

UK Shopping Centre and High Street Bulletin

Quarter 4 2013



SUMMARY

■ For the consumer we expect that 2014 will be a year of improving optimism and declining savings ratios. This will feed through into higher spending in the nation's high streets and shopping centres.

■ 2014 will see a highly fragmented retail landscape in terms of retailer demand. Prime and secondary towns and pitches look supportable, but tertiary towns and pitches will remain hard to let.

■ We expect that hardening yields in the shopping centre investment market in 2014 will make the market increasingly institutionally dominated.

■ Prime high street yields have already moved downwards due to strong institutional demand. We expect to see more investor demand in 2014 for core plus type assets.

.....
"It is our view that a proper national rental rebasing will not have washed through the high street retail market until 2015/16."
.....

→ The consumer economy

Consumer confidence took a slight downward turn in the run-up to Christmas. This was probably due to a mix of bearish headlines about how tough Christmas was going to be for retailers, the bad weather, and a degree of realism about real earnings growth.

British consumers should be feeling more positive with unemployment down to 7.1%, inflation expectations down to 2.4%, and base rates likely to remain low for the foreseeable future. However, real earnings growth remains stubbornly negative, with the latest data from the ONS showing that average weekly earnings are rising at 0.9% per annum, well behind the latest CPI figure of 2.0%.

The coalition's argument that real earnings growth is rising for "most" people is a touch optimistic, and we believe that it won't be until 2015 that most people are actually feeling that their real wage has risen year-on-year (let alone corrected the losses of the last six years.)

However, 2014 will be a year of improving optimism and declining savings ratios. There will be more money spent on the nation's high streets, shopping centres (and computers), but confidence will remain fragile, and the recovery will be more of a choppy ripple outwards from London than a ubiquitous national bounceback.

The retail occupational market

Q4 2013 saw a further pickup in retailer confidence and requirements, albeit tempered by a lack of suitable stock.

This positivity continued into the crucial Christmas trading period (as we predicted in our last bulletin), with an average reported increase in like-for-like sales of 4.8%. While LFL sales data is a fairly blunt metric, it does indicate some degree of year on year improvement in sales. Furthermore, more retailers this year mentioned margins in the context of "maintaining" or "improving" them, which is probably a rather more significant change on 2012/13.

Our key takeaways from this Christmas and New Year are that there were fewer negative trading statements than last year; dramatically fewer administrations on the quarter day; and some hints that the housing market recovery may be starting to feed through into parts of the retail market. On the other side of the coin, the continued strong LFL growth of Dominos Pizza is an indication that consumers might still be in a relatively cautious frame of mind when it comes to leisure spend.

We expect 2014 to see a continuation of the trends that were seen in retailing in 2013, with a highly fragmented market between prime locations (central London & Tier one town and cities), secondary markets (where rents are correcting downwards to a sensible floor), and tertiary markets where structural change is still redrawing the local retail offer.

The key story in the central London retail market will be the challenge of creating voids. Not only will vacancy rates remain virtually zero, but it will be hard to get retailers out of their stores. We expect to see a pick-up in reverse premiums as new entrants try and create opportunities for themselves.

Where voids do occur in the prime markets, they will be welcomed by landlords as an opportunity to raise rents. For example, it is rumoured that the new tenant for the Gilly Hicks unit on Regent Street is paying £200,000 more than the outgoing tenant.

Prime central London's strength will benefit fringe locations, with strong retailer demand and growth expected in fringe markets such as Brompton Cross, Kings Road, and Piccadilly. It will also benefit prime regional and sub-regional centres, as new entrants to UK retailing grow in confidence and expand beyond their central London base. We expect to see further national acquisitions in 2014 by the US retailers in particular. Names to watch in this space will be American Eagle, J Crew, Anthropologie, Pottery Barn, West Elm and Victoria's Secret.

Elsewhere, the prospects will be mixed with retailer demand returning to locations where the demographics are right and the rents have rebased to a more affordable level.

Shopping centre investment

The Shopping centre investment market witnessed a surge in activity in 2013. A total of 84 centres were transacted representing a capital value of £4.58bn. This was a marked increase on the £2.7bn traded in 2012. Interestingly average initial yields in Q4 2013 were 7.6% down from 8.94% in Q4 2012, reflecting the weight of capital attracted to the sector.

