Shopping centre and high street bulletin

Q3 2010

"We are set for a very busy final quarter in the investment market"

- While the outcome of the Comprehensive Spending review is not particularly favourable for retail spending in some locations, we believe that an end to the uncertainty about the scale of potential cutbacks will be good for consumer confidence.
- In the occupational markets we believe that a number of markets will significantly out-perform in terms of retailer demand over the next few years.
- Investment competition is strong for assets in prime locations. We anticipate that the final quarter of this year will see a flurry of larger deals.

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The consumer economy

Consumer confidence, while less negative than it was in 2008/9, remains markedly pessimistic and seriously volatile. While the economy has now been growing for three consecutive quarters, concerns about job security, house price stability, and most importantly the imminent comprehensive spending review are all putting consumers into a save rather than spend frame of mind.

So when will this change, and what will drive an improvement? While some retailers can anticipate a rush over Christmas and early January as consumers move to buy big-ticket items before VAT goes up to 20%, this is unlikely to be the prevalent trend during 2011. A sustained pick up in sales will only come once consumer confidence is back to normal, and the spectre of 25%-40% cuts in public spending has been crystallised and factored in to people's perceptions of their own financial stability.

The outcome of the CSR was not as scary as it was being trailed. The impacts will be geographically spread and tapered in over time. The fact that there is now increasing clarity on the outcomes should give some support to consumer confidence.

The retail occupational market

The Performance Spectrum

The headline statistics for Q3 2010 – voids static at circa 12% - 13%, minimal decline in overall rental levels at around –1%, footfall stabilised year on year, and the development pipeline continuing to shrink significantly – camouflage a huge divergence in performance at sub market levels.

Bottom of the class is the group of ordinary mid range towns that have been christened as "Clone Town UK" – no point of difference, a deteriorating shopping environment, and strong competitive pressures from nearby retail parks and other competing locations with better tenant mix and infrastructure – and as a result increasingly unattractive to its local catchment. The new focus on out of town stores from Debenhams, House of Fraser and JLP provides another nail in the coffin for these ordinary towns. Combine these circumstances with the strong likelihood of public sector cuts and lack of public realm investment in these compromised locations, and the prognosis for continuing and, in places, significant rental decline is undeniable.

At the other end of the spectrum, our locational analysis shows the best prospects for outperformance from the following sub-markets:-

- Central London markets
- Affluent tightly held towns with attractive shopping environments
- Certain micro locations in provincial city centres
- Strong food anchored neighbourhood centres

The future agenda for regional shopping centres is more difficult to call. The majority provide shopping environments of real, if artificial quality, acres of free parking and sufficient variety of tenant mix to draw shoppers from an extensive catchment. However, rental levels of £300 Zone A to £400 Zone A applied to a myriad of standard shops may well prove unsustainable unless owners are sufficiently far sighted and well financed to reconfigure traditional designs and so provide the efficient space that the best occupiers now demand. So for these assets to outperform, a realistic rental base, planning flexibility and a well financed forward thinking owner will provide the best recipe.

The Changing Definition of "Prime"

At a macro level, our Q2 Retail Bulletin highlighted the polarisation between prime and secondary and our expectation that this trend would continue for the remainder of 2010. This holds true, but there is a significant change in perception taking place. The old definition of prime from a traditional investor's viewpoint as the location where the highest rents prevail is becoming outdated.

In practice it is occupiers, not investors, who create value in property and the properties they occupy are merely a means to an end. The occupier seeks out not the location where rents are highest, but instead the location and class of property where he can generate maximum profit. Influencing factors on the occupier's decision are pedestrian flows, space efficiency, suitability of environment, quality of tenant mix, geography and demographics, and property overheads.

So a redefinition of prime to the location where occupational demand is at a maximum is the logical corollary of this change in perception.

Shopping centre investment

The number of shopping centre transactions in Q3 slowed over the summer period to just 10 deals (down from 16 in Q2) and accounting for just £250.83m. This brings the total number of individual centres traded to the end of the 3rd quarter to 45 and accounting for £1.571 billion in capital value.

Interestingly while the number of transactions fell average initial yields also dropped significantly to 6.88% (down from 7.54% in Q2).

Notable transactions included:

- The Mall Portfolio: Acquired by Rockspring for

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£137m reflecting a net initial yield of 7.68%. The portfolio included four mall schemes in Falkirk, Gloucester, Southampton and Romford.

- N1 London: Acquired by Henderson for £112m reflecting a net initial of 5.22% and an equivalent yield of 6%.

- Stratford Shopping Centre, London: Acquired by Catalyst Capital for £91.55m reflecting a net initial yield of 7.25% and an equivalent yield of 8%.

There is no doubt that investors took advantage of the holiday period placing money into the market into key/strategic assets they believed had significant Asset Management/Development opportunity. The pressure to place money into the Market remains and many investors are continually disappointed with several assets going to second and even third round bids. This is particularly pertinent of the well secured newly built and let assets such as White River Shopping Centre, St Austell.

The depth of bidding is coming from the UK institutions, property companies and opportunity funds and to a lesser extent the Sovereign Wealth Funds and REITS. That said we will begin to see the re-emergence of these investors as the bigger, more dominant assets such as Drakes Circus Plymouth, Overgate Dundee and Dolphin Centre Poole come to the market. It is highly likely that with such interesting stock coming through we will see prime yields edge below 6% and town centre dominance possibly fall below 6.5% for the very best of assets.

