Shopping centre and high street bulletin

Q4 2010

"The disparity between prime and secondary will widen in 2011"

- Consumer confidence remains weak and we believe that with consumers facing falling real earnings in 2011 a recovery is unlikely until 2012.
- Retailer trading statements for Christmas 2010 were dominated by the word "snow". Retailers face considerable headwinds in 2011, but we expect to see continued expansion by retailers into prime city centre and regional locations.
- After a rush of shopping centre transactions in Q4 2010 the total turnover for the year was £3.67bn, nearly double 2009's total.
- In the high street retail investment market the major institutions have become more discerning. We expect that 2011 will see a renewed focus on towns that offer the best future rental growth prospects.

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Retailers

The consumer economy

While the snow might be the convenient political excuse for the poor economic performance in Q4, we believe that consumer caution remains the biggest factor dogging the retail market in the UK. GfK's January consumer confidence indicator fell to a 22 month low of -29, indicating that consumers remain firmly of the view that we are in recession.

We believe that this caution will continue throughout 2011 as public spending cuts beguin to bite, and real wages fall. This is a big new trend for the UK consumer to adapt to, seeing as the last time that real personal disposable incomes fell was in 1981 so until inflation falls and earnings growth rises we expect that consumer behaviour will remain recessionary.

The economy will continue to recover this year, and we believe that the likelehood of a double-dip is minimal. However, it will not be until 2012 that the output and employment losses of the recession are recovered and the real recovery actually begins. As ever there are downside risks to such a scenario, and we believe that a too early and too fast rise in interest rates would delay this real recovery for at least another 12 months.

The retail occupational market

As ever, the focus on Q4 was on the Christmas trading period. Retailers are still reeling from a difficult Christmas period caused by adverse weather conditions. The high street suffered as snow bound consumers were unable to make it to the shops and turned to the internet for Christmas shopping. As a result, retailers suffered the worst Q4 in decades with overall like for like sales down 1% for the Christmas period.

The main winners over the Christmas period were the major food retailers; in particular Sainsburys who reported a record Christmas as well as an increase in market share. John Lewis was also a winner recording their biggest week of sales ever.

Strugglers over the festive period included HMV who issued a profit warning and announced it was shutting 60 stores. In addition, Next revealed it lost £22m in full price sales because of snow with Mothercare and Clinton Cards also among those issuing profit warnings.

The start of 2008 and 2009 was tough, with a profusion of retail administrations and pre packs. In 2010 the number of retailers that collapsed totalled 165 vs. 290 in 2009. This is welcome news for the high street and secondary / tertiary shopping centres where voids are already prevalent and should momentarily relieve mounting pressure on vacancies.

The squeezed development pipeline continues to be an issue with quality retailers such as New Look and H&M struggling to find right sized space, as a result landlords are having to consider refurbishment of existing assets to accommodate such demand. Debenhams and House of Fraser's decision to pursue out of town representation is a direct reaction to limited in town development.

Looking forward, 2011 will ultimately be the year in which fiscal austerity measures will be realised. This, combined with the VAT increase and likely increase in interest rate to combat spiralling inflation will have a significant impact on disposable income. As a result, most retailers are approaching 2011 with trepidation.

In 2011 analysts believe that retailers positioned at the quality end of the market with protected niches will see the most success. Indeed, certain surveys suggest that higher taxes and sharp public spending cuts are unlikely to faze British shoppers.

For clothing retailers, the biggest challenge will be rising input prices as increases in cotton and raw material prices work their way through. Cotton price increases have been driven by a poor Chinese cotton crop. As a result clothing prices have been rising significantly over the last few months, increasing by 11.3% year on year. There is a limit to the extent to which retailers can pass on rising costs to shoppers in the form of higher prices, as a result retailers will see an impact on their margins that will be far more substantial that the effect of the rise in VAT. Given the cost pressures, sustaining profitability will be key to retailers. As a result, retailers will be keen to shave their property portfolios further in 2011. There is likely to be a move away from secondary centres, with retailers concentrating on prime city centre and regional locations. As a result, there will be a simultaneous increase in rent in these locations, and an amplification of the gap between prime and secondary.

Shopping centre investment

The number of shopping centre transactions in Q4 2010 totalled 25; a significant increase on the 8 deals traded in Q3 2010.

The 25 transactions accounted for £2.114bn in capital value terms and represented an average initial yield of 7.38% (up from 6.99% in Q3 2010).

Looking at the statistics on an annualised basis the shopping centre transactions in 2010 totalled 68 up from 21 in 2009 and accounting for £3.671bn nearly double that traded in 2009 at £1.823bn.

Notable transactions included:

- Dolphin Shopping Centre Poole: Acquired by Wereldhave for £80m representing a net initial yield of 6%.
- Overgate Shopping Centre Dundee: Acquired by Land Securities for £140m representing a net initial yield of 6.7%.

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- Westfield Shopping Centre Stratford: Acquired by APB/CPPIB for £871.5m representing a net initial yield of 5.75%.

As predicted in Q2/Q3 2010, Q4 saw a flurry of larger transactions pushing the total traded to a 3 year high. There seems to be little slow up in appetite for the sector with competitive bidding across the board. This was no more representative than the Sapphire Portfolio incorporating Charterwalk, Burnley, Queens Arcade Cardiff and Harvey centre Harlow where over 10 proposals were received and bidding went significantly above the quoting level of £130m to £145m.

We expect 2011 to continue where 2010 left off. There are currently £2.7bn of shopping centres under offer (to include Trafford Centre, St Martins shopping centre assets and Liffey Valley) and £726m in the market.

Assuming these transactions are concluded we expect this to be a £5bn+ year in transactions.

