savills

Spotlight
UK Commercial Leisure

Q1 2014

Image: Curzon will be opening a five screen cinema at Land Securities' Nova scheme, Victoria in May 2014

SUMMARY

■ Consumer spending on leisure has remained comparatively resilient throughout the downturn. We expect that spending on leisure services will grow by 1.3% per annum over the next five years.

■ Tenant demand for the best leisure schemes and locations has continued to be strong. Robust expansion in the cinema sector, combined with a large number of acquisitive restaurant and Health & Fitness operators should continue throughout 2014.

■ Leisure investment volumes rose by 30% in 2013, with investor demand wider than ever. Lack of stock will be a challenge in 2014 and beyond, but we expect investor demand for quality locations to be sustained.

"Leisure will continue to be on investors' shopping lists in 2014 and beyond."
James Hurst, Savills Leisure

The Leisure Economy

Whilst there is some concern amongst economists and other commentators that the UK economic recovery is a bit unbalanced, the consumer and housing led pick-up is undoubtedly good news for the leisure economy.

As Graph 1 shows, consumer confidence picked up to -7 in January 2014, its least pessimistic level since October 2007. This indicates that the UK consumers have returned to their normal state of mild pessimism! The pick-up in the housing market has undeniably had an impact on consumer confidence, and this along with rising employment levels should improve leisure spend throughout 2014.

One lurking issue on the consumer side of the economy is real earnings growth. Average weekly earnings in the UK only grew by 1.3% in 2013, and while this is slight improvement in the rate of growth, it still means that in real terms the average UK household is experiencing a contraction in its income. This means that any future rise in spending can only be supported by reductions in the savings ratio or increased borrowing. Much of the boost that retailers and leisure operators saw in the run-up to Christmas was delivered by a reduction in the savings ratio, but the scope for most households to reduce this further is limited.

The prospects for spending growth are definitely brighter in 2014 than they were in 2012 and 2013, but it will still be some time before spending power is sufficiently strong to support the rates of consumption growth that we have seen recently.

A continuing theme of this report throughout the downturn has been that spending on leisure is generally more resilient in a recession than spending on other things. This was definitely the case in the most recent downturn, when total household spending contracted by 0.2% per annum and spending on recreational and cultural services rose by 0.2% per annum. The difference is even more significant if we strip out spending on goods and housing, which leaves spending on other services contracting by 1.1% per annum over 2007-11.

The recovery in the economy will lead to another rebalancing of consumers' spending priorities, and we expect that spending on the things that people cut back on in the downturn will grow faster. This means that against a background of average annual household spending growth over the next five years of 2.4% per annum, spending on goods will rise by 3.5% and spending on leisure services by 1.3% per annum.

Cinema occupational review

Cinemas are still seen as the holy grail by the leisure sector; unquestionably as essential anchors to any new development and in recent years as saviours of secondary shopping centres where retail demand has stalled. With over 60 cinema developments scheduled to open between 2014 and 2017, and a further 50+ in the early phases of planning proposals, the cinema operators' relentless drive for growth is propelling the leisure sector forward. This is being driven both by solid returns and pressure to increase market share by the operators' private equity backers.

We do question how long the space race can continue, with only small gains of 5% in admissions between 2005 and 2011, yet a 22% increase in multiplex screens over the same period. With 'over-screening' becoming a real threat, we predict some consolidation occurring, with older first generation cinemas beginning to come under threat.

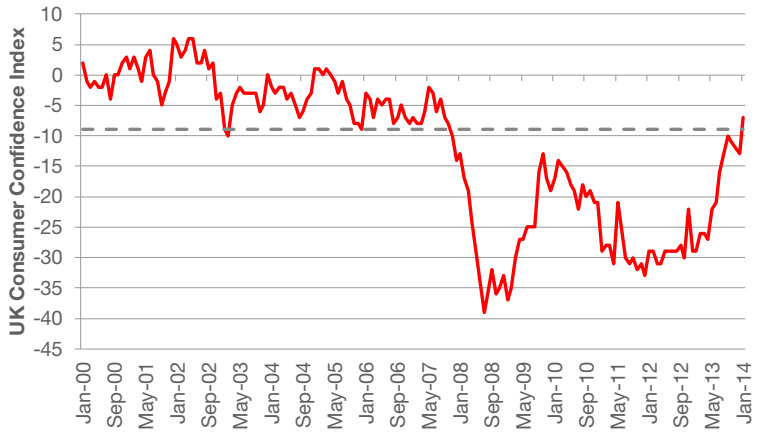
While this growth continues to be dominated by the big three; Vue, Cineworld and Odeon (65% of total UK cinema screens), the smaller boutique operators such as Everyman and Curzon are also gaining market share and credibility with landlords and restaurant operators. As a result, smaller format cinemas are themselves acting as anchors to cinema developments in smaller towns/ catchments, such as Curzon cinema in Harrogate. Even in larger towns and cities, where another multiplex is unviable, 2/3 screen boutique cinemas can offer a point of differentiation, for example at Trinity Leeds (Everyman).

