Shopping centre and high street bulletin

Q1 2011

"We are now seeing evidence of the widening yield gap between prime and secondary."

- Consumer confidence continues to worsen due to austerity, high inflation and rising taxes. We do not expect these headwinds to lessen until early 2012, and the spectre of rising interest rates will be a further worry for UK consumers in the short to medium term.
- There continue to be pockets of retailer demand from all segments of the market. However, locational criteria remain very selective.
- Downward pressure on prime high street and shopping centre yields has begun to re-emerge.

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Retailers

The consumer economy

The triple whammy of rising taxes, high inflation and increasingly negative announcements on public sector austerity plans have knocked consumer confidence back to a low similar to that of early 2009. In the short term it is hard to see any of these headwinds relaxing, but by January 2012 we expect that inflation at least will have begun to be less of a factor.

However, between now and next year the spectre of rising interest rates will be hotly debated. Given that interest rates are currently at an 'emergency' low, they will have to rise but it is the timing and gradient of that rise that we believe will have the biggest impact on consumer confidence. While the March inflation figures surprise on the downside, with CPI sliding back to 4.0% from 4.4%, it is still double the 2% target and has now been above that target for 16 consecutive months.

The key drivers behind this high level of inflation are threefold: two VAT rises, various fiscal measures related to deficit reduction, and high commodity prices. The impact of the VAT rises at least will reduce from January 2012.

Despite this, there remains a lively debate about the timing of the beginnings of a return to 'normal' interest rates. One of the arguments put forward by those who favour an early rate rise is the need for the MPC to send a signal that it is not prepared to tolerate high inflation. However, even the Governor has said that this would be a "futile gesture". We would argue that at this stage a rate rise would do more harm than good. Rising rates would not reduce inflation, and would do nothing to relax the inflationary squeeze on the nation's wallets and purses. Furthermore, it is inevitable that the banks will pass any increase in the Bank Rate onto their borrowers, which would have a further dragging effect on household incomes and spending.

The prospects of a rise in May have now diminished, but the MPC will remain under pressure to begin raising rates in the August meeting.

The retail occupational market

If one takes the national press headlines as gospel it would be fair to assume that the end of the UK retailing world is nigh.

The worst quarterly retail sales figures in 16 years, record numbers of retail businesses on the brink of administration, online retailing soaring, high inflation being driven by increasing commodity prices, successful and failed CVAs, the recent VAT rise linked with wider austerity measures resulting in materially reduced purchasing power and low consumer confidence. It is a bleak picture. Or is it?

In 2010, Easter fell much earlier. This year's sales figures may therefore paint a slightly distorted figure.

The rise in popularity of the "stay-cation" coupled with the warmest, driest spring on record should add a further boost to retailers' performance in Q2.

In London the Royal Wedding was viewed by around 750,000 people on the processional route and in Hyde Park. There will be an undoubted boost to local shops, bars and restaurants. Nationwide, catering for street parties and increased pub opening hours will further enhance food sales figures.

Ultimately, shopping is the British public's number one pastime. Although retailers who face stiff price competition from other sectors, fail to adapt their brands to changing consumer demands and fashions, or have limited online presence may struggle, those which are more dynamic and can provide shoppers with an enhanced retailing experience, either through store design or customer service, can still make a strong claim for a proportion of shoppers' pounds.

There continue to be pockets of occupational demand across the retail sector from luxury brands, right the way through to the niche, mass and discount markets.

Strong growth seems to be particularly visible in strong market towns and cathedral cities where competition for premises continues to provide examples of rental growth. In prime central London locations, almost every deal results in a new record Zone A rate being set.

Further, any appetite which exists for new town centre retail space will be difficult to fulfil given the constrained development pipeline for the next three to five years. Retailers need to increase floorspace to drive sales growth and where large store opportunities can be created, competitive scenarios should exist.

Ultimately, the horsemen of the retail apocalypse may appear to have tacked their mounts but hopefully we won't be riding into town just yet.

