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UK Shopping Centre and High Street Bulletin

Q2 2014

SUMMARY

■ Consumer confidence rose to its highest level for nine years in June, though it fell back slightly in July. We expect this story to remain through the Autumn, and that promises a strong trading Christmas for UK retailers.

■ Store portfolio rationalisation remains an ongoing trend, but we have detected an increase in the number of retailers who are opening new stores. In many cases this is being driven as part of a response to the new omnichannel world.

■ Shopping centre investment volumes could exceed £6 billion this year. Yields on secondary assets have now started to shift inwards.

■ Prime shops on strong high streets have started to attract institutional interest. However, higher yielding more asset management intensive shops are still proving hard to sell.

"Prime shops in second and even third tier towns could now present good value for investors"

The consumer economy

The macro-economic drivers behind shopper behaviour have continued to improve over the last quarter, at least on some measures.

The provisional estimate for Q2 GDP shows that the UK economy has finally regained all the lost ground of the last five years, returning to its pre-crisis level of output. However, the jubilation should not be overly loud yet, since the population has grown over this period and thus both GDP per capita and retail sales per capita remain below their 2007 peaks.

On a more positive front unemployment has continued to fall over the last three months. This is yet to have any impact on real average earnings growth, which remains firmly negative. As we have said numerous times in the past, the real retail recovery will not come until shoppers actually feel that their wages are rising faster than the cost of living. This makes it rather hard to explain why the GfK measure of consumer confidence moved into positivity for the first time in nine years two months ago.

Clearly the consumer is taking some comfort from the positive economic commentary in the media, and may well be hoping for a pay rise in the forseeable future. This has fed through to retail sales volumes, which rose at their fastest pace for a decade in Q2 2014. However, June was relatively quiet, perhaps due to the World Cup which has traditionally led to a month of low sales followed by a pick-up in the following month.

We expect that consumer confidence will stay above its long-term trend over the remainder of the summer, and this bodes well for Christmas trading.

The biggest risk to this relatively positive picture is too much speculation on the prospects of an early rise in interest rates. The Governor's relatively hawkish words recently have been widely broadcast, but we believe that this is more a move to prepare us for an interest rate rise, rather than a signpost of an imminent rise. Too much noise around this topic too soon could well drive the economic positivity back down, and that in turn could lead to a weaker than expected final quarter for retailers. Base rates will and should go up, but too soon and too fast would be very damaging to consumer confidence and retail sales.

The retail occupational market

Retailer performance has remained fragile in the second quarter of this year, with like for like sales generally weak in June and July on the back of rising concerns about the economic prospects.

While the flow of administrations has been gentler this year, La Senza, Jane Norman and Paul Simon have all slipped into administration in recent months. However, the big change that we have noticed is in demand for the stores that are being released by these failures. La Senza's portfolio is generally in high quality locations and retailer interest in these has been strong. At the other end of the scale there has also been strong interest in some of the Paul Simon stores from discounters and bulky goods retailers. This trend emphasises the polarisation in the retail market at present, with a wide spread between those who are rationalising with no expansion, and those who might still be rationalising, but are also opening new and often larger stores.

The main topic of conversation in retailer boardrooms continues to be how to adapt to the multi-channel world. Increasingly this is now being seen as an opportunity rather than a challenged, with wider customer bases to play for, but the logistics of dealing with new forms of customer behaviour testing every retailer's store and distribution model.

Retailers such as Argos have proven the need for stores in this new environment, and the focus for many retailers is now how to encourage customers into their store via click and collect or when making returns. This then allows their staff to upsell and drive profits.

While the focus of the retail property industry is often on the next hot new entrant, with retailers such as Hema and American Eagle recently arriving in the UK, our opinion is that the domestic retailers offer far more potential for landlords who are looking to fill voids or drive rents. Now that many of the major multiples are looking to grow their portfolios to capture the economic recovery and service multi-channel sales, a 2% increase in store numbers for one of the major multiples will deliver far more openings than a new entrant who might have plans to open three or four stores in the next 12 months.

