate, perhaps even more so. As explored in our *‘Retail Renaissance’* report, retail certainly compares unfavourably with other property use classes in terms of MEES classifications. A paltry 4.2% of retail stock is currently rated as A/A+, with just a further 22.4% rated B.

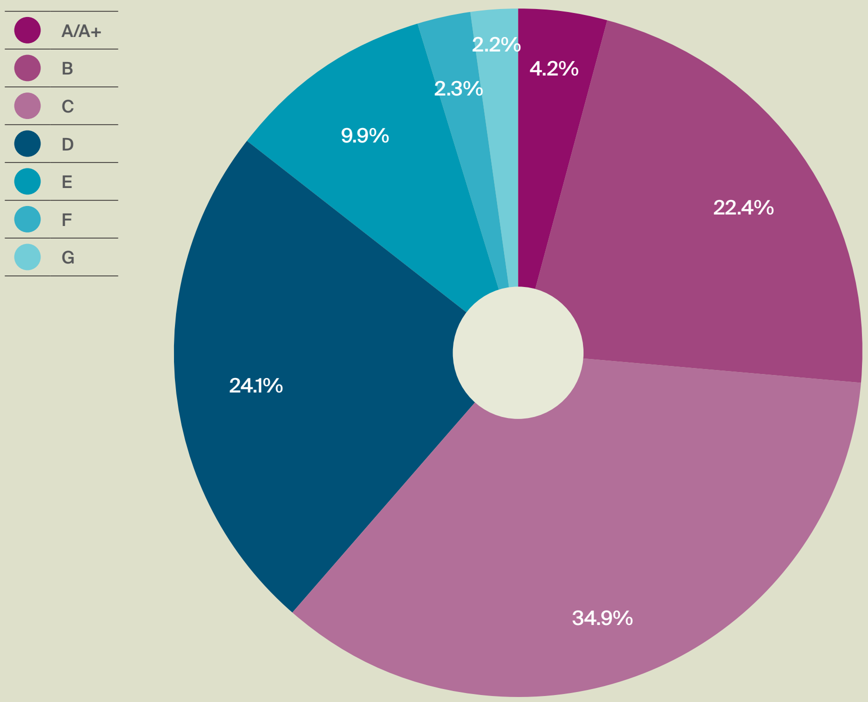
If MEES proposals become legislation – admittedly a massive if at this stage – 38.5% of retail units will be unlettable from 2027 and 73.4% from 2030. These figures are alarmist and make for sensationalist media headlines, but the key point is that retail is less evolved in the ‘E’ of ESG than other real estate sectors (although arguably plays better in the ‘S’ space, as we also explore in the *‘Retail Renaissance’* report).

Why is retail the laggard? In part, this is the negative by-product of a communication breakdown between occupiers and landlords, the former thinking it to be the latter’s responsibility and financial obligation, the latter the former’s. An impasse that doesn’t exactly shower the retail sector in glory and from which few edifying lessons could be learned.

Turning the argument on its head, other property sectors have become so preoccupied with ESG that it almost borders on paranoia. That is not to undermine or denigrate its importance in any way, but there is a risk that everything else can become subordinate. The pursuit of achieving the necessary ESG credentials overrides other equally critical operational fundamentals.

Retail’s regulatory risk of obsolescence: Only 26% of stock meets 2030 EPC B target