Shopping centre investment

The 2011 shopping centre investment market started slowly with just 14 deals traded (of which Savills have transacted 9) in the first quarter and accounting for £2bn in capital value terms.

The average capital value of assets traded was £145.75m (skewed by Trafford Centre) with the average unweighted Initial Yield being 7.84%.

The most notable of these deals are highlighted below;

- Green Lanes, Barnstaple
- Three Spires, Lichfield
- Monument Mall, Newcastle
- Centrale, Croydon
- Halton Lea, Runcorn

Investors

The market is certainly gaining momentum and in addition there are now a further 12 shopping centres under offer and 16 in the market. We are also aware of a further ten being prepared for sale.

The big question that still remains ia the availability of stock. We are now beginning to see a small wave of disposals being released to the market. We believe this will gather pace through the year.

Certainly Savills amongst other advisors are being asked to consider a wide range of assets.

From a banking perspective advice is centred on maximising value in the short to medium term but with an ultimate exit strategy. Key issues will be expiry profile, incentives to renew leases and the attraction of tenants to the asset.

From the administrator's perspective we have already seen assets actively managed over the shorter timeframe but with an exit strategy pursued earlier than through the banks.

Cash remains king.

The appetite for stock remains across the spectrum. As highlighted in our Q4 2010 bulletin we are now seeing evidence of the widening yield gap between prime and secondary.

We anticipate that both the prime and town centre dominant sectors will come under downward pressure as investors seek higher quality dominant assets.

The secondary end of the market will remain very town centre specific with initial yields ranging from 8-10%.

As more stock comes to the market prospective purchasers will begin to scrutinise income expiry profiles, tenant risk of default, location and competition. Key will be working out the 'true re-based' rental position to ensure that a superficially attractive initial yield does not drop 150-200 basis points as a result of the true rental position being reflected.

From a debt perspective there is certainly more appetite for prime rather than the more secondary asset. Loan to values generally remain around the 60-65% with margins in the order of 200-250 basis points but many banks are now asking for heavy amortisation on loans.

	Q3 2010	Q4 2010	Q1 2011
Prime	6.00%-	5.75%-	5.50%
Town centre dominant	6.50%-	6.50%	6.25%-
Secondary towns	9.00%+	9.00%+	9.00%+

High Street investment

The first quarter of 2011 has seen a further yield gap appear between prime and secondary high street investments. There is also arguably quite a material 'disconnect' between the occupational and investment markets.

The institutional market place has seen most funds continue to want to buy. But it must be the right thing – ideally blocks with clean overriding leases in prime locations in strong towns and cities. However with little institutional pressure to sell there is a dearth of such stock coming to the market. This has created a further hardening in prime yields. Discerning institutions are focused on robust centres generally situated in the South East where occupational demand remains strong and the prospects for re-letting even under today's harsh economic conditions remain good. Single unit investments have seen yields come into the 4.75 – 5.00% bracket and for larger holdings/parades in the top centres, yields are now even keener than this.

The private investor also remains acquisitive, looking for prime well-secured shops ideally with over ten years unexpired on the lease and up to around the £1.5m mark. For larger lot sizes there are fewer buyers and only a select number of parties who are able to enjoy often quite lucrative pickings between £2-5m.

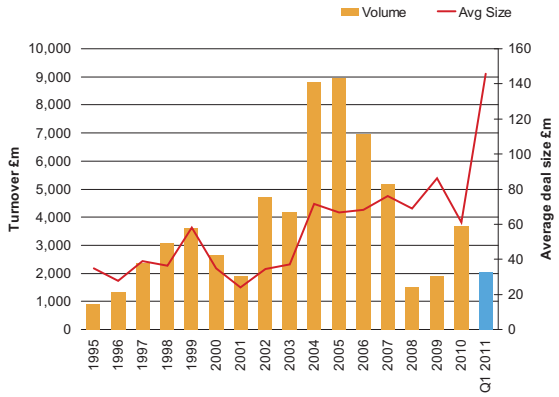
The property company fraternity continued to be debt starved leaving only the major REITS free to exploit opportunities. In the main these parties have focused their efforts on shopping centres rather than single units or parades.

