C&P

Spring
Retail Report
2010

Out-of-Town Market Snapshot
Retailers striking a hard bargain

Strength and Resilience
Supermarkets & Superstores bucking the trend

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Q&A on the state of the high street

CHASE & PARTNERS
Retail & Leisure Property Specialists
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Introduction by Graham Chase

Predictable Future?...

Some pundits are suggesting that this is the hardest market in which to make predictions – I disagree, the previous three years have been far more difficult and challenging. Anyone who has run a property-related business will know that the uncertainties that arose in the financial sector in the Spring of 2007 resulted in a string of corporate events which were inevitable but hidden in the fog of self-belief, perhaps encouraged by advice from the Chancellor of the Exchequer that economic cycles were consigned to the rubbish dump!

The excesses of the banks and poor investment and lending policies; borrowing short on wholesale money markets to lend long in retail mortgage markets and failings of the credit rating agencies, have again put the property sector and its security as an asset base under pressure. The concept that property was a secure, safe haven has been rocked to its foundations with capital value write downs of 44% - offsetting the 43% increase achieved between the end of 2003 and the mid 2007 peak, and the potential for rental growth seen by many as years away.

The retail occupier sector has mirrored the harshness of the recession as the high street has average vacancy rates nearing 15% outside central London and parts of the South East. It has been a lonely and cold winter, not helped by inclement and freezing weather conditions.

Empty rates, brought in as a policy to ensure developers were not encouraged to assemble property simply for profit, is clearly out of time. It is a significant drain on both landlords and occupiers and has sent many companies into oblivion and reduced employment opportunities, particularly within retail companies, all sacrificed in the name of an outdated and flawed Government strategy.

Where were the Credit Rating Authorities and the FSA when they were needed most? Why have they not received the same criticisms as the banking fraternity of their failures? How could Lehman Brothers be posted with a positive rating and two day's later find itself one of the largest corporate failures the world has seen? Why were Banks able to lend to house buyers, on self-assessment applications, six or seven times salary, and sometimes even with a bonus loan to spend on a holiday and/or a car purchase, so as to assist with the pressures of the house buying process?

Few of these questions will ever be adequately answered. My only hope is that the lessons from this recent and disastrous past will ensure that we emerge stronger and fitter in the future with prudent lending, coupled with achievable, objective and rational decision making, based on good quality advice and expertise. The one thing the Government of any colour and the public must acknowledge is the importance of the City of London and financial services sector to the health and strength of the UK economy. The poor business and lending practices of the banks and unhealthy short-term bonus arrangements cannot be allowed to return but the UK and the public need the City at its full strength.

As to the future, it is relatively predictable. Public sector employment, which over the past three years has provided two thirds of all new jobs created, will now go into reverse. Private sector employment will see growth and although it will be slow and cautious it is only likely to absorb losses in the public sector. Because of quantitative easing, inflation is an inherent danger - it will increase but will not replicate the out of control figures of the early 80's but is likely to remain below 5% for the foreseeable future, although this is only a six month window at the present time. Property service companies will survive to see growth but only after further failures and rationalisation during this year, as the cash and well of instructions run dry. Those retailers who remain will benefit from the reduced competition as a result of those retailers who have not survived. Secondary shopping centres and high streets will struggle to promote a positive trading position and will need to diversify. Refinancing of retail property purchased at the height of the market in 2006/7 is now a major headache. Vulture funds will convert to mezzanine finance based activities to take advantage of these refinancing opportunities. Prime yields will remain low but the gap with secondary property will remain wide. Development finance will remain limited for the next 24 months. Food superstore and smaller supermarket outlets will continue to perform well and may provide the only viable catalyst for regeneration of many failing retail locations. Retailers will adapt existing formats so as to occupy existing property on a more cost-effective basis. Some retailers, particularly department stores, will have to rework their business models for new property to meet the more limited opportunities that landlords can offer in terms of incentives. Failure of retailers to adapt will limit their growth potential and could even threaten their future existence in some cases. Rental levels will show growth from current levels for prime property within the next 12 months leading to investors considering reversionary value potential. Environmental issues will feature far more in both occupiers' and investors' decision making processes, return estimates and cost plans. Pension funds will continue investing in prime real estate reflecting increasing net deposits.

