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Spotlight
European Shopping Centres - Investment benchmark

October 2012

Public debt hanging over retail sales prospects

Financial and political instability in the Eurozone has risen since the beginning of the year and this has led to further volatility on stock markets. The economic recession has worsened in the peripheral markets and the risk of a spill-over effect to the core economies has increased. European economic growth is predicted to be down by -0.3% in 2012 and increase slightly by 0.8% in 2013 according to Oxford Economics.

Austerity measures to control sovereign debt together with the deterioration of the labour markets in most European countries are likely to have a strong negative knock-on effect on European household revenues. In spite of lower consumer prices, private consumption is expected to decrease by -0.4% pa in Europe at year-end.

All in all, retail sales are forecast to be -0.3% in 2012 and 0.8% in 2013, exactly in line with GDP figures.

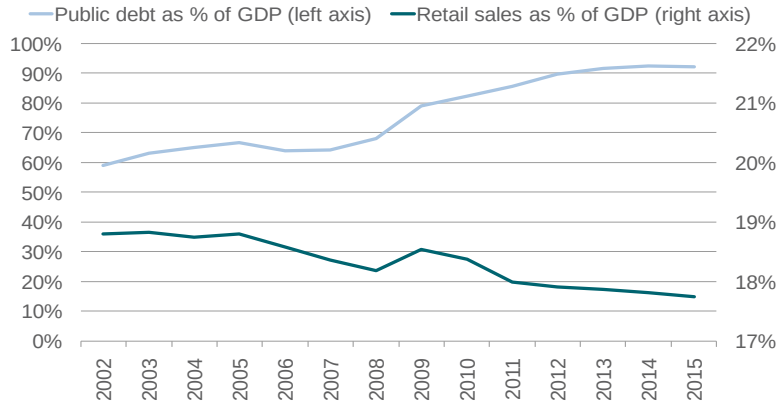
Almost three-quarters of the shopping centre transactions in Germany, Poland and the UK

The first half of 2012 saw a decline in retail investment transactions, which is more likely to be attributable to the lack of prime product and the smaller size of deals compared to last year, rather than weaker investor interest. However the worsening economic conditions are creating some nervousness amongst investors.

In the 16 countries covered in this report, the retail turnover totalled €11.3 bn in H1 2012, a decrease of 31% compared to the previous six months, according to RCA.

GRAPH 1

Public debt vs retail sales



Graph source: Focus Economics, Oxford Economics, Savills

Summary

- This report presents the results of our first shopping centre (SC) investment benchmark in which, we analyse the market size, retail prospects, the risk assessment and potential return across 16 European countries.
- Germany, the UK, France, Norway and Sweden have emerged as the top five core destinations notably thanks to their market size, economic stability and sustained consumer spending.
- Romania, Poland, Hungary, the Czech R. and Austria are ranked top five opportunistic destinations due to their fast recovering economies, strong expected growth of retail sales and good development potential.
- In most countries public austerity drags on consumer spending. Overall retail sales are unlikely to recover before the end of 2013.
- The lack of prime products and the smaller size of deals recorded this year resulted in a fall in the shopping centre investment volume. Yet investor interest remains robust in spite of the uncertainties surrounding the future of the Eurozone.
- Investors are still predominantly steering clear from risk but they are becoming more watchful for increasingly competitive prime assets located in more variable economies.

"Countries with proven consumer spending resilience or prospects remain preferred although trophy assets located elsewhere are becoming an option." Lydia Brissy, Savills European Research

Defensive strategies have steered investors towards retail assets, notably prime shopping centres in the best locations across Europe. During the first half of the year, shopping centre investments totalled €3.9bn in the studied area, representing more than 35% of the retail investments. Germany, Poland and the UK account for nearly three-quarters of this turnover.

The average prime European shopping centre yield in the surveyed area softened by 4bps over the past twelve months and stands at 6.43%. However, the growing appetite for the best shopping centres has put downward pressure on yields in the most sought after locations. The annual prime achievable shopping centre yield shift has been negative in almost one-third of the markets that we cover, notably Berlin, Munich, Stockholm, Oslo and Warsaw, showing investor confidence in these markets, which is in line with the general capital flow focus in Nordics, Germany and Poland to a certain extent. In the rest of the markets we have seen some yield softening, especially in the troubled peripheral markets, with the exception of the UK, France, Belgium and Romania where the prime yield has remained stable.