We predict that the banks will make more positive steps in 2011 to unwind troubled positions particularly as fixed rate swaps come to an end. With the lending market still showing few signs of easing debt leveraged purchasers are finding it extremely difficult to be competitive.

Cash remains king and with over 70 active shopping centre investors seeking stock we expect this trend to continue.

Just 10 deals of the 69 traded were debt only in 2010 with the balance being cash or a cash acquisition with debt raised following completion.

The disparity between “prime” and “secondary” in 2011 will widen. There will be a flight to ‘prime’ highlighted by the 50% stake of Southgate Bath on the market at 5% initial yield. As a consequence the yield gap between prime and secondary assets which had disappeared by 2006/2007 will move back to c.300-350 basis points.

	Q2 2010	Q3 2010	Q4 2010
Prime	6.00%	6.00%-	5.75%-
Town centre dominant	6.50%+	6.50%-	6.50%
Secondary towns	9.00%+	9.00%+	9.00%+

High Street investment

The final quarter of 2010 saw the major institutions become even more discerning over what they bought and with retail performance hampered over the important Christmas period, stock selection and quality of income will remain vital during 2011.

The appetite of private investors remained steady with the last round of auctions all showing good results albeit the focus continues to be on safe, well secured product. Private investors continue to seek out worthwhile returns and unit shopping not only provides a good yield but it also presents a cash investor with a manageable lot size with no obsolescence.

The main gaze of the property companies remains permanently fixed on shopping centres and perhaps will continue to do so until there is an expectation that High Street portfolio acquisitions will show trading opportunities. Availability of debt for both large and small property companies remains scarce and ‘survival’ re-financings still dominate activity in the property company market.

Institutional interest for the first two quarters was driven by just a handful of major funds. The need to invest in the High Street stuttered slightly in the last quarter leaving the market with a number of technically institutional calibre properties unsold. The fear, as 2011 starts to gain traction, is that institutional focus will become even narrower, arguably putting more pressure on prime yields. With the occupational market still redefining the rental tone in many town centres, institutions will, quite understandably, continue to adopt a cautious approach. It will also be interesting to see what happens with capital inflows into the retail funds which towards the end of the year were falling away quite materially.

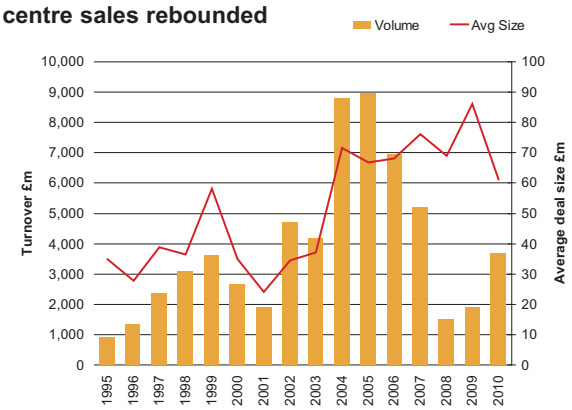
There will however be a ‘turn around’ point. Some major cities have already seen letting transactions on very unpalatable terms. The worst we have seen is the equivalent of a three year rental package for just a six year term certain. If town centres can retain a more stable void level as we head into the New Year then the first signs of rental growth could return quite quickly. Those towns where realistic shopping centre proposals have currently been shelved potentially provide the best prospects for a swift turn around. The skill of the investment agent is to identify those towns that perhaps did not fly too high on the upturn, where void rates are low and where occupational pressure could come to bear as take up accelerates.

Finally the last quarter saw the banks finally start to take positive action on their distressed loan books. They now seem to have organised their teams, have the right level of property expertise and most importantly are making clear exit decisions. This should provide the market with much needed stock although the quality of assets that are brought to the market could be mixed.

Savills High Street Investment team anticipate a lower volume of product for the early part of 2011 and the aim will be to identify for both big and small investors assets that will hopefully perform in the longer term but ideally also in the short term.

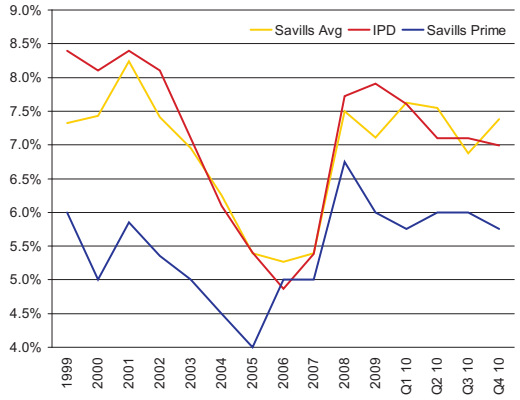
Data

Due to a strong Q4, 2010's volume of shopping centre sales rebounded



Source: Savills

Yields remained broadly stable in Q4 2010



Source: Savills, IPD

Recent significant investment deals

Shopping centre	Size (sq ft)	Purchaser	Vendor	Price	IY
Overgate, Dundee	800,000	Land Securities	Lendlease	£140.96m	6.70%
Drakes Circus, Plymouth	425,000	British Land	Kandahar	£240m	6.00%
Castlegate, Stockon-on-Tees	341,394	Angelo Gordon/Lathe	Capita	£27.85m	10.12%
The Galleries, Bristol	309,450	HSBC RET	The Mall/Aviva	£50.20m	7.40%

High street	Tenant	Purchaser	Term unexpired	Price	IY
38/46 Church St, Liverpool	Dorothy Perkins	NFU Mutual	6 years	£16.65m	5.39%
14 North St, Chichester	Paperchase	F & C REIT	9.75 years	£1.89m	5.00%
81/89 Kings Rd, London	Marks & Spencer	Private Middle East	12 years	£66m	4.98%
301/307 Oxford St, London	River Island	European Investor	10 years	£95m	4.00%

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