Despite positive news stories in terms of cinema pipeline, 2013 was a disappointing year for box office revenues; with cinemas taking £1.15bn in 2013, down 1% on the previous year, representing the biggest dip in returns since 1991 (Rentrak). Arguably this is largely due to the lack of box office hits such as Skyfall in 2012, with takings of £100m. 2013's biggest movies were animated sequel Despicable Me 2 (£47.2m), Les Miserables (£40.8m), Iron Man 3 (£37.2m), The Hobbit (£34m) and The Hunger Games (£32.5m).

Further press comment this year has revealed that Guy Hands has pulled a planned £1.25bn float of the Odeon cinema chain amid weak trading in its Spanish business. The private equity veteran, who controls Odeon & UCI Cinemas Group has decided to maintain control of the business until trading improves. It is the second time in three years Terra Firma has pulled a proposed sale of the Odeon business,

GRAPH 1

Consumer confidence has recovered



Source: Savills, GfK

having ended a process in May 2011 after a £475m refinancing.

Restaurant occupational review

The restaurant market has been reasonably robust throughout the downturn, which highlights both the strength and depth of the market, together with the UK consumer's desire to eat and drink out on a more regular basis. Like for likes have increased across the board, with The Restaurant Group being one of the sectors star performers, as highlighted by their recent results for the 52 weeks ended 29 December 2013 whereby the Group's revenues grew by 9% to £580m, EBITDA has increased by 13% to £108m and like-for-like sales were 3.5% ahead of the previous years which has continued in the eight weeks to 23 February 2014, 3.5% ahead of the same period in the previous year.

Due to such positive financial figures, private equity activity throughout 2013 was significant with the likes of Byron Burger and Cote capturing the biggest headlines. Byron was sold by the Gondola Group to Hutton Collins Partners in a £100m deal whilst Cote's Richard Caring sold his stake in the chain in a deal with CPBE Capital worth £100m, further to the company reporting a 28% increase in EBITDA to £12.8m. We believe this renewed interest will continue at pace during 2014, with a number of potential targets already being circled.

Whilst there have been undoubted winners in the sector, there have also been some losers, with the individual/local restaurants struggling to compete with their larger branded competitors. There has been a trend in recent years where restaurants are seen as the saviour of the high streets, and to a certain extent this is true. But it is not the case that one size fits all! Yes, the likes of Zizzi, Pizza Express, Costa and Starbucks have been active in growing a significant presence in our town centres, however their requirements in terms of property fundamentals haven't changed. All, for example still place a large importance on size, configuration and a location that offers day and night time trade, limiting options to certain pitches within often already thriving UK high streets, such as Friary Street, Guildford, where Five Guys have taken prime retail space at over £63/sq ft.

With some traditional high streets still struggling, retail and leisure parks together with shopping centres have become the new destinations of choice for both operators and investors. These schemes can offer open plan, well configured units to the operators' standard shell specifications. Despite the attractions of the UK's major shopping centres, the trade in such markets can be disappointing and only in the best schemes can operators' overcome the limitations of daytime trading. As a consequence, the cinema anchored, mixed-use schemes continues to cement their position as the top A3 trading locations.

In terms of new brands/trends in the restaurant sector, unsurprisingly London has provided the main focus in what can only be described as a booming A3 market. We are seeing a plethora of new independents and pop-up brands emerge, especially throughout the more dynamic, "edgy," locations in the West End and The City. Much of this activity is centred around affordable, quick service bites in casual 'back-to-basics' environments. Notable cuisine trends are Mexican offers such as Chipotle, Chilango and Tortilla and pan-Asian concepts such as Pho, Rosa's and Thai Pad, together with outfits offering authentic American burgers & steaks, such as Bubbledogs, Pitt Cue, Burger & Lobster and Honest Burger.

