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Shopping Centre and High Street Bulletin

Quarter 1 2012

Image: 61/64 Broad Street. Acquisition on behalf of Scottish Widows Investment Partnership

SUMMARY

- We remain of the view that 2012 will be the turning point of this cycle in the consumer economy.
- Some retailers are speculating that there will be an Olympic boost to sales this summer. Generally, trading remains tough.
- Only 12 shopping centres were sold in the first quarter of 2012, totalling £461m. There remain a large number of equity buyers for shopping centre investments, and an even larger spread in yields between Super Prime and Tertiary.
- The high street investment market has also started the year quietly, and many institutions feel no pressure to buy or sell retail assets.
- We predict that while prime high street yields are likely to remain at their current level in the near future, secondary yields could harden as investors realise that the spread is now too wide.

"There still remains a huge level of denial on 'true asset values'."

The consumer economy

British consumers remain buffeted between conflicting stories on whether they should be feeling more positive or negative about the future. While the majority of forward looking business surveys are indicating a pick-up in activity and confidence, the same is not true of the consumer confidence indices. The latest data from GfK NOP shows that the headline rate of consumer confidence fell unexpectedly in March to its lowest rate this year.

We remain of the view that 2012 will be the turning point of this cycle in the consumer economy. With speculation about an economic "double-dip" finally, and quite rightly, dieing down the consumer will now be able to focus more clearly on their own financial position and prospects.

The massive shock of falling real earnings is reducing as inflation has started to fall, and while the oil price has not come down as fast as we expected, we still believe that positive real earnings growth will return for the average UK consumer by the end of this year. Clearly there are areas of the economy that will recover sooner than others, and we remain concerned about the localised effects of public sector austerity and high unemployment. However, the consumer recovery will begin this year, and it wont just be London and the South East that feel its benefits.

The retail occupational market

Surprisingly March quarter date didn't provide the doomsday scenario for retail that the soothsayers were predicting.

There were of course the much discussed administrations of major high street occupiers such as Game / Game Station as well as the continued flow of bad news through the press of further rationalisation of large retailers portfolios.

Large scale disposals through Mothercare, Argos and Starbucks come in addition to the ongoing portfolio rationalisation by Arcadia, Thorntons and River Island through lease expiries and covert targeted marketing.

The collapse of Peacocks provided a focal point of activity for the ever expanding discount occupiers and in certain instances substantial premiums have been paid (and dare I mention that word "rental growth")!

Consumer confidence appears to be holding firm, with a polarisation to either end of the retail spectrum. With customers flocking to the continuingly expanding value retailers or holding onto their faith in selected and highly regarded brands, the mid market retailers without a recognised and valued brand continue to be the victims in this market.

The biggest issue facing retailers in the short term is not however the economic climate but the weather itself. The unseasonably warm spell of weather pre Easter saw a short lived return to optimism for those retailers who have managed to weather the economic storm to date through a strong brand and loyal customer base.

This optimism was short lived and severely dampened by a return to typical Easter bank holiday weather and saw a resultant decline in sales across the country for most retailers.

There are still pockets of good news (outside of the resilient super prime Central London market) and reason to be optimistic. Retailers are still selectively acquiring and due to the lack of quality stock in strong market towns (predominantly South East biased) competition for space is seeing a rare return to straight 10 year leases, minimum rent frees and strong rentals (although this is town and unit specific).

With there being only 100 days to the Olympics (18/04/12) there appears to be a general feeling of optimism that this could be the boost that retailers need although it is widely appreciated that this will be a South East benefit which should, over time, have a ripple effect throughout the rest of the UK.

Whether the Olympic boost actually materialises and whether the weather returns to form will make this next 4 months the most eagerly anticipated for some considerable time.

Shopping centre investment

We have witnessed a slow start to the shopping centre investment market in 2012. Just 12 deals have been transacted in Q1 accounting for £461.55m in capital value terms (Q4 2011 17 deals in £609m). The average capital value of assets traded was £38.46m.

