savills

UK Shopping Centre and High Street Bulletin

Quarter 4 2012

Image: Meadowhall.

SUMMARY

■ We believe that 2013 will see a turning point in the UK consumer economy. Inflation will slow, earning will rise and confidence should follow.

■ The big challenge for landlords in 2013 will be retaining their tenants. Landlords need to take a flexible attitude to lease negotiations and review spending on their schemes.

■ 2013 will see more high quality shopping centres coming to the market. It will also see investor demand expanding to include "value-add" opportunities.

■ In the high street investment market the challenge will be to find locations and investments where the base rent offers growth potential.

"This year will continue to see a widening gap between the strong and weak trading locations across the UK"

The consumer economy

A tough year for the UK consumer ended on a typically subdued note with consumer confidence sliding back to its recent level of significant negativity, and retail sales growth marginally contracting month-on-month in December.

However, there are reasons to be more optimistic about 2013, with UK economic growth forecast to be stronger at 1.0%. A further positive boost will come from continuing growth in real incomes, which will be boosted by falling inflation and the September 2011 indexation of state benefits up by 5.2% While CPI inflation has fallen significantly during 2012, it still remains some way above its target. However, high food and domestic energy prices will delay its fall until the second half of this year.

Thus, by the end of 2013 inflation will be back to its 2% target, and this will mean that real earnings growth will be back in positive territory. This will combine with improving output and employment data to rebuild household confidence and reduce the perceived need to precautionary save

The retail occupational market

The final quarter of 2012 was one of mixed fortunes for UK retailers. Our analysis of the Christmas trading statements show an average increase in like-for-like sales of 1.9%, but the continuing pain on the high street was highlighted by seemingly inevitable slide into administration by Comet, Jessops HMV and Blockbuster. We expect large parts of these portfolios to be taken up by phoenix companies or new occupiers in the next 6-9 months

While 2012 saw retail sales grow at their fastest level since 2007, retailers continue to battle against a highly price-conscious shopper, and rising rates and service charges. We believe that in 2013 the industry as a whole will have to think about rates and service charges, and consider how better these costs might be dealt with so as to support the growth of the UK retailer.

The majority of retailers that we speak to are undertaking portfolio reviews, with the aim of identifying poor-performing stores than can be closed, and this will undoubtedly be a continuing theme in 2013. However, the end result of such reviews tends to be less dramatic than the aspirations, and with rent continuing to fall in many locations we expect the profitability of those locations to be enhanced during 2013 as the consumer economy recovers.

This year will continue to see a widening gap between the strong and weak trading locations across the UK, and this will be reflected in the retailer demand, trading, and ultimately the rents that are being paid. We expect to see continued expansion amongst the coffee shops, discounters , footwear and luxury clothing retailers, as well further but slower expansion by the smaller concept foodstores.

These requirements will be heavily biased towards the aforementioned strong trading locations, with rising vacancy rates in the weaker markets almost inevitable. Another theme for this year will be the impending bulge in lease expiries and the level of over-renting across the UK. While the knee-jerk reaction to this might be to expect a large scale release of space and a downward re-rating in rents, the majority of tenants are likely to renew (albeit with a renegotiation of the rent in the majority of locations.)

The big challenge for landlords will be to continue to retain their tenants, and while a flexible attitude to lease negotiations will be vital, we also believe that there needs to be a return to investment in retail assets. IPD data shows that the day to day investment in shopping centres has fallen to very low levels and this is hastening the drift of some centres from secondary to tertiary. With retailers reviewing their options on a regular basis, schemes that are decaying due to lack of attention may well suffer from an outflow of retailers.

Shopping centre investment

The final quarter of 2012 saw 14 shopping centres transacted accounting for £1.22 bn, almost double the £634 m transacted in Q3, although the Q4 figures are skewed significantly by the sale of a 50% interest in Meadowhall Shopping Centre. This resulted in £2.72bn being transacted in 2012 in 44 deals, both well below the respective long term averages of £3.7bn in terms of transactions and 77 in terms of number of deals.

