Shopping centre and high street bulletin

Q3 2011

"There remains a broad spectrum of purchasers for all asset types particularly at the super prime, prime and town centre dominant ends of the market"

Sidney Street, Cambridge

- Overall retail sales rose in September, but so did inflation. We do not expect to see a sustained retail recovery until real earnings begin to rise again next year.
- The retailer occupational market remains mixed nationally. Premium retailer demand remains buoyant and fiercely competitive within Central London, beyond the South East the retail market can be a very gloomy place.
- Good quality shopping centre assets remain sought after, and we expect to see a flurry of deals in the final quarter.
- An increasing number of good quality high street shops, held by private investors, may come to the market as banks step in, offering attractive opportunities for investors during 2012.

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Retailers

The consumer economy

UK retail sales rose by more than expected in September, due to an unexpected increases in laptop and video game sales. This mean that the overall retail sales volume including fuel rose by 0.6% in September after August's 0.4% fall. However, spending remains highly volatile, and clothing sales fell by 2.1% on the year, their biggest annual fall since April 2008.

With inflation rising above 5% this month the negative real earnings growth will remain the main drag on consumer spending and confidence until it falls. We remain of the view that inflation will begin to fall from January 2012, and this will begin to stimulate a pick-up in consumer confidence. Until then spending is likely to remain focused and cautious, particularly if the Eurozone situation is not resolved quickly and comparatively painlessly.

The retail occupational market

The best way to describe the current retail market is schizophrenic.

In the premium brand sector, retailer demand remains buoyant and fiercely competitive within Central London as foreign tourists bolster floundering UK consumer confidence. A raft of recent deals on Regent Street and Bond Street follows the high profile entrants to Oxford Street earlier in the year, where the clamour for "flagship" stores from international brands appears to be without end.

The recent successful opening of Westfield Stratford appears to have done little to dent these "mega brands" appetite. However, there is an undercurrent developing that the mid market fashion brands are starting to see the impact of increased retail competition on their sales densities on traditional "safe" locations.

The lack of foreseeable retail development outside of London in the South East, especially in wealthy market towns, is actually to the benefit of the retail market where demand remains focussed on specific retail stock in terms of size, configuration and character. In certain locations and for the "right property" premiums are still being offered and competitive bidding is becoming increasingly normal where supply is limited due to historically low values and limited relocations/ business failures.

Outside of these rare South East market town "gems" the retail market is a very gloomy place. Increasing vacancy rates, limited demand from national occupiers, increasing levels of incentives being offered and a substantial de-basing of town values through subleases being agreed at discount rents to historic passing tones, are common.

There is a growing trend amongst national occupiers with large portfolio's to use lease expiries as an opportunity to remain in occupation on turnover only deals, providing a high level of flexibility on the lease term. There is a danger that in some secondary shopping centres historic rental evidence will be completely undermined as retailers move to turnover only deals. Also their unwillingness in poorer locations to take long leases is creating a significant division between prime and secondary where earlier this year the division between the two extremes were blurred.

Following the recent spell of unseasonably warm weather and the inability of mid market fashion occupiers to cope with the changing buying patterns of their customers, there is an expectation that unless consumer confidence returns significantly in the run up to Christmas, the number of business failures will be substantial post the December quarter date. The next financial quarter will be one of the most important in recent years for retailers continuing success into 2012 and beyond.

Shopping centre investment

Q3 witnessed just 16 shopping centres being transacted accounting for £423.75m bringing the total number of shopping centres traded for the year to date to £2.9bn in capital value terms.

Unsurprisingly, the average initial yield of those transacted in Q3 compared with Q2 moved outwards from 7.32% to 8.43% reflecting the nature of the secondary stock being traded and the nervousness in investor sentiment.

Notable transactions in Q3 2011 included:-

- The Mall, Barnsley – Sold to F&C REIT for £25m reflecting 7.6% Initial Yield and 8% Equivalent Yield.
- The Mall, Middlesbrough – Sold to F&C REIT for £83m reflecting 8.6% Initial Yield and 9% Equivalent Yield.
- St Mary's Place, Market Harborough – Sold to RREEF for £18.7m reflecting 6.5% Initial Yield and 7.44% Equivalent Yield.
- Victoria Place, London – Sold to Network Rail for £91.8m reflecting 5.75% Initial Yield.

To date:-

- 40 shopping centres have been traded (Savills have transacted 13 of these).
- 18 shopping centres are under offer accounting for a capital value of £1.07bn.
- 28 shopping centres are in the market accounting for a capital value of £1.06bn.

Investors

We do not expect many more shopping centres to come to the market this year as the timescales to deliver a contractual commitment prior to the year end after mid October is too tight.

At the start of 2011 we predicted that there would be £4-5bn in transactional volumes for the year. If all of the deals that are under offer and in the market complete we will reach the £5bn mark. This is unlikely in our opinion as a number of the assets currently in the market may fail to sell owing to a summer of secondary softening with the Euro concerns and drop in investor sentiment. We therefore estimate that closer to £4bn to £4.5bn will be traded in 2011, which is in line with the annual market average.

The wider, macro economic situation is being felt and those investors that are in "acquisition mode" are revisiting their cashflow models and scrutinizing income streams far harder than would normally be the case. Banking margins and loan to values are under pressure from the early summer months where debt terms were more easily obtained.

There remains a broad spectrum of purchasers for all asset types particularly at the super prime, prime and town centre dominant ends of the market. We currently have a 500bps spread between prime and tertiary assets. We expect this to become 600-700bps as tertiary assets begin to trade at 11-12% initial yield through to 2012. Many purchasers have been waiting a long time for double digit yields on secondary and tertiary assets. Many of the banks are exploring the reduction of their loan books in 2012 and 2013 with a number of balance sheet and securitised loan expiries. The next 12 months will provide for a very interesting purchasing opportunity for many investors with a flurry of deals expected over the final quarter of this year.