The average initial yield in Q1 2012 was unsurprisingly higher than Q4 2011 at 8.3% up from 7.95% reflecting market sentiment and nature of the secondary stock being traded.

Notable transactions in Q1 2012 included:-

- Ocean Terminal, Edinburgh. Sold to Resolution for £90m reflecting 7.5% initial yield 8% equivalent yield.
- Marriott's Close, Witney. Sold to RREEF for £29m reflecting 5.8% initial yield and 6% equivalent yield.
- St Johns Shopping Centre, Liverpool. Sold to Infrared for £76.5m reflecting 8.75% initial yield and 8.5% equivalent yield.

To Date

- 12 shopping centres are under offer accounting for £690m.
- 17 shopping centres are in the market accounting for £905m.

We believe that 2012 will be the polar opposite to 2011. The first six months of the year will be dominated by uncertainty, a lack of quality stock and limited trading volumes. We expect the second half of 2012 to see greater activity with an increase in volume of quality stock coming to the market both direct and via stakes in major shopping centres.

As ever stock selection is critical particularly in the secondary sector. Care needs to be taken when bidding off "superficially" attractive initial yields. In many towns the re-basing of rents is beginning to occur but it will not be until 2015 onwards that we truly begin to see the clear rebased rental tone through the raft of forthcoming lease expiries / break options.

That said, there remains a large number of equity buyers at present albeit with a focus on Greater London, the South East and major City Centres. Despite press coverage the right

assets, in the right locations depicting strong fundamentals are being very competitively fought over and in many cases at near pre-recession yield levels.

Where assets become available – particularly in the secondary sector we are still witnessing over-inflated pricing expectations from vendors, whether banks or investors, based upon historic valuations. The lag between 'valuations' and reality is still a large issue particularly on "annually valued" funds.

Super Prime and Prime have remained resilient whilst Secondary and Tertiary continue to come under pressure. The disparity is now up to c.900 basis points.

There remains about 50 active shopping centre requirements in the UK at present (reduced from approximately 80 about 12 months ago). This is partly due to the tightening of the debt markets and the inability of the property companies to achieve leveraged returns. The active shopping centre requirements can broadly be divided into five categories:-

- UK REITS
- UK Institutions
- UK Property Companies
- UK Funds
- Sovereign Wealth Funds / Overseas Investors

The banks will continue to release stock albeit in a much lower rate than anticipated.

Loan to values have fallen over the past 8 months to c. 50%-60% and interest rate margins have increased by 100 bps to 325 bps for prime assets.

This tightening in the market has opened up opportunities for mezzanine providers, insurance companies and pension funds.

Interestingly, we are now seeing instances of NAMA/consensual led asset sales that are openly marketed beginning to fail to sell because they did not reach the pricing expectation. These assets will continue to fall in value in the short to medium term.

Shopping centres are living business plans, they need specialist proactive asset managers, equity to inject vitality, to refurbish, extend leases, take out break options and bring new tenants in to create a point of difference.

There still remains a huge level of denial on 'true asset values'.

TABLE 1

Shopping centre yields

	Q4 2011	Q1 2012
Super-Prime	5.00%	5.00%
Prime	5.50%	5.50%
Town Centre Dominant	6.25%	6.50%
Secondary	9.00%	9.00%
Tertiary	12.00%+	13.00%+

Source: Savills

High street investment

To say that the high street investment market is firing on all cylinders at the moment would be considered misleading. This year has started very much in the same way that 2011 ended, ie a continued slowdown of investment transactions. The urgency or desire to invest by the majority is on the whole absent. In the main institutions are in a cash neutral position with no urgency to sell or acquire assets. Cash reserves have been built up since 2009 and the institutions can afford to monitor the property market from the sidelines.