The average initial yield in Q4 2012 moved out to 9.06% (from 8.16% in Q4 2011), which is a continued reflection of the stock being sold.

Notable transactions in Q4 2012 included:

- Acquisition of a 50% stake in Meadowhall, Sheffield for £762.5m, reflecting 5.09% initial yield, by Norges Bank IM
- Acquisition of The Lanes, Carlisle for £64m, reflecting circa 7.60% net initial yield, by F&C REIT
- Forward sale of Westfield Bradford for £210m, by Meyer Bergman
- Acquisition of Metquarter, Liverpool for £21m, reflecting 9.00% initial yield, by Columbus UK Real Estate Fund LP
- Acquisition of a portfolio of five shopping centres for £85m, reflecting 9.7% yield, by New River from Threadneedle.

There are currently:

- 24 shopping centres under offer for £1.1 bn (based on quoting capital value)
- 16 shopping centres in the market accounting for £1.3 bn (based on quoting capital value)

Shopping centres in the market of particular interest are :-

- Legal & General marketing 100% interest in Midsummer Place, Milton Keynes for £230m, 5.50%.
- Wereldhave are selling their two UK centres – The Broadway Centre in Ealing is under offer to British Land and Dolphin Centre, Poole is under offer to Legal & General, both for sums below the levels paid 12 and 24 months ago.
- The rumoured sale of a 25% interest in Trafford Centre, Manchester by Capital Shopping Centres.

We believe that these three sales mark the trend in 2013 of more institutional and better quality schemes. The larger ones, over £150m, are targeting the increasingly active Sovereign Wealth Funds from around the world. This is

in line with our thoughts from 2011 that it is the "time for prime". Despite this the remains active demand across the range of quality from institutions, REITs, opportunity funds in joint ventures, property companies and debt buyers. We believe that these trends will continue into 2013 although the post Christmas trading feedback will have an ever more important role in investor confidence and transaction figures.

Key statistics for Q4 2012:

- Average lot size £135.7m
- Average yield 9.06%
- Average lot size £57.38m

Key statistics for the whole of 2012:

- Average lot size £75.55m
  excl Meadowhall £55.92m
- Largest lot size £762.5m
- Average yield 8.11%
- Highest yield 16.1%
  (Greywell, Havant)
- Lowest yield 3.3%
  (Whitgift, Croydon)

TABLE 1

Shopping centre yields

	Q3 2012	Q4 2012
Super-Prime	5.00%	5.00%
Prime	5.50%	5.50%
Town Centre Dominant	7.00%+	7.00%+
Secondary	9.00%+	9.00%+
Tertiary	14.00%+	14.00%+

Source: Savills

High street investment

In the last quarter of 2012 the high street investment market continued in a cautious manner. The gap between a seller's price expectation and that of a buyer widened causing the market to stall further. Institutional activity from the retail funds remained selective, on the buying side, and with little pressure to sell, limited on the selling side. Private investors led the charge on the buying side realising that they could pick up institutional calibre stock with less competition from the funds. However with the debt markets still essentially closed cash remained king.

The challenge for everyone was judging price accurately. With so few buyers around, and in some towns none, there was often insufficient competition to drive prices to the levels at which many property companies, funds and even the banks were prepared to sell. In the last quarter institutional buying was orchestrated by the valuers. No fund manager wants to buy an asset, however good its long term potential, if the valuation is going to be immediately marked down before year end. It is only right that a fund manager looks to defend their year end performance as that performance may be crucial to winning new money in the year to come.

Overrenting and its real impact on value has finally come to roost. Accurate reading of the occupational market and the rental tone (net of incentives, not headline) has become a crucial skill. Furthermore with tenants still dictating the terms on renewals, valuers have been valuing short unexpired terms ruthlessly.

Having assessed the last quarter everyone is now looking forward to what will happen in the retail world during the course of 2013. What is clear is that the retail revolution is now well under way. The canny investor must follow new retailer trends avidly. What is clear however is that as the online shopping market expands the requirement for the same number of unit shops as was historically the case is less. Retailers store sizes are also changing to reflect modern display and stock requirements. There is arguably less need for storage space in shops but retailers still wish to present their product in good sized well configured stores with enough retail 'theatre' to appeal to the customer who may then make the purchase online.