Activity led by institutional investors

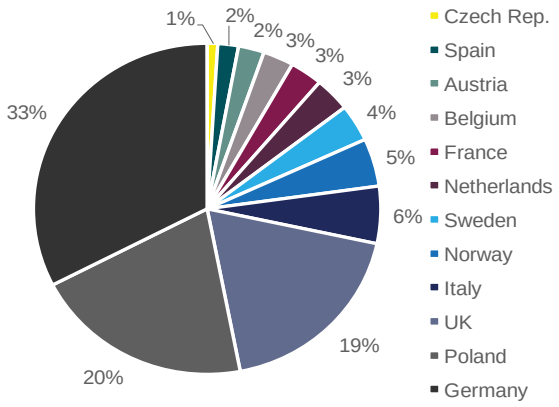
The market remains mainly driven by institutional players. Yet they became negative net buyers since the beginning of the year. Public funds who were predominantly selling last year are starting to buy again whereas private funds continue to dispose of their properties.

Since the beginning of the year the top five buyers include Unibail-Rodamco, Morgan Stanley, CBRE Global Investors, AXA Group and MFI AG. The top five sellers are Meridian Capital, Capital Partners, Commerzbank, ING Group and Unicredit Group.

"Prime shopping centre interest remains strong with sovereign wealth funds, North American pension funds and European listed property companies all actively seeking such product." Danny Kinnoch, Savills European Retail Investment

GRAPH 2

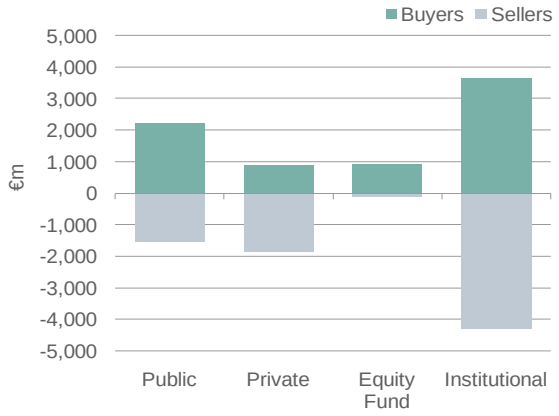
SC investment volume in H1 2012 – Breakdown by country



Graph source: RCA

GRAPH 3

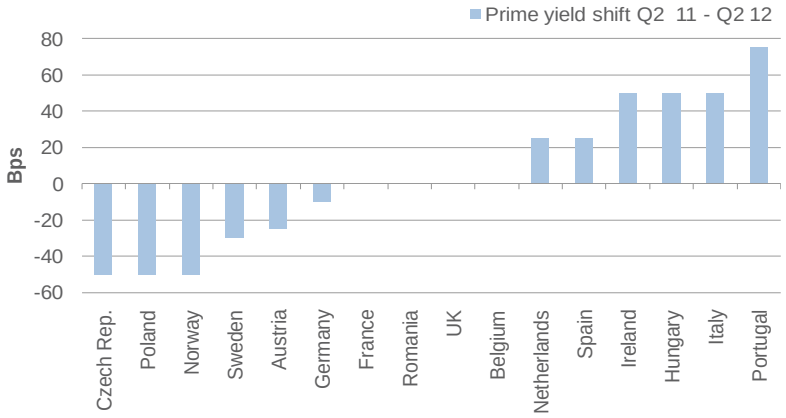
SC investment volume in H1 2012 – Breakdown by type of investors