Notable deals in Q4 2014 included:

- Elephant & Castle Shopping Centre in London. Acquired by Delancey/ APG for £80m. This reflected a NIY of 4.25%.
- King Edward Court, Windsor acquired by Scottish Widows for £102m. This reflected a NIY of 5.6%.
- Royal Exchange, London was sold to Oxford Properties for £83.5m. This reflects a NIY of 4%.
- Queensgate Shopping Centre, Peterborough acquired by Invesco for £202m. This reflected a NIY of 6%.
- Centre MK, Milton Keynes. A 50% stake was acquired by Henderson/ Australia-Super Fund for £260m. This reflected a NIY of 5.4%.

The shopping centre market has witnessed new entrants into each of the subsectors on a monthly basis. This is especially true at the prime/ super prime end, where we predict further yield hardening due to the tight supply and weight of capital as markets polarise to prime / dominant assets. Such is the scarcity of stock at the prime end, we are now seeing the REITS and Sovereign Wealth Funds looking to acquire 50% passive stakes in joint venture which 12 months ago would not have been considered.

There are currently 18 shopping centres under offer accounting for £1.35bn, 13 in the market accounting for £1.7bn and approx 22 shopping centres being prepared for sale.

As Savills predicted 18 months ago the last 12 months has seen significant interest in strong town centre dominant centres with yields coming in c. 50-70 bps over the year. This area of the sector has been dominated by the opportunity funds and we expect this trend to continue through 2014.

The secondary and tertiary markets

→ remain difficult with pricing remaining at a significant discount to prime and for good reason. We would anticipate some inward yield shift through the year but only in the stronger secondary assets. Lease expiries, retailer portfolio rationalisations and the polarisation of markets will continue to create challenges in this subsector.

The debt markets remain extremely active with competitive terms from a broad range of lenders, albeit this is predominantly focussed on the super prime, prime and Town centre dominant ends of the spectrum. Loan to values are typically in the order of 65%-70%, with margins of 200-225bps for these assets.

The majority of the lenders are becoming more and more focussed on a tighter group of “core borrowers”. There is a much reduced pool of lenders for the secondary / tertiary assets and importantly with more stringent terms. Loan to values would typically be in the order of 50% with margins in the order of 350-400 bps.

One note of caution on the horizon is the creeping rise in swap rates which are beginning to factor in future interest rate rises. The impact on the markets, yields and types of buyers is yet to be seen.

Our prediction is that as swap rates creep up, margins will come under pressure, yields will likely harden and the opportunity funds/private companies will be priced out of many situations leaving an institutionally dominated market in 2015.

TABLE 1
Shopping centre yields

	Q3 2013	Q4 2013
Super-Prime	5.00%	5.00%
Prime	5.25%	5.25%
Town Centre Dominant	7.25%	7.25% ↓
Secondary	9.00%	9.00%
Tertiary	15.00%	13.00%

Source: Savills

High street investment

The uptick in market sentiment that we reported in the third quarter of 2013 turned into more of a frenzy of activity as we headed towards Christmas.

The funds came under pressure from new capital inflows placing downward pressure on yields in all sectors of real estate including high street retail. Institutional activity continued to focus on only the best stock. With polarisation by occupiers toward only the top UK towns, and prime locations in those towns, institutional activity followed resulting in yield compression. The evidence now clearly shows that prime yields have sharpened from 4.75% to 4.5%.

It goes without saying that to venture to the new benchmark yield level requires either established or anticipated letting activity delivering rental evidence showing growth, something that is now starting to happen across many towns in the UK as historic rents default to their new datum point. Nationally speaking rents continue to decline and as a broad rule the further from London and the UK's major cities you go the higher the rate of that decline. It is our view that a proper national rebasing will not have ‘washed through’ until 2015/16 and in many towns especially in the north of the country, where decline has been significant, it will not be until after the 2017 rating revaluation before rents are able to grow into the space left by the anticipated rates reduction.

At the riskier end of the spectrum with the exception of only one or two property companies few have looked at the riskier “workable” end of the market and we do not see that situation changing dramatically in the short term.