The most sought after locations are starting to see a slight swing in terms from the 100% tenant friendly environment that has prevailed in recent years, and we have noticed that many retailers are now prepared to pay the headline rent to access these pitches, and the incentives that landlords are prepared to offer are falling.

Looking ahead to the remainder of this year we expect that trading will improve, and many retailers are rushing to get new stores open in time for Christmas. Indeed, the success of the American style "Black Friday" promotions last year is leading a number of retailers to comment that the Christmas season has now extended, albeit with the need to offer some deep discounting to drive shopper excitement.

Shopping centre investment

The second quarter saw 15 shopping centres traded, accounting for a capital value of £1.487 billion, taking the first half total to £3.37 billion.

The average lot size increased to £123 million (up from £117 million in Q1), whilst initial yields moved in from 7.98% to 7.77%.

Notable transactions in Q2 2014 included:

- The acquisition of Bridges in Sunderland by AEW for £152.7 million off Land Securities (advised by Savills) reflecting a net initial yield of 7.1%;

- The acquisition of Golden Square Warrington by clients of LaSalle Investment Management off Legal and General and Lend Lease for £142.5 million reflecting 7% initial yield and 6.6% equivalent yield;

- The acquisition of Washington Square Workington by Europa /Scoop for £31.5 million reflecting a net initial yield of 7.5%;

■ The acquisition of The Guineas Newmarket by Ignis for £18.29 million off Helical Bar (advised by Savills) reflecting 8% initial yield.
The most significant transaction of the quarter was the acquisition by Land Securities of Lend Lease's 30% stake in Bluewater shopping centre. The stake included the asset management remit and as a consequence led to one of the most fiercely contested battles seen in many years.

The £654 million acquisition reflected a net initial yield of 4.1%, thereby bringing in super prime yields by 75-100bps.

TABLE 1

Shopping centre yields

	Q1 2014	Q2 2014
Super-Prime	5.00% ↓↓	4.25%
Prime	5.25%	5.25%
Town Centre Dominant	7.00%	6.75%
Secondary	9.00%	9.00%↓
Tertiary	12.00%	12.00%↓

Source: Savills

There are currently 23 shopping centres in the market which are under offer accounting for £1.15 billion. Notable amongst these are East Kilbride (c.£170 million), the Swallowtail shopping centre assets (c.£350 million) and Telford (c.£150 million). Savills are advising on all of these assets.

There are 27 assets in the market accounting for £950 million.

As it stands if the assets currently under offer and in the market happen it will be a c.£5 billion year. We are aware of a number of assets coming through to the market in September and as a consequence it is not inconceivable that the year could reach c.£6-6.5 billion. This level of activity has not been seen since 2006.

Savills has been fortunate to have been involved in many of the transactions in 2014 and as it stands there is no evidence of a slowdown in investor appetite. We are in unprecedented times when all areas of the buyer spectrum together with the debt markets are seeking to deploy equity. It is well known that the top 50 private equity fund managers have raised $175 billion to invest in property since 2009.

As yields compress this will undoubtedly drive some investors out but as we have seen many of the opportunity funds are coming down the return curve with new "core funds" seeking 10% returns rather than the traditional 15% plus.

As net inflows increase for the institutions we are now seeing pressure on them to invest again. This has led to a number of institutional investors acquiring what would have traditionally been opportunistic assets.

Finally we are beginning to see a small inward yield movement on some of the better secondary assets. Many of these secondary towns have been resilient through the recessions but extreme caution must be taken in this sub sector and forensic diligence undertaken to determine sustainability

High street investment

The key feature of the first half of this year has been the sheer weight of money being deployed into the property market by the opportunity funds and mainstream UK institutions. As a consequence of these capital inflows large lot sizes, and in some instances portfolios, are the only way to invest the money quickly and efficiently. In the retail sector, shopping centres and retail warehousing have therefore been the main focus and unless a high street block is over £10 million it scarcely registers on these buyers radar.