Graph source: RCA

GRAPH 4

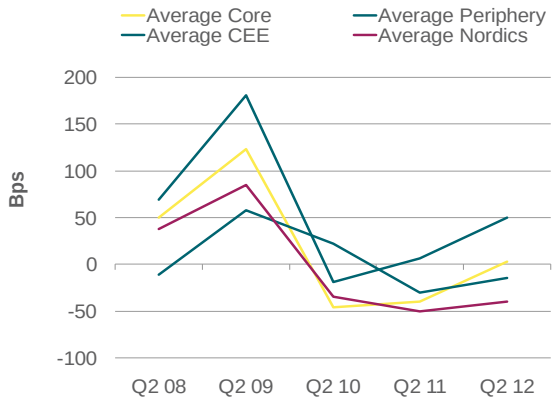
Prime shopping centre yield shift



Graph source: Savills

GRAPH 5

Annual prime yield shift - averages



Graph source: Savills

Top five core destinations

The analysis shows that **Germany** currently ranks top as core shopping centre investment destination notably thanks to a good balance between its large market size and reliable market stability. Germany is the biggest consumer spending market in Europe, worth €1.3bn and consumption per inhabitant is amongst the five highest of the surveyed countries. Additionally, the shopping centre density is comparatively low (165 sqm per 1,000 inhabitants, against 298 sqm on average in the surveyed area), which offers significant potential for development and investment activities. However, retail sales prospects are relatively low compared to most other countries, 1.5% pa on average until 2017. The growing interest from both domestic and international investors for shopping centres in Germany has brought about further downward pressure on prime yields, which have moved in by 20 bps in Munich and by 10 bps in Berlin and Dusseldorf. Prime yields in German cities are the lowest recorded in Europe.

The **UK** stands out as second thanks to its large consumer size and volume of shopping centre sales. Additionally, retail sales are expected to grow at an average rate of 2.8% until 2017, well above the European average at 1.9%. Prime rental growth has proven to be steady since the beginning of 2010. In Q2 2012, the London prime rent rose by 4.5% pa, currently equivalent to approximately €7,795 per sqm/year (£420 per sqft/year) the highest in Europe. The prime shopping centre yield for London remained stable over the past year at 5.50%. The UK is also a non-Eurozone investment opportunity for conservative investors looking to avoid exposure to the Eurozone.

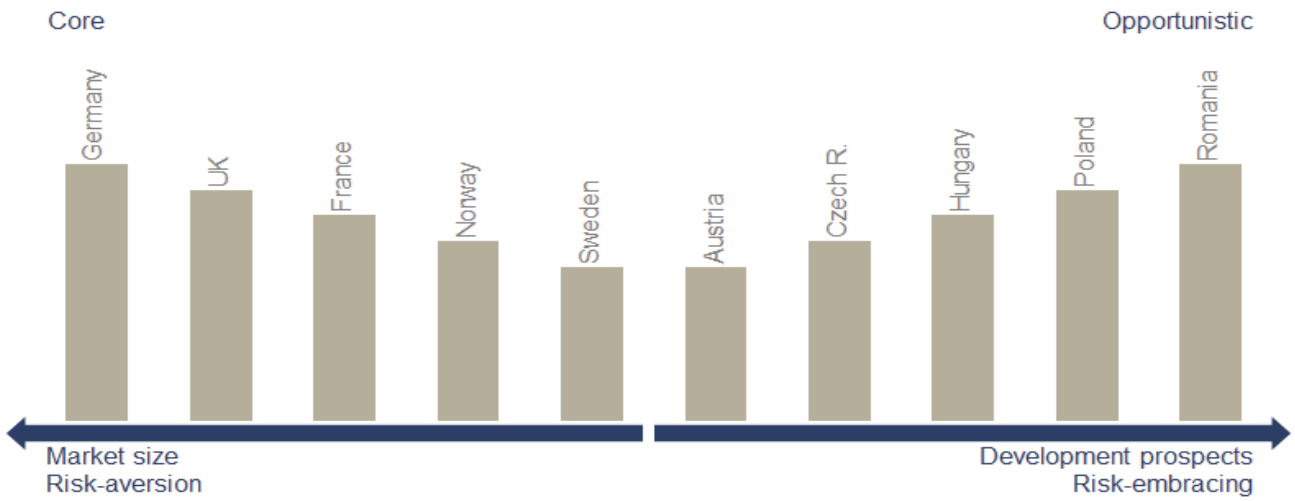
France is ranked third notably due to its market stability. Over the past 20 years France has turned out to have the least volatile economy out of the 16 countries surveyed. France is the third biggest market in terms of consumer spending size after Germany and the UK although spending per capita is relatively weak. However, the volume of sales in shopping centres is estimated at €118,100 m, the highest level in Europe. The prime annual rental growth has also proven to be very stable over the past five years. The prime shopping centre rent currently stands at €2,000 per sqm/year. Yet uncertainties around political and fiscal changes do not bode well for the future prospects of the French economy. Retail sales are expected to grow on average by 1.8% pa over the next five years.