As we look into 2014, we believe the restaurant sector is well placed to provide similar good news stories in the regions, with cathedral cities and strong market towns being priority locations. Ordinarily, London is the catalyst for operators looking to expand further afield and with a number of operators now being private equity backed, the need to expand their relevant portfolios has never been greater.

Detailed below are operators currently on the acquisition trail, which we believe will be ones to watch for 2014:

■ Benito's Hat

Mexican kitchen Benito's Hat have secured private equity backing to grow its four strong London estate to 10 sites by the end of 2015. The group received an investment of £1.4m with the majority of the funds coming from the UK based private-equity firm Calculus Capital.

■ Giggling Squid

Small Thai restaurants have been particularly active with Giggling Squid, Koh Thai Tapas, Thai Pad and Rosa's amongst those operators looking to add more to their portfolios throughout 2014. Giggling Squid have recently opened in Reigate and Marlow and have their sights set on 80 sites over the next seven years

■ Five Guys

The popular US burger chain has opened its first three sites in Long Acre, Islington and Reading and has recently secured new units in Guildford & Kingston. Five Guys have aggressive expansion targets and so far have not shied away from paying hefty premiums to secure prime sites.

■ Cote

The CBPE-backed group saw turnover climb 31.2% to £64.7m in the year to 28 July 2013, while pre-tax profit increased from £6.9m to £8.9m. With a strong focus on Central London, Cote are beginning to press further into the south east and affluent towns.

■ Living Ventures

With the ambition of becoming a £100m turnover company, recent figures suggest Living Ventures is halfway there. In the 53 weeks to 31 March 2013, total revenue increased by 23% to £47.3m, while EBITDA rose 39% to £4.1m. Living Ventures operate 32 venues across 11 different brands. The New World Trading Company brand has secured a new bank facility of £2.2m and

will open five further sites in 2014 in London, Birmingham, Glasgow and Manchester. The Alchemist has also recently secured a site in the City, which will be the fourth under the brand, with the most recent being the highly acclaimed opening at Trinity Leeds in 2013.

■ Cleaver

CLEAVER

The brand, who fall under the Prezzo group, is on the acquisition trail in 2014 after a successful four openings in Cobham, Wokingham, Leatherhead and Oxford. The concept offers a simple menu, with a choice of burgers, chicken or ribs in a rustic setting.

Health & Fitness occupational review

The UK Health & Fitness industry total market value has grown by 1.5% to £3.92bn over the 12 month period to March 2013 (State of the UK Fitness Industry Report 2013). The sector has also seen a 3% rise in the number of fitness facilities and a 4.5% rise in the number of members (The Leisure Database Company). As these figures imply, we are witnessing the dawn of a new age in the Health & Fitness sector, driven by strong performances in the private and public sector, particularly from the budget sector, which now accounts for 6% of the total clubs and 14% of private sector membership (The Leisure database company).

These budget operators are continuing to expand aggressively and the recent merger of Pure Gym and The Gym presents a formidable force in this sector. The combined group dominate with over 100 clubs between them, with a further 27 sites in the pipeline. easyGym, advised by Savills, are also looking to open a further six clubs this year on top of their existing 10, with a Greater London focus. Fit4less, Xercise4Less and Lifestyle Fitness are also on the expansion drive and JD Sports are set to launch their own chain of value fitness centres.

The mid-market continued to be "squeezed" throughout 2013, leaving many of the operators such as Nuffield, LA Fitness and Fitness First now concentrating on retaining membership and refurbishing top performing clubs. Following in Fitness First's footsteps, LA Fitness were the next to enter into a company voluntary arrangement (CVA) in February 2014, which will see 33 of its existing 80 gyms closed and more focus on protecting the profitable assets in the portfolio. However, mid-market operators are beginning to respond to the threat from behind. Fitness First have recently under-gone a major ad campaign for their new "Classes Only," concept and David Lloyd have secured rights to the US concept involving high street personal training studios.