However, it would be wrong to conclude that institutional money is no longer buying high street property, although at the present time this capital is reserved for only the very best opportunities. In particular prime, well secured rentally 'rebased' shops with long leases in the UK's top 50 towns. Those vendors who have spotted this fact are enjoying premium returns.

With the weight of demand pushing up the price of shopping centres and retail warehousing (and offices and industrial) we would expect more capital to start to flow into high street stock, especially if it starts to look cheap relative to the other sectors. In short, there continues to be downward pressure on high street institutional yields driven in part by the lack of stock.

The disparity is that high yielding more asset management intensive property is still struggling to find a home. The uplift in sentiment at the end of last year has helped, and the banks are now at last willing to offer finance. However, property companies must be warned that if they think there is a strong enough market now, at last, to sell difficult assets they need to think twice as the number of buyers for secondary stock is still limited.

At least investors are now beginning to understand how retailers blend high street shopping with their online capabilities and whilst occupational demand for the very best shops is better than it has been, the supply/demand balance in all towns needs to be considered carefully before entering the market.

In conclusion, demand at both the institutional and property company end of the market is beginning to improve but the weight of demand and depth of demand for secondary assets is still fragile and accurate pricing remains crucial to achieving sales.

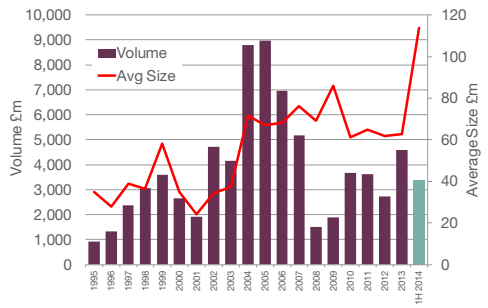
The busy end to last year left many investors anticipating a quicker improvement in pricing and therefore there has often been a reluctance to sell in the expectation that a property will be worth more later in the year. With a slightly stagnant secondary market we see many investors attempting to now "bite the bullet" especially with an expectation of an increase in interest rates and an early election next year.

Interestingly, some of the money being deployed has focused on large shop portfolios with Projects Tree, Minard and Moon all finding buyers who will ultimately look to sell down in the next few years. This could suggest that prime shops in second and even third tier towns could now present good value and when you look at the yield profile that some shopping centres in fairly nondescript towns are achieving this could definitely be the case.

We certainly believe that a window of opportunity exists to invest in prime shops in the £3-10 million bracket where ultimately institutional money will return. n

GRAPH 1

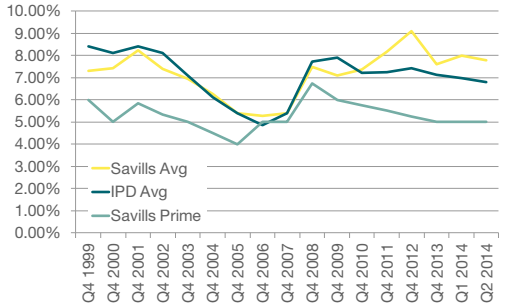
Shopping centre investment volume



Source: Savills

GRAPH 2

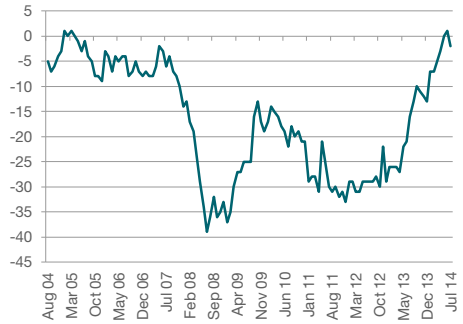
Shopping centre yields



Source: Savills, Investment Property Databank

GRAPH 3

Consumer confidence



Source: GfK

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