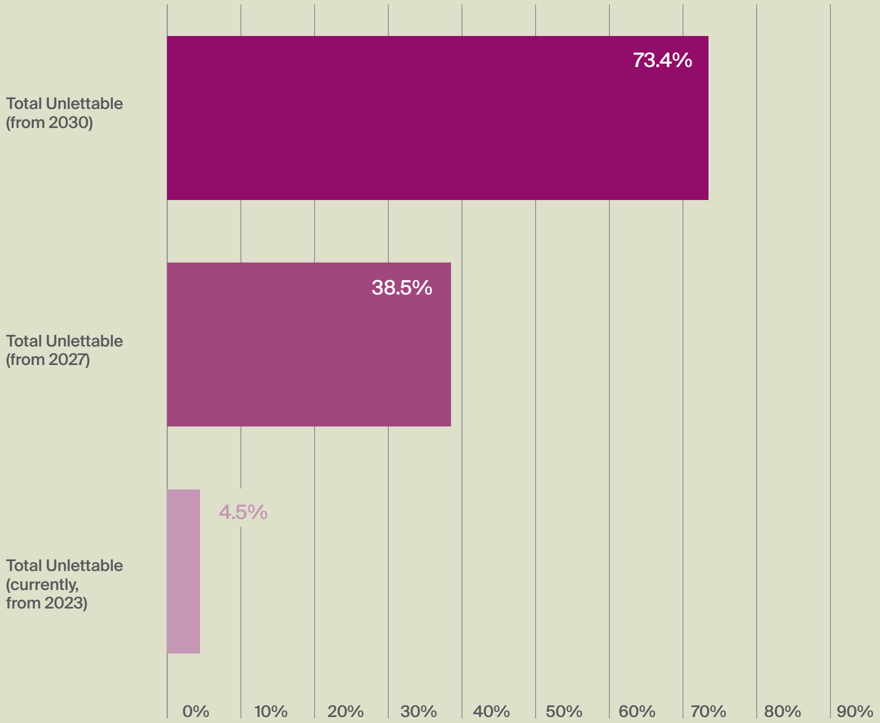
% of retail assets by EPC rating



Source: DLUHC, Knight Frank Insight

Proportion of retail floorspace at risk of becoming unlettable in next decade

% of potentially unlettable floorspace, by EPC milestones



Source: DLUHC, Knight Frank Insight

> "The retail market is oversupplied, no question, no denial."

But as already alluded to, obsolescence does not exclusively relate to ESG, it may equally arise through financial or commercial barriers. Given the choice of occupying a BREEAM Outstanding or MEES A+ store, or one with highly questionable ESG qualities (but one where a retailer will make more money), any retailer would opt for the latter. An uncomfortable truth maybe, but commercial decisions will always trump 'doing the right thing'.

By extension, a brand new, high spec, ESG-compliant building is still obsolescent if there is no demand to occupy it. Even the best, most prime stock can be obsolescent if it is irrelevant to the fundamentals of supply and demand.

Of course, retail has always differed from other major commercial real sectors in that it is operational – in base terms, retail floorspace has to deliver in terms of sales or profit/sq ft and this is very measurable. Stores either make money or they don't and that essentially dictates whether they are fit-for-purpose or obsolescent.

With offices increasingly aspiring to evolve towards a more operational model, surely some lessons to be learned from retail's highly-commercialised approach to obsolescence?

OVERSUPPLY – IDENTIFYING AND ACTIONING

The retail market is oversupplied, no question, no denial. How this situation arose is slightly more debateable, but essentially retail was guilty of overdevelopment in the good times, with no process of obsolescence management. These fundamental fault lines only became truly apparent amidst the tsunami of structural change, explored in **Paper 1** of this series. Too much retail floorspace was built both in-town and out-of-town (especially), surplus or deteriorating stock was left to drift, all the time that the multiple forces of structural change were waiting in the wings.

The actual quantum to which retail is oversupplied is a moot point. One of the largest REITs is on record as saying the retail market could be as much as 45% oversupplied (though, curiously, absolutely none of their substantial retail holdings falls into this category). A national vacancy rate of 14-15% is perhaps a better yardstick, if one is even needed.

A moot point or a total irrelevance? To focus on quantifying national retail oversupply misses the more serious issue of diagnosing where the problem is and delivering an effective solution. Oversupply is very much a localised, asset-specific issue. Town-level metrics drill down one level and are instructive to a certain degree. Knight Frank's core three retail oversupply metrics (vacancy, rental decline, space productivity) provide a more than decent starting point.

To summarise the full analysis, across the 300 PMA PROMIS centres:

- Vacancy rates range from 3.7% to 38.0%
- 10 year Zone A rental performance ranges from +25% to -233%
- Space productivity ranges from £30/sq ft to £542/sq ft
- 46 centres have vacancy rates above the 'critical threshold' of 25%
- 64 centres have seen rents fall by more than >100%
- 55 centres have space productivity below the 'critical threshold' of <£100/sq ft
- 10 centres worryingly exceed all three 'critical thresholds'

There are any number of metrics and methodologies that we can deploy to identify and understand retail oversupply at a regional or town level. But these are only a gateway to translating this onto an asset-specific playing field and actually doing something proactive to address the issue.

Offices may be more advanced than retail in their embrace of ESG, but in terms of confronting oversupply? From a purely retail standpoint, many within the office space appear to still be in denial, drawing on prime metrics and changing definitions to suit, rather than address over-supply that is definitely there in certain locations.

Lessons to be learnt from retail? Understand and differentiate between which stock is working hard and remains fit-for-purpose. And seek to find solutions for that which isn't, the sooner the better.

RELEVANCE THROUGH REPURPOSING

Repurposing is seen as the default option for failing or obsolete property stock, whatever the use class. So much so, that it has become a universal buzzword.

The reality is much more challenging – a number of great divides have to be crossed to make any would-be repurposing projects viable.