	Q1 2010	Q2 2010	Q3 2010
Prime	6.00%	6.00%	6.00%-
Town centre dominant	6.50%	6.50%+	6.50%-
Secondary towns	8.50%	9.00%+	9.00%+

With 11 deals under offer accounting for £684m, 23 deals in the market accounting for £1.18bn and 35 centres coming to the market we are set for a very busy Q4.

High Street investment

A leading authority on the market once said, “the world of shops never sleeps!” This is perhaps true, but in the third quarter of 2010 the market certainly seemed to doze off. There was little deal tension. Those purchasers buying took their time to process transactions once in solicitor’s hands and vendors, often lacking underbidder depth, did not have the luxury of being able to force deals through. For the agent fraternity it became a long drawn-out summer coaxing deals forward rather than an opportunity to pursue fresh stock.

Savills were hopeful that with a steady 12 month run behind us vendors would use the summer period to capitalise on pricing levels by quietly offering opportunities that could be fully marketed in September if they failed to find a buyer. This never really happened. In short there has been a dearth of good prime institutional stock over the quarter and there will probably be hardly any new good opportunities to come through now before Christmas.

The private investor market has arguably also cooled slightly not withstanding the fact that a good well-secured shop still offers one of the best returns available in any asset class. This is partly because again there has been a lack of good product and yields in the last quarter arguably reflect slightly more secondary opportunities that were often well-secured but with unexpired terms of less than ten years.

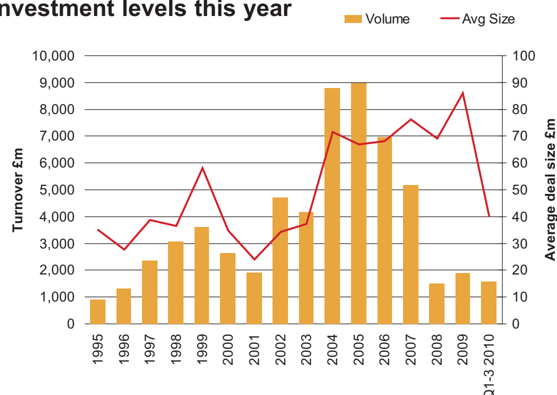
It is the property company market that has seen, and in our view will continue to see, the most pain. The large REITS continue to pursue larger asset management roles with Sovereign Funds. At current pricing levels the high street shop is not on the agenda. The middle ranking property companies continue to crumple with Kenmore and Kilmartin now sold and with Targetfollow currently in the bank’s sights (pun not intended). The smaller property companies not only lack good opportunities but are also starved of debt and any form of occupational buoyancy.

At the institutional end funds are generally neutral. Capital inflows have reduced in volume but remain generally positive leaving fund managers under no pressure to sell and only buy if the right quality of prime shopping becomes available. In our view this position looks unlikely to change in the short term although some funds may be forced into a flurry of activity to commit their cash reserves prior to the Christmas break.

So with the private investor steadily picking up well-secured long dated shops at an optimum lot size of around £1m and with institutions chasing either top quality ‘vanilla’ prime or high yielding blocks or shopping centres, there remains one big black hole. The clever well financed investor or small property company could have the chance to exploit this gap in the next 12-18 months. The ‘difficult’ properties are the prime shops or blocks over £2m but below £5m where unexpired terms are short and there is a workable occupational play. The ultimate ‘cherry on the icing’ is where there will also be the opportunity to sell the asset back to the institutional market when a deeper market returns. The problem at the present time is one of price. Generally speaking the product that delivers this opportunity is not worth the price a vendor requires and whilst attempts are made to sell this type of asset today it will not be until the quoting yields move out that a proper market is re-established in this true area of opportunity.

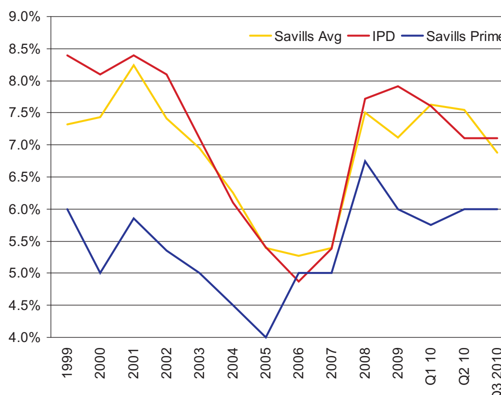
Data

A busy Q4 will lead to higher shopping centre investment levels this year



Source: Savills

Yields broadly stabilised in Q3 2010



Source: Savills, IPD

Recent significant investment deals

Shopping centre	Size (sq ft)	Purchaser	Vendor	Price	IY
The Mall Portfolio		Rockspring	The Mall Fund	£137m	7.68%
N1, London	142,000	Henderson	Delancey/Metro	£112m	5.22%
Stratford SC, London	330,000	Catalyst Capital	Land Securities	£91.55m	7.25%

High street	Tenant	Purchaser	Term unexpired	Price	IY
Montague Centre, Worthing	Various	Ignis AM	Various	£8.48m	7.98%
48 Coney St, York	TK Maxx	Redevco	14.75 years	£8.73m	5.15%
160 New Bond St, London	Luis Vuitton	Louis Vuitton	14 years	£47m	3.12%

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