Investment agents without an occupational agency background, or without occupational agency support, can only broker rather than advise clients. Understanding the occupational side of the business is crucial to understanding current and, more importantly, future rental growth trends.

Two elements determine value, both of which must be considered based on the supply and demand characteristics of the moment. The first is rent. Rental growth is likely to be flat at best in the short term until the markets have properly re-based, possibly by around 2015. The secret is to buy off new low base rents so that when growth does start to come through values will increase immediately. With shorter leases now very much the market norm, demand will polarise toward the best units in the best locations and we are already seeing situations where competitive bidding is returning. Where a shop is overrented (the rent being paid is in excess of the current market rental value) the question will be how long will it take for the market to recover to surpass that level if at all! Savills are advocates of buying overrented shops only if we believe that the supply/demand characteristics will see that overrenting 'wash out' in the short term and the yield reflects the risk.

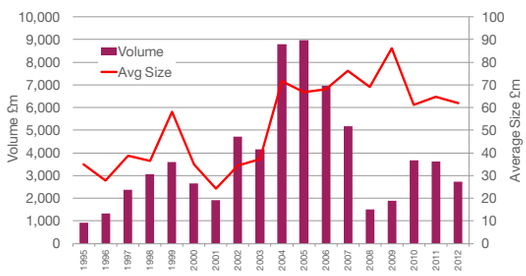
The other aspect that determines value is yield. With the occupational markets still in turmoil there is an argument that prime high street yields should move outward from the prime rate of 4.75%, at least in the short term. However a lack of good prime stock and strong private demand will we believe keep pricing steady. With the institutions relatively quiet now, is an excellent time for private buyers to buy prime shops often with little competition.

There will also come a point where secondary stock turns a corner and prices begin to improve. However at the moment for an investor who wishes to opt for safety rather than risk, prime shops in strong towns are the way forward.

In conclusion 2013 is highly likely to be less higgledy piggledy and more topsy turvy!

GRAPH 1

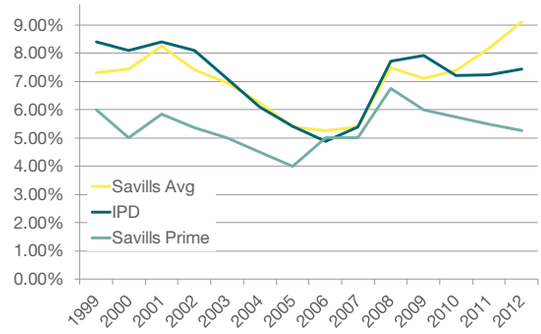
Shopping centre investment volume



Source: Savills

GRAPH 2

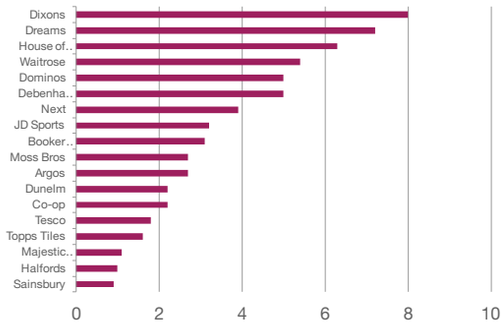
Shopping centre yields



Source: Savills

GRAPH 3

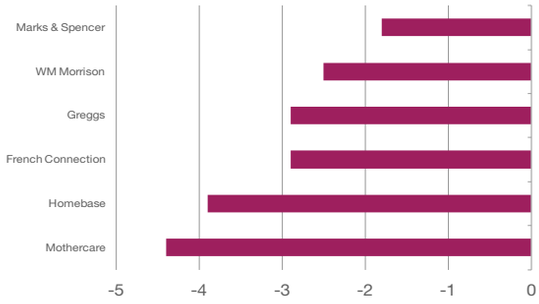
Christmas 2012 LFL sales



Source: Retailers, trading periods differ

GRAPH 4

Christmas 2012 LFL sales



Source: Retailers, trading periods differ

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