With 3.3% GDP growth forecast for 2012, the highest in Europe, **Norway** ranks fourth out of our top five core destinations. The unemployment rate is the lowest of all European countries, at 3.3%, and Norwegians are the biggest consumers compared to the 15 other nationalities. The attractiveness of Norway also relies on good retail sales prospects with 2.2% of growth pa on average expected until 2017. In spite of the crisis, the prime shopping centre rent has not stopped rising, from NOK4,000 per sqm /year (€513 per sqm per year) in 2008 to currently NOK6,000 per sqm /year (€840 per sqm/year). The shopping centre stock per inhabitant is the highest of the surveyed countries (719 sqm per 1,000 inhabitants).

Sweden distinguishes itself by an economy that has been relatively resilient to the economic downturn, albeit quite volatile over the past 20 years. Annual GDP growth is expected to be 1.2% in 2012 following a 4% increase last year. Swedish nationals are the third biggest consumers and both consumer spending and retail sales are expected to grow by 2.7% pa on average over next five years. After a slight slide down observed in 2009, the prime shopping centre rent in Stockholm has increased again since the end of 2010 and prime annual rental growth was 3.1% in Q2 2012. After Norway, Sweden has the biggest shopping centre density (650 sqm per 1,000 inhabitants).

GRAPH 6

Top five core and opportunistic destinations



Graph source: Savills

Top five opportunistic destinations

Romania ranks first out of the five opportunistic destinations mainly thanks to fast growing consumer spending and retail sales expected over the next five years, 6.1% and 6.2% pa on average respectively. Although the Romanian economy is volatile, notably tied up to the Greek economy's fate through trade and financial linkages, the government has made good progress on the fiscal front, with the last administration managing to cut the budget deficit to 4.2% of GDP in 2011. The unemployment rate is relatively low at 7.4% and the shopping centre density is the lowest of the 16 countries analysed, 84 sqm per 1,000 inhabitants offering good development opportunities. The prime shopping centre yield in Bucharest is 8.75% the highest in the survey area after Dublin.

Annual GDP growth is expected to be 2.7% in 2012 in **Poland**, the second best result after Norway. The country not only benefits from a robust growth background in the current economic climate but consumer spending and retail sales are expected to increase fast in the coming five years, by 4.1% and 4.2% pa on average, the best rates expected after Romania. However, the unemployment rate in Poland is relatively high at 9.7%. Additionally, the provision of shopping centres is still lower than the average of the 16 countries, 217 sqm per 1,000 inhabitants against 298 sqm. Poland has recorded an annual rental growth of 3% on average since 2007. In 2011, the retail income return calculated by IPD was 7.4% the highest amongst the countries surveyed in this report.

Hungary stands out third of the opportunistic destinations. The expected annual growth at year-end is below the European average (-1.3% against -0.3%) but should be back above the European GDP growth from next year. Forecasts for retail sales and consumer spending over the period of 2012-2017 are respectively 2.0% and 2.1% pa on average, higher than the European averages. However, recent tax changes, notably the 200 bps hike in VAT and the depreciation of the HUF at the end of last year have triggered pressure on prices. Prime shopping centre rents have grown by 5.0% pa over the last five years. The shopping centre density is 131 sqm per 1,000 inhabitants, the second lowest after Romania.

As in Hungary, the forecast GDP growth at the end of the year in the **Czech Republic** is below the European average (-1.4%) but back on track from 2013. Retail sales are forecast to rise by 3.1% pa on average until 2017, the third best rate expected within the study area. However, the recent deterioration of the political situation may become a cause of concern for investors, together with tighter credit conditions and declining lending growth since the end of 2011. The shopping centre density in the Czech Republic is 208 sqm per 1,000 inhabitants, lower than the average.