Retail oversupply indicators: performance benchmarks and critical thresholds

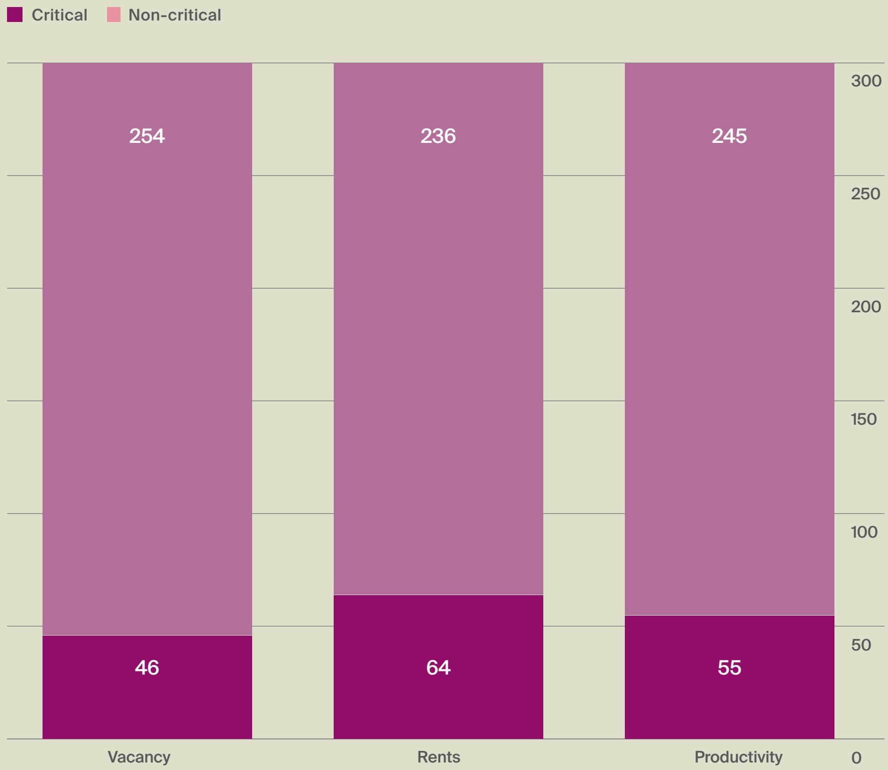
METRIC	VACANCY	RENT DECLINE	SPACE PRODUCTIVITY
Average	18.3%	-65%	£182/sq ft
Worst in Class	38.0%	-233%	£50/sq ft
Best in Class	3.7%	+25%	£542/sq ft
Critical Threshold*	>25%	-100%	<£100/sq ft
Count of Retail Centres exceeding the Critical Threshold	46	64	55

*The point at which an asset's performance suggests structural, not just cyclical, issues

Source: PMA, LDC, CACI, Knight Frank Insight

‘Critical’ Centres by metric – PMA 300 Centres

No. of Centres



Source: PMA, LDC, CACI, Knight Frank Insight

On our *UK Cities DNA Paper ‘Five Great Barriers to Repurposing’*, we distil the challenges into the following generic divides:

1. Geography

2. Configuration/Ownerships

3. Asset Compromises/ Fabric Issues

4. Planning

5. Value alignment

Some or all of these will apply to a varying degree in any potential repurposing project. That is the nature of the beast. But ultimately, all these stars must align if the project is to have legs.

As an oversupplied market staring down the barrel of increased obsolescence through tightening ESG compliance, retail is an obvious, if not totally willing, volunteer for widespread repurposing. But rather than the repurposing poster child it is purported to be, retail actually shines a light on many of the complexities that these identified barriers pose. To focus on but one: value alignment is very difficult to achieve in retail, except in very specific locations (e.g. Greater London, some of the largest regional cities, certain affluent market towns in the South East).

> “It is fair to say we are probably likely to see far less repurposing of retail space going forward than was projected even as recently as a couple of years ago.”

Yes – there have been positive case studies of retail repurposing projects. But, by and large, these have been relatively small in scale, department stores rather than shopping centres. There have been examples of the latter, but generally, these have been few and far between and many proposed projects remain works-in-progress. The level of talk on shopping centres in particular has yet to translate into a commensurate level of activity. On the other hand, the 160-strong former Debenhams portfolio is slowly being reabsorbed into the market.

What is interesting is the variety of alternative uses that have been found for the Debenhams stores to date. From hotels, gyms, cinemas, F&B and competitive socialising formats on the Leisure side, through student accommodation and BTR on the residential side, through to life sciences, standard and serviced offices, to call out but a few. This is a key learning from this repurposing process – there is no ‘one size fits all’ solution to obsolete stock, repurposing is asset-specific and will need to reflect local demand and dynamics.