2013 also witnessed the beginning of a push away from the traditional gym model of large floor-plates and extensive equipment and machinery. An increasing number of specialist independent operators and pop-up concepts are cashing in on the "new age of fitness", with a focus on innovative and dynamic ways of keeping fit, such as spin gyms, boot camps and cross-fit. This sector will continue to grow throughout 2014, albeit with a London centric bias. Brands to watch include US concept Barry's Bootcamp (high intensity indoor fitness operating from floorplates as small as 5,000 sq ft), Soul-Cycle and Psycle (spin-only concepts), HotPod (yoga classes in inflatable pods) and Bikram yoga.

The last 12 months has seen a surge in transactional activity in the Health & Fitness sector compared to previous years. Fitness First shed a number of clubs as part of its CVA, with many picked up by budget brands and David Lloyd was subject to one of the year's largest buyouts. Looking forward, we would expect to continue to see a rise in activity, as well as organic expansion by successful brands, throughout 2014 especially given the upturn in economic activity and return of consumer confidence.

■ **Who's Hot and Who's Not?**

↑ **Pure Gym/The Gym**
The recent merger of the two leading brands positions the brand as a formidable market leader in the low-cost sector, with a top covenant and property portfolio to rival the more established mid-market players in number.

↑ **easyGym**
With a more selective acquisition programme, the brand has managed to secure some enviable Greater London locations, including their Oxford Street flagship. With 10 sites

TABLE 1

Key leisure investment activity - 2013-14

Date	Scheme	Location	Area (sq ft)	Price	Yield	Purchaser
Mar 14	Middlesbrough Leisure Park	Middlesbrough	110,000	£21.25m	6.90%	Legal & General
Jan 14	The Circus	Manchester	140,500	£24.45m	5.70%	CBRE Global Investors
Oct 13	Great Northern	Manchester	339,000	£71m	9.50%	Resolution Property
Sep 13	Junction Leisure Park	Llandudno	39,700	£8.21m	6.53%	Legal & General
Sep 13	Fife Leisure Park	Fife	130,000	£26m	6.30%	Legal & General
Aug 13	iScene	Ilford	140,000	£19m	8.60%	Cordea Savills
Jun 13	The Light	Leeds	221,000	£18.5m	7.20%	Legal & General
Apr 13	Mary Ann St	Cardiff	112,500	£20m	6.89%	Henderson UK

in the UK and the best equipment and fit-out in the low-cost sector, easyGym are one to watch for 2014.

↑ **Microgyms**
Barry's Bootcamp, Boom Cycle, Barrecore, these high-intensity microgyms have exploded onto London's Health & Fitness scene with all targeting further openings throughout 2014. The smaller size requirements will help drive their successes in securing key sites in a competitive market.

↓↑ **Fitness First**
In May 2012, Fitness First underwent a financial restructuring followed by a CVA to avoid going into administration. After closing 80 sites, the firm is looking to re-position itself as a more up market brand specialising in classes only.

↓ **LA Fitness**
Early in 2014, LA Fitness called in administrators to look at a CVA to shed 33 of the loss-making sites in order to reduce debt.

Investment review

In line with the wider property market, as the economy continues its recovery, we have seen a notable increase in leisure investment activity over the past 12 months. Approximately £675m was transacted in 2013 showing a 30% increase by way of volume (excluding the corporate acquisition by Land Securities of a further stake in the X-Leisure Unit Trust), compared to 2012 volumes of circa £450m. Of the £675m transacted last year, 65% was acquired by UK Institutions, 15% by UK REITs and 20% by Prop Co's and private investors.

Investor demand for the leisure sector is wider than ever, with a large pool of institutional and non-institutional investors seeking access to the market place. Such pent up demand is being driven by the continued strength and expansion of the occupational market (particularly cinemas and restaurants), long leases with index-linked rent reviews, rental growth prospects and ever-improving covenant security.

That said, there has been a continued squeeze on stock flow, with a limited supply chain, in particular for larger prime assets and multi-let parks. The most sought after product in the main is owned by UK Institutions, who continue to be net investors with an appetite to increase their exposure to the sector rather than sell.

Key recent multi-let investment transactions are listed in Table 1.

We are of the opinion that for a prime leisure investment, with sound property fundamentals including: strong location, national covenants, 15 years + average unexpired lease term, a degree of fixed uplifts/indexation, a strong trading platform and a lot size of between £10m - £30m; a net initial yield of 5.75% - 6% is achievable in the current market.

UK cinema and leisure sale and leaseback investment market

After a number of years of relative inactivity in the solus cinema investment market, 2013 was characterised by a real resurgence in this sub-sector with circa £190m of solus cinema investments transacted (28% of total volumes transacted in 2013).