As for the privates, the cash rich investors are struggling to find suitable opportunities while those reliant on debt are finding the process of raising finance even more challenging, especially with the ever decreasing list of lenders. On top of this there remains a needless nervousness about the survivability of the UK 'High Street'. Where and when rents will stabilise remains an unanswered question and accordingly the urgency to do deals is for many, not on the agenda. Indeed for those who are considering selling, pricing certain assets can be difficult, particularly when question marks remain over establishing the true rent and also the potential longevity of a retailer.

With continued negative press commentary surrounding the failure of retailer failure; consumer confidence; and store rationalisation, it is easy to see how investors can be sucked into the subdued sentiment of the current state of UK high street investment market.

That said, prime yields continue to defy market sentiment and remain at 4.75%, but this is only for a handful of towns, i.e. Guildford, Oxford, Cambridge, Chichester and Kingston. In fact so far this year there has only been one prime investment transaction, on Guildford High Street, where the property was let to Jack Wills for 8 years at arguably a rack rent. The appetite for prime well secured assets remains but the lack of opportunities has been a frustration which is the key reason why yields have remained so robust. Moving away from these prime locations the yield starts to soften considerably. The difference between prime and secondary started to drift during the summer of 2011 and it is fair to say that the current gap hasn't been this wide since the 1973 oil crisis!

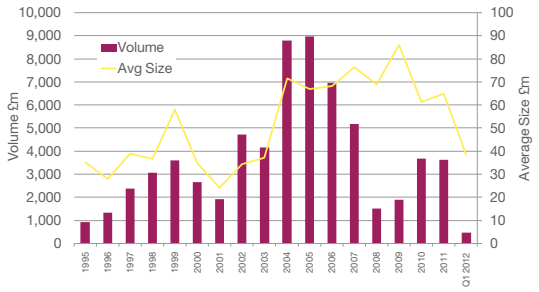
Although one might interpret the above as a sign to stay away from the high street we believe that this is potentially the optimum time to consider investing in this market. To those would be investors the message is simple. It is time to buy.

We are currently witnessing a significant discount in pricing and we see this as a once in a cycle opportunity to acquire some worthwhile opportunities which are attractively priced. Of course there are locations which must be avoided. But for those towns where high street is not threatened by either a dominant out of town retail park or a major shopping centre, there are some shrewd opportunities to consider and there are signs that some investors are beginning to mull these over.

We predict that while prime yields are likely to remain at the current level for the near future, secondary may start to look more appealing to active buyers due to the attractive return it offers, and more importantly the realisation that risk has been priced in. It is possible that by the end of the year the gap between prime and secondary could narrow as more investors start to focus their attention on these assets. With our unrivalled retail intelligence and expertise Savills are best placed to advice on these opportunities.

GRAPH 1

Shopping centre investment volume



Source: Savills

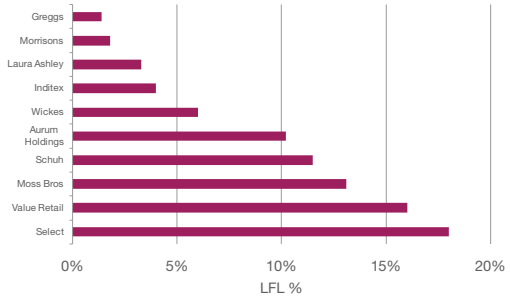
GRAPH 2

Average shopping centre yields

Source: Savills

GRAPH 3

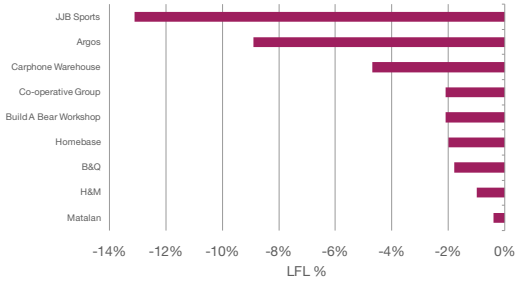
Recent retailer trading figures



Source: Retailer trading statements, Savills

GRAPH 4

Recent retailer trading figures



Source: Retailer trading statements, Savills

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