Shopping centre and high street bulletin

Q4 2011

“We predict that yields on the best centres will harden in 2012 as global capital seeks a safe haven”

Image: Corby Town Centre

- 2012 will see inflation fall back to its target level of 2%. This will have a significant positive effect on household’s real earnings.
- Retailer sentiment remains very fragile, and while some retailers maintained margins and sales over Christmas, others have suffered.
- The investment market in 2012 will continue to be dominated by risk-averse investors searching for prime and secure income streams. There will be activity in the secondary and tertiary markets, but this will have to be at more realistic prices.

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Retailers

The consumer economy

For most of last year we were predicting that 2012 would see a turning point in the consumer economy. While the lack of positive action in the Eurozone has undoubtedly delayed the UK economic recovery, a number of temporary factors that had previously elevated inflation will drop out of the numbers this year.

At the beginning of this year we will see last January's VAT rise drop out of the inflation numbers, and as the year proceeds this will be supported by the removal of the impact of last year's fuel and energy costs. This will result in inflation falling back to below 2% by the end of 2012, offering a reversal of the unpleasant trend in real incomes that we saw in 2011. Household incomes will also benefit from some fiscal changes, with the higher personal allowance and lower earnings limits for NIC's coming into play from May. Benefits will also rise sharply, as their growth is linked to a period oh high inflation.

While all these things may not be quite enough to stimulate a return to normal levels of consumer confidence, we do expect to see a reveral of the recent downward trend in confidence. This will mean that 2012 will be a better year for the UK consumer, and hence the UK retailers.

The retail occupational market

Savills Q3 bulletin identified our concerns regarding the forthcoming Christmas period, and how well this key trading season would pan out for retailers increasingly dependent on the last month of the year. Some more bearish commentators were predicting a retail bloodbath.

So what was the outcome and what does this mean for 2012 ? Some of the results for the festive season are now out (as of 12/01/2012). In terms of like for like sales announced by the bricks and mortar retailers, the winners and losers are shown on the back page of this report. The overall average LFL change so far is +0.35%, not bad in the context of the tough economic environment but the comparison is with a period held back by bad weather. More notable for the market than like-for-likes has been the announcement of administrations by La Senza, Past Times, D2, Hawkins Bazaar and Blacks.

Our snapshot conclusion is a mixed picture; some seasonal cheer, but on balance a flat Christmas with seasonal gloom more the order of the day. The retail failures and administrations announced admittedly came as no surprise, as most had been largely trailed in the last half of 2011.

The big shock for the market was the failure of Tesco to perform at Christmas, which swiftly resulted in a seismic £5.0 billion being wiped of the value of the company. Whilst Tesco remain for the most part tightlipped, the reasons for this seem to result from a mix of longer term underinvestment in the UK stores, combined with increasing reliance on price promotions (" The Big Price Drop " - this year) . Added to this was a massive dip in non-food sales contributing to an overall reduction of 2.3% in Christmas LFL sales. The outcome was an embarrassingly poorer performance than Tescos main competitors who were all in positive territory and resulted in a future profit warnings from the company.

Elsewhere, the woes of the marketplace continue, especially for retailers such as Game, HMV and Thorntons. Other notable under performers at Christmas included Debenhams and Clinton Cards. In a positive vein, the La Senza and Blacks chains are to be taken into new ownership by Alshaya and JD Sports repectively, but almost certainly not without the dropping of the more unprofitable stores and widespread renegotiating of lease terms.

Christmas 2011 leaves a market place for 2012 where sentiment continues to be very fragile. Both occupiers and owners will need to tread very carefully in terms of strategies and managing their portfolios for the year to come.

Shopping centre investment

Q4 2011 saw 17 shopping centres transacted accounting for £609.22m (up from £423.75m in Q3 2011) bringing the total number of shopping centres traded for the year to 59, reflecting £3.6bn in capital value terms. Savills transacted 26% of the market by number of deals.

The average initial yield in Q4 2011 moved out to 8.16% (from 7.38% in Q4 2010) once again reflecting the nature of the stock being sold.

2011 was a year of two contrasting halves. The first six months of the year witnessed strong pricing on many assets and a positive market sentiment. The compounding affect of the worsening Euro crisis damaged investor confidence and yields started to slide from July for the balance of the year often meaning that by the time assets came to the market pricing was often markedly different to the initially reported achievable figures. This position inevitably led to pricing adjustment discussions.

For the most part the transactions already under offer have now been concluded albeit at lower levels. Only in a few instances where assets were valued annually i.e. Dec-Dec did they fail to sell.

2012 will continue for the most part where 2011 ended. We believe that the banks, bond servicing firms and administrators will release more stock onto the market – and this will be priced accordingly to current market conditions. This will also reflect the noticeable reduction in the availability of senior debt.

Investors

Double digit yields on the more secondary / tertiary assets will become commonplace and the gap between Super Prime and Tertiary will become 700bps+; a long way from yield parity in 2005 – 2007!

The acquisition of secondary / tertiary stock in 2011 has been dominated by just a few property companies and institutions. We expect the number of parties interested in these assets to rise through 2012, if the banks – as has already been suggested, begin to staple debt at c. 50% plus loan to value to assets (albeit with very high margins).

The key issue remains the evaluation of the true underlying rebased rental position, as opposed to being attracted to centres with superficially attractive initial yields.

We predict that yields at the "Super Prime" and "Prime" centres will harden in 2012 as global capital seeks a safe haven. We also believe that we will see further stakes sold down to passive global investors enabling existing owners to release equity for further investment whilst retaining the valuable asset management mandate.