The other key lesson is that repurposing is seldom binary. There are instances of a straight substitution from one use class to another, but these are the exception rather than the rule. Many successful repurposing projects are mixed use, leveraging synergy between different property classes, again dictated by local demand. The prevailing sentiment that any/all surplus office stock can be turned into residential is far too simplistic and a far less blinkered mindset is required to make a success of potential repurposing opportunities.

RETAIL – BACK TO THE FUTURE?

Repurposing is challenging, but is achievable with the requisite know-how (for more detail, please refer to the *UK Cities DNA Paper ‘Mapping out the Repurposing Journey: the Keys to the Kingdom’*). But it is fair to say we are probably likely to see far less repurposing of retail space going forward than was projected even as recently as a couple of years ago.

If anything, we are now seeing a slight shift away from retail repurposing and more towards refurbishment and retrofits.

Some key examples of this shift include British Land's significant U-turn on Thurrock Shopping Park. The REIT bought the scheme from Nuveen for £82m (£3.8m per acre) back in 2021. With considerable fanfare, it secured planning to repurpose the scheme as a 664,000 sq ft urban logistics project at the end of 2023. Repurposing a failing sector (retail) into a prospering one (urban logistics) seemed an absolute no brainer. Until the recent decision was made to turn the retail space... back into more retail.

A few years ago, Landsec were equally ambitious in pivoting away from retail, announcing plans to repurpose key shopping centre schemes such as Buchanan Galleries in Glasgow. That was before they acquired Liverpool ONE at the end of 2024 for £490m. A major change of heart that is likely to see renewed investment in core shopping centres, rather than divestment or full-scale repurposing. Investment that is likely to see retail footprints redefined – and made better – rather than downgraded completely. A switch away from retail...back to retail. But better retail.

Repurpose to make relevant. Or refresh and make relevant. Relevance is the ultimate end game either way. And rediscovering relevance is the roadmap that any oversupply or obsolescence challenges must ultimately follow.

> "Investment that is likely to see retail footprints redefined – and made better."

THE AGENT VIEW

"Retail for retail's sake"

Sam Waterworth, Dan Serfontein – Partners, Retail Capital Markets

SAM WATERWORTH

DAN SERFONTEIN

"Even before the Russia/Ukraine conflict, the viability of retail repurposing was challenging. With the resultant build cost inflation, a far more stable occupational market and the challenges of securing vacant possession becoming clearer, we are now, in the main, appraising retail for retail's sake.

For town centre retail, the obvious exceptions are department stores and peripheral pitches. If a former department store has not been taken and reoccupied by now, the likelihood is that repurposing is needed. With a national high street vacancy rate of 13.7% (and shopping centres at 16.8%), it is clear that many towns are oversupplied. However, this is most manifest in secondary/tertiary pitches, where Existing Use Values (EUVs) are low, and this is where projects start to become viable and where developers are focused.

Out-of-town retail, by contrast, has far lower levels of oversupply, as evidenced by a vacancy rate of just 6.4%. Repurposing to date has generally been driven by higher value uses rather than obsolescence, but with retail warehouse values increasing, the balance is gradually tipping. The rate of repurposing is consequently slowing and there are numerous examples of would-be developers opting to maintain the status quo. We are, however, seeing investors modernise their parks, particularly with regards to decarbonisation, to access the ESG premium available for best-in-class retail warehousing, with core Local Government Pension Scheme (LGPS) money typically having a minimum EPC requirement.

Some of the most interesting repurposing projects we have seen:

- Lindt House, Richmond – former House of Fraser acquired in 2022 for ca. £350/sq ft. Comprehensively repurposed to provide two high-end restaurants, a Third Space gym and Lindt's Global HQ.
- Former Sainsbury's, Austin Drive, Coventry – an oversupplied foodstore market where planning has been secured for conversion to self-storage.
- Johnnie Walker, Edinburgh – former House of Fraser repurposed into Johnnie Walker's 75,000 sq ft flagship visitor experience.
- Former B&Q and Homebase, Wandsworth – an example of repurposing to higher value uses, two retail warehouses redeveloped into over 1,000 much needed new homes.
- Former Debenhams, Cardiff – perhaps most unusual, but certainly hitting the 'S' of ESG, Landsec are transforming this former department store into a public square with a splash pad, play park and raised terrace with two restaurants overlooking the city square.

Interesting projects, successful repurposings – but more the exception than the rule?"

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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