	Q2 2011	Q3 2011
'Super' Prime	5.00%	5.00%
Prime	5.50%	5.50%
Town Centre Dominant	6.00%+	6.00%+
Secondary	9.00%+	9.00%+
Tertiary	10.00%+	11.00%+

High Street investment

As the summer holiday period approached the high street investment market was carrying good momentum. Converting deals that were under offer at that time took a little longer than usual but sentiment was still positive. Has the world completely halted since investors and their agents returned from the summer break?

Many would say that it has. Certainly as the global economies from Europe to the US lurch one way and then the other, caution definitely abounds. Everyone is looking for a safe haven for their money, something that the stock market does not necessarily offer as it yoyo's up and down. Bricks and mortar do and the fundamentals remain the same; prime, well secured assets ideally let off current market rents and on long leases. Long leases now becoming the difficult aspect to identify.

Private investors are certainly more cautious, wishing to see how things unwrap (Christmas pun not intended) before investing. Amongst many there is the belief that the market will get cheaper before it gets better and that waiting until Christmas retailer statements have been issued could see prices cheapen when the next tranche of retail failures are confirmed. For every private investor hesitating there are still others who look at the opportunities that are now presenting themselves as too good to miss. In short the market has less investor depth but it is certainly not dead. We would predict that small prime quality investments will continue to attract and appeal to private investors even in these gloomy times.

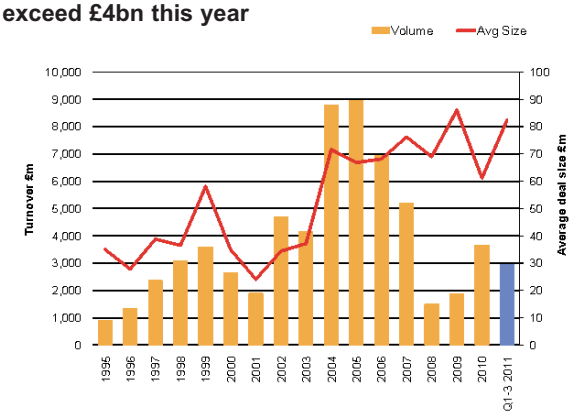
The larger property companies are still busying themselves with shopping centres and other than one or two specialist investors, there are few who are prepared to enter the High Street sector for the time being. That leaves the funds. IMA (Investment Managers Association) track retail fund capital flows and over the last quarter, in many instances, inflows have turned to outflows. There is an expectation that the retail funds will have to further disinvest in 2012 as purse strings tighten and redemptions increase. Retail funds are holding cash reserves in readiness. This stance inevitably creates a neutral market. Retail funds will only buy if a property is very good and could be easily sold again whatever market conditions. Everything else is left alone.

On the sale side we have yet to see the funds come under pressure to sell. If there is further pressure from redemptions it will be the poorer stock that comes to the market first. Holding the higher quality 'family silver' gives a fund manager the chance to improve the quality of the portfolio. The life funds may also come under pressure especially if the equity markets remain depressed and they are forced to rebalance their weightings.

One area that has now become a steady trickle, and could potentially turn into a river, is bank sales. On the high street side there are a number of really good quality shops held by private investors (often Irish) where the fundamentals are still good but where the banks may step in. All this leaves investors with potentially huge opportunities over the coming months and specifically during the course of 2012. On the basis that high street investments are bought for income everybody will be watching the Christmas trading patterns and holding their breath to see what happens next.

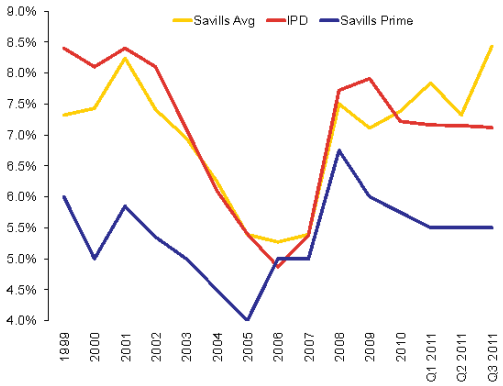
Data

Shopping centre investment volumes likely to exceed £4bn this year



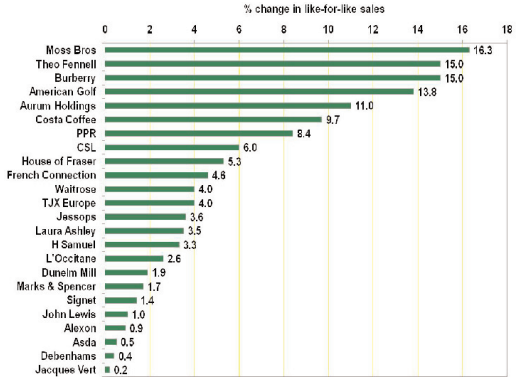
Source: Savills

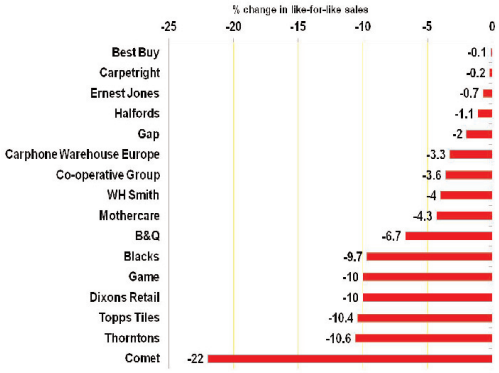
Downward pressure on prime yields continues



Source: Savills, IPD

Selected retailer trading figures reported in Quarter 3 2011





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