	Q3 2011	Q4 2011
'Super' Prime	5.00%	5.00%
Prime	5.50%	5.50%
Town Centre Dominant	6.00%+	6.25%
Secondary	9.00%+	9.00%
Tertiary	11.00%+	12.00%+

High Street investment

The final quarter of 2011 continued as a time of huge uncertainty, firstly in relation to the European situation but secondly in relation to retailer's performance. As 2012 'fires' into action the former continues to unsettle the markets and the latter seems, for most retailers, to have been acceptable in the run up to Christmas. That is not to say there were no tenant failures and that all is now well on the high street. This is certainly not the case. However those well run retailers who are not burdened by debt are surviving albeit with online retailing becoming a larger portion of their business.

Private investors were still active in the last quarter but this was generally for smaller lot sizes with a particular focus on well secured long dated assets. 'Cash is king' and with the exception of Central London debt is now almost impossible to obtain. This leaves larger lot sizes of between £2-5m as being more difficult to sell as the size is just too big for the private investor but too small for the funds. This could be a good area in which to seek bargains.

Debt remains even more of a challenge to smaller property companies whereas the larger property companies and REITS still seem to be able to persuade banks to provide funding although the costs, margins and loan to value ratios are all more challenging. This is an issue that could stifle performance. Many property companies are instead now trying to align themselves with the banks and receivers converting to consultancy practices rather than traditional property companies.

Institutions are looking at strategy. We would anticipate that redemptions will increase leading to more sales but this is likely to start later in the year. Many retail funds have already built up pools of cash hoping to avoid the disastrous emergency sales that they were forced to undertake in 2008/2009. On the buying side, this will differ fund by fund but as with any market there will always be small pockets of capital seeking a home.

The reality for the banks is that difficult secondary and tertiary property is getting more difficult to sell. The longer a sale is left the more likely tenants will fail and the less sellable the asset becomes. As such a number of the banks have started to take a more pragmatic approach to selling assets. We would anticipate more "assisted" sales with consenting borrowers but finding buyers for a number of assets will prove to be almost impossible.

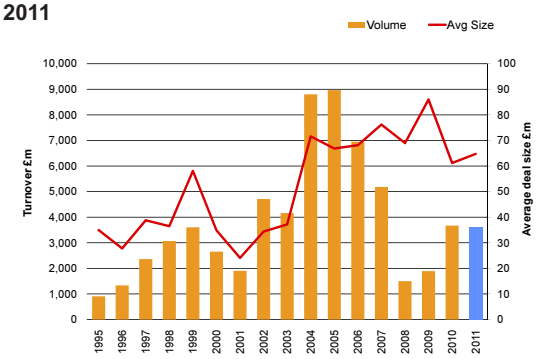
In the next 12 months there will be more tenant failures creating an increase in vacant space. CVA's will focus on the best located shops in the top towns. Savills completed on the sale of a Blacks store in Cambridge just before Christmas to a private investor who was confident in both the short term re-letting prospects, if Blacks were to vacate, and the future growth potential of the asset. A void was always unlikely. This was one of Blacks best performing stores and the lease had value to the administrators. Indeed the investor's confidence has been rewarded as JD Sports have bought Blacks out of administration and have continued to pay the rent.

Another key factor to consider this year is lease expiries. At expiry both good and bad retailers will be quick to ditch stores that are not profitable. The UK's last "race for space" was in the late 1980's and came to an abrupt halt in 1990. Those old 25 years leases are now coming to an end enabling retailers to significantly rationalise their property portfolios in the next 2/3 years when these and other short leases expire.

The impact on rents could also be material and whilst many landlords might look to protect headline levels this is only possible with an extended rent free period with two years now standard for a ten year lease in all but the very best centres. Investors must focus on these new re-based rents in order to achieve good future rental growth once the economy turns up.

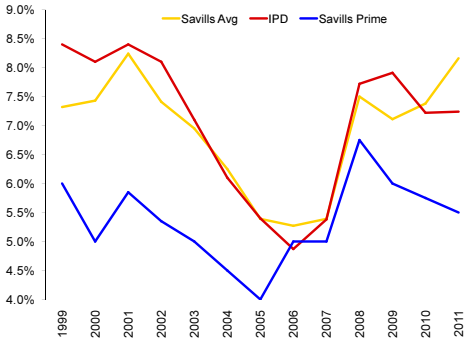
Data

Shopping centre investment volume was £3.6bn in 2011



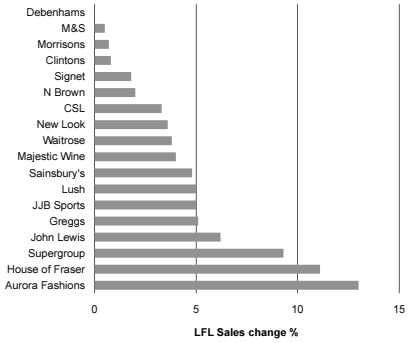
Source: Savills

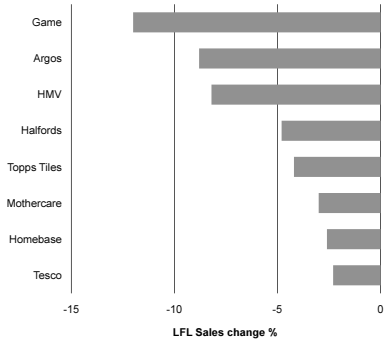
Downward pressure on prime yields continues



Source: Savills, IPD

Selected retailer trading figures reported in Quarter 4 2011





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