Austria ranks fifth out of our top five opportunistic destinations, notably thanks to its steady and balanced figures. Austrian consumers have to date benefited from a very low unemployment rate, below 4%, the lowest rate after Norway. Spending per inhabitant is amongst the fourth highest of the survey area and retail sales are expected rise by 1.8% pa on average until 2017, just in line with the European average. However, the level of sales in shopping centres is amongst the lowest of the 16 countries. Additionally the shopping centre density is very low, 181 sqm per 1,000 inhabitants. Credit conditions

"Strong core funds are keen on Nordic retail. This demand has resulted in aggressive pricing. Scandinavian demand is supported by funds looking to invest out of the Eurozone." Danny Kinnoch, Savills European Retail Investment

METHODOLOGY

This research covers 16 European countries including Austria, Belgium, Czech R., France, Germany, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Romania, Spain, Sweden and the UK. It benchmarks shopping centre investment opportunities at country level based on four main market features: market size, retail prospects, risk assessment and potential return. Market criteria and data used for this analysis are weighted according to investment strategies, from core to opportunistic investments. Market size, economic stability and sustained consumer spending have been put at the forefront to define core destinations. Consumer spending, retail growth prospects and development potential are the criteria standing out to define opportunistic destinations.

Criteria	Data	Source
Market size	Consumer spending in €m	Oxford Economics
	Consumer spending / inhabitants	Oxford Economics
	Shopping centre sales	ICSC / Savills
Retail prospects	Consumer spending prospects	Oxford Economics
	Retail sales prospects	Oxford Economics
	SC stock per inhabitant	Savills
Market stability	GDP stability	Oxford Economics / Savills
	Unemployment	Oxford Economics
	Bond yield	Oxford Economics
Potential return	Annualised 5-year rental growth	Savills
	Annualised 5-year total return	IPD
	Capital growth	IPD

Note: The views expressed herein are based on macro level statistics and do not take into consideration regional specificities or shopping centre standards. Certain data in this research paper were supplied by external sources and are believed to be reliable as of the date presented. Information presented herein is for discussion and illustrative purposes only and is not a recommendation or an offer or solicitation to buy or sell any properties. The information contained herein is subject to change without notice.

have remained more favourable than in most other Eurozone countries but banks have recently tightened their credit standards.

Conclusions and outlook

In all of the countries surveyed in this report, fiscal correction will drag on spending. Some countries will weather the storm better than others, notably the Nordics and some Central Eastern European (CEE) countries, either thanks to trade links outside Europe or to the resilience of some labour markets allowing them to maintain steady domestic demand. In this context, we anticipate consumer spending to remain subdued over the next 12 to 18 months. Overall retail sales will start recovering from 2014 onwards. On average retail sales are expected to grow by 1.9% pa until 2017 in the surveyed countries (1.9% in EU 27) with some strong growth expected in Romania (6.2%), Poland (4.2%) and the Czech Republic (3.1%).

As a result of uncertainties surrounding the European economy and weak levels of lending, we expect investors to continue looking predominantly for core shopping centre assets in 2012-2013. Germany, the UK and France will remain the most sought after destinations due to their large market size and stability, whilst the Nordics will appeal to investors due to their solid growth prospects. However, we believe shopping centre investment activity could remain restrained by the lack of prime products in the coming year. From 2013 we expect to see an increasing interest for opportunistic shopping centre assets as prospects for the economy should look slightly brighter, contingent on an orderly resolution adopted to definitely ease the European crisis. The CEE countries notably Romania, Poland and the Czech Republic offer good investment potential as their economies recover fast and retail sales grow strongly. Although not shown in our final ranking results, peripheral countries, notably Spain and Italy may offer some ad hoc investment opportunities to risk-embracing investors, which could arise from distressed sales especially given that further pricing correction is expected in these countries.

In all other markets covered in this report the prediction is for yield stability for the year-end, with the exception of some of the CEE countries where yields are expected to move in slightly. All in all, we expect the prime average yield to remain around 6.40% until the beginning of next year.

TABLE 1

Top five shopping centre deals - January to September 2012

Date	Country / City	Name	Buyer	Seller	Price in million
Q2 12	Germany / Leipzig, München, Berlin, Gera	5 shopping centres	Unibail-Rodamco	Perella-Weinberg	NA
Q1 12	Poland / Warsaw	Zlote Tarasy	AXA REIM - CBRE Global Investors	ING REIM	€475
Q2 12	Germany / Sttugart	Shoppingcenter Milaneo	Hamburg Trust	ECE - Strabag SE	€400
Q3 12	UK / Basingstoke	Festival Place	TIAA-CREF	Grosvenor Group Holdings Limited	€356 (£280)
Q2 12	Germany - Bochum	Ruhr-Park	Unibail-Rodamco	Perella-Weinberg	Bond yield

Graph source: Savills

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