This was hugely dominated by Odeon Cinemas who have undertaken an extensive sale and lease back programme over the past 12 months, which has culminated in a collective receipt of approximately £146m encompassing 22 cinemas sold both on and off market. Odeon have

TABLE 2

Key recent leisure sale & leaseback transactions

Date	Tenant	Town	Size	AUT	Price	NIY %	Purchaser	Comments
Mar 14	Cineworld	Dublin	17 screens	13	€26m	6.90%	TBC	Under offer
Mar 14	Marstons	Newcastle upon Tyne	10,400 sq ft	35	£7.55m	4.35%	Cordea Savills	5 yearly RPI linked rental increases, collared at 1%, capped at 4%.
Dec 13	Odeon	Dudley	10 screens	24.6	£7.7m	5.95%	Aberdeen Asset Management	Annually received RPI rental increases, collared at 1%, capped at 5%.
Dec 13	Odeon	Leicester Square	6 screens	22.8	£17.9m	6.97%	Daily Mail Pension Fund	Annually received RPI rental increases, collared at 1%, capped at 5%.
Dec 13	Odeon	Harrogate	5 screens	24.7	£7.75m	5.10%	CBRE Global Investors	Annually received RPI rental increases, collared at 1%, capped at 5%.
Nov 13	Odeon	UK wide	10 properties	24.9	£80.6m	7.00%	LondonMetric	Annually received RPI rental increases, collared at 1%, capped at 5%.
Nov 13	Odeon	Richmond	7 screens	25	£12.1m	4.75%	RLAM	Annually received RPI rental increases, collared at 1%, capped at 5%.
Jul 13	Vue	Leicester Square	9 screens	22	£23.5m	8.25%	Cordea Savills	Income strip deal: 2% per annum fixed rental uplifts.
Mar 13	Marstons	UK wide	27 properties	40	£69.71m	5.10%	Legal & General	5 yearly RPI linked rental increases, collared at 1%, capped at 4%
Dec 12	Marstons	UK wide	18 properties	35	£40m	5.65%	Standard Life Investments	5 yearly RPI linked rental increases, collared at 1%, capped at 4%.

been offering 25 year leases on their freehold/long leasehold assets, with annual rent reviews linked to RPI (collared and capped at 1% and 5% respectively).

In addition, the trophy solus cinemas of VUE and Odeon, Leicester Square, London have also been traded, along with one of the best performing cinemas in Ireland (Cineworld, Parnell Street, Dublin), which is currently under offer.

The volume of investors and level of prices being achieved for such prime cinemas (5%+ net initial yield outside of London) further demonstrates investor appetite for the sector and in particular the robust cinema market.

It should also be noted that demand for strong covenants, long income and indexation has given rise to other sale and leaseback initiatives, as carried out by Marstons plc. The group has generated over £120m comprising 76 properties in four portfolios and one solus sale, with a further portfolio known to be under offer. The assets have offered lease terms of between 35 - 40 years, with the benefit of five yearly RPI linked rent reviews collared at 1%, and capped at 4%.

Key leisure sale & leaseback transactions are listed in Table 2.

Funding Pipeline

Again, linked to the highly acquisitive occupational market, there is a particularly healthy development pipeline in leisure with a significant number of 'cinema anchored' schemes proposed over the next two to three years. Given the difficulties that investors face in trying to secure prime stock, the funding route is becoming ever more favourable and is creating some competition for the best sites, most of which have planning consent and a large proportion of the income secured. Examples include proposed schemes in Bournemouth, Ruislip and Bedford.

As a product of the investor competition, the yield gap between 'as built' and funding is continuing to narrow and in our opinion is now between 0 - 25 bps.

Outlook

Leisure will continue to be on investors 'shopping lists' into 2014 and beyond. The ability to acquire dominant leisure schemes in strong locations, with solid covenant profiles, long dated lease terms and the chance to add value with proactive management will prove challenging and therefore such 'rare beasts' when openly marketed will induce competitive bidding. Like the majority of sectors, leisure transactional volumes have suffered, although not due to lack of money in the market, but rather due to stock availability. 2014 will see selective asset disposals, often dominated by off-market approaches and development fundings will continue to create buying opportunities where traditional investment opportunities are likely to remain scarce.

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