Central London retail investment sits in a totally different place. The occupational market in London continues to see buoyant demand which should ensure sustainable rental growth in most of the core retailing locations. This in turn has fuelled investor demand, not only from the domestic market but also from the world's 'uber rich'. Savills has been selling 138 New Bond Street, a new 15 year lease to Missoni off a rent of £670 per sq ft Zone A. This sub £10m leasehold interest (1,883 years unexpired) has generated strong global demand and is likely to result in a 'Roger Bannister' initial yield (sub 4%).

Savills high street investment team anticipates a continued lack of quality stock ensuring that prices will remain keen throughout the year. Where investors need to keep focused and remain sensitive is toward the occupational market. The Government's austerity measures have undoubtedly had an impact on retailer performance. This has curtailed many retailers' expansion plans and left the weaker run businesses with the need to shed units as quickly as possible to try and prevent administration/receivership. This supply/demand imbalance will continue to materially upset the growth in most of the UK's town centres and with CVA legislation still having savage repercussions on landlords, meticulous consideration needs to be made on covenant quality before any acquisitions are made.

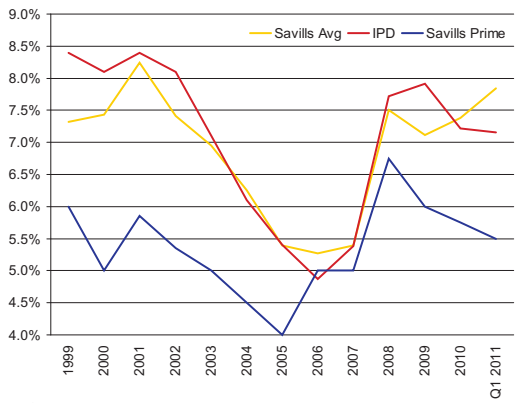
Data

Strong turnover in Q1 fuelled by Trafford Centre



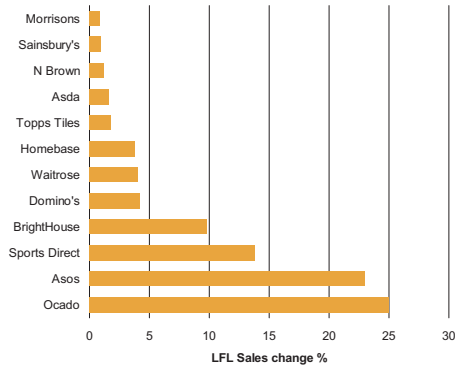
Source: Savills

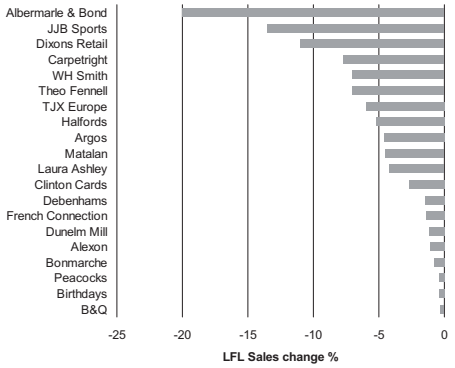
Downward pressure on prime yields has resumed



Source: Savills, IPD

Selected retailer trading figures reported in Quarter 1 2011





For further information please contact

Nick Hart
Investment
020 7409 8837
nhart@savills.com

Jeremy Lovell
Investment
020 7409 8745
jlovell@savills.com

Charlie Neil
Investment
020 7409 8163
cneil@savills.com

Mark Garmon-Jones
Investment
020 7409 8950
mgarmon-jones@savills.com

Moira Hamilton
Leasing
020 7409 8156
mhamilton@savills.com

Jonathan Stott
Professional
020 7409 8167
jstott@savills.com

Dan Peake
Leasing
020 7409 9967
dpeake@savills.com

Mat Oakley
Research
020 7409 8781
moakley@savills.com

Savills
Research

savills.com/research

savills