The private investor remains cautious and whilst it is clearly encouraging to see an improvement in sentiment it is a

becomes over excited that their asset is worth much more today than it was last year. 2014 should be the year when the spotlight falls again upon the riskier end of the market, however we do not anticipate that the private investors will venture far beyond vanilla shops let to substantial covenants with more than eight years unexpired. Even though we are now over five years into the new financial world many property companies are still feeling real pain as they either extend their debt arrangements or fall into the hands of the banks and now the opportunity funds who have released the debt liability so effectively from the banks. In short under the surface most property companies are still trying to survive and work out how to keep the banks at bay so that they can live to recover from the recent onslaught. Until genuine new debt providers arrive offering money at margins and rates that show value we do not foresee the end of distressed sales just yet.

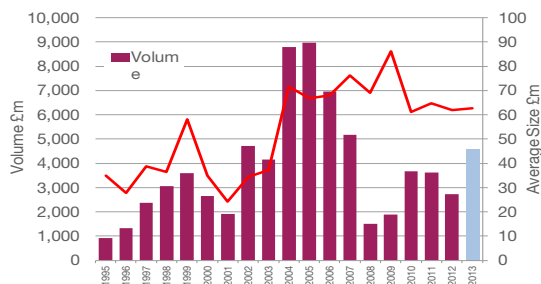
Savills high street team sold and bought just shy of 50 assets in 2013, in almost as many towns. This gives us an unrivalled national market intelligence and more importantly a detailed database of buyers. From secondary locations in smaller towns through to some of the most ground breaking prime institutional transactions, Savills were involved.

TABLE 2
Recent (Q4 2013) high street benchmark deals

Address	Retailer	Lease expiry	NIY	Price (£)
Lincoln - 200/201 High Street	River Island	2028	4.50%	£5.78m
Chichester - 89/91 East Street	Topshop Topman	2025	4.40%	£7.3m
Richmond - 70/72 George Street & 21 The Green	River Island	2023	4.55%*	£12.5m
Oxford - 7/8 Queen Street	White Company	2023	4.50%	£5.5m

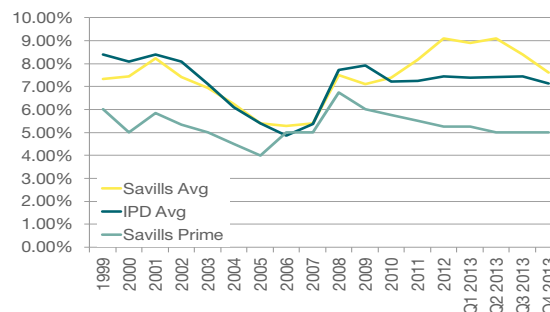
Source: Savills * Blended yield including office and retail elements. Retail yield if isolated is closer to 4%

GRAPH 1
Shopping centre investment volume



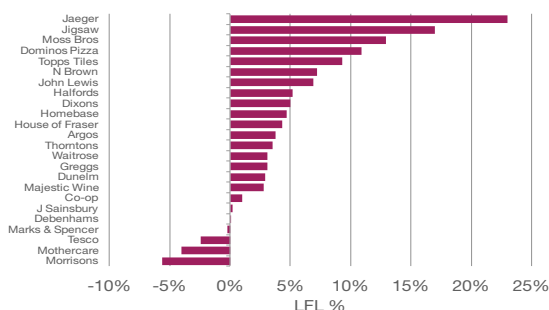
Source: Savills

GRAPH 2
Shopping centre yields



Source: Savills

GRAPH 3
Christmas 2013 LFL sales figures



Source: Retailer statements

Savills Retail team

Please contact us for further information



Nick Hart
Shopping centre investment
020 7409 8837
nhart@savills.com



Mark Garmon-Jones
Shopping centre investment
020 7409 8950
mgarmon-jones@savills.com



Jeremy Lovell
High street investment
020 7409 8745
jlovell@savills.com



Ben Tyack
High street investment
020 7409 8084
btyack@savills.com



Dan Peake
Agency
020 7409 9967
dpeake@savills.com



Dan Walker
Agency
0207 409 8168
dwalker@savills.com



Jonathan Stott
Professional
020 7409 8167
jstott@savills.com



Mat Oakley
Research
020 7409 8781
moakley@savills.com

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 500 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.