Central London retailing will remain buoyant while Sterling continues to be discounted against other currencies, although recent rental growth will flatten. European visitors to the capital will be replaced by those from the USA, China and India as the Euro begins to weaken and the Dollar strengthens. An increasing number of joint ventures will be put in place to manage and upgrade existing

commercial property stock, rather than the grandiose new development schemes of the past 10 years. Cash will remain king both this year and next year.

So, as will be seen, such predictions are not so difficult and they have certainly been easier than in previous years. What will hold back the general UK economy and the property industry is likely to be found in two areas. The first is a hung Parliament following the election on May 6th because of the uncertainty and lack of decision making that this will bring. Strong decisions, even if they are bad decisions, will be better than a Parliament in suspension. The second is that last year, from the perspective of the consumer, it was a phoney recession. The general public have watched and been bemused as they read about the credit crunch and sub-prime lending in the middle of 2007, the collapse of Lehman Brothers in September 2008 and the falling profitability of the Banks coupled with bonus payments to bankers during the latter part of 2009 and the beginning of this year, none of which were met with much understanding. The reality of these events will now find their way into the living rooms of most households, whether it be redundancy notices, graduates without jobs, school leavers without university places or who can no longer afford the costs of a further three years in education, reducing salaries, increasing income tax burdens, rising property rates and local taxes, National Insurance increases and potentially higher VAT charges (try 20%).

As the Government found out at the end of January, when for the first time since 1993 it had to borrow money to fund an unexpected shortfall in taxation revenues (obvious to many businessmen and women), the impact in the "high street" is now because of the inertia that all markets suffer. However, despite the inescapable truth that the future is brighter, it will take another year at least to realise this is a fact. Consequently this year will see the real recession impact on the consumer and the public at large, even though the economy has in reality turned the corner, as demonstrated in the encouraging recovery of the share price of Lloyds TSB and RBS, which now almost matches the value of the public purse in unplanned investment and rescue of the two banking giants.

Out-of-Town Retail Agency

Market Snapshot

Tenants have negotiated hard. In some locations they have been "bought" in by the landlord to secure occupation and rent on a property that would otherwise remain vacant. Landlords have carefully assessed demand and negotiated with a single potential occupier accordingly. Competition for units has been much reduced and in some sectors of the market there is effectively only one acquisitive retailer.

Redevelopment of retail parks has remained a desktop analysis. Acquisitive investors/developers have looked at several opportunities where redundant buildings can be brought back to life. However, the strength of tenant demand means that feasibility is difficult, so the existing owner will be forced to make the numbers work to their best advantage.

Void business rates have affected the market. Landlords have deliberately kept units vacant while administrators are technically "in possession". Where tenants may be interested in a temporary occupation of former MFI, Land of Leather or Allied Carpets units, the threat of void rates to the landlord stops negotiations progressing. Equally, where Galiform guaranteed MFI leases, Galiform are paying rates on an unused property that they can't sublet and the landlord will not accept a surrender unless they can re-let, so the property remains vacant. Is this what the Government wanted? To summarise, landlords are deliberately keeping some properties unlet and reducing new business opportunities to retailers. In the meantime, no rates will be paid by the administrator.

Retailers continue to look at each property to make sure it is the right size and in the right location. Smaller sizes continue to be looked at and many former MFI units have been subdivided, or will be.

Some retailers have found it difficult to secure "quality" stores. Retailers are still being choosy and without new build units some are finding that there is effectively a reducing supply.

As some retail park leases come to an end, the issue of dilapidations is becoming more prevalent and the number of regearing and reversionary lease negotiations is increasing.

Green Shoots

The sale of Pets at Home was a stunning success and the new owners KKR are increasing their expansion plans. Hobbycraft will be sold soon. Investors' valuations did not match John Hargreaves' required price, despite improving profitability and expansion, so he has refinanced instead. New Look's IPO did not proceed as planned in February but Advent successfully bought DFS in April 2010.

As the sector is dominated by institutional owners, tenants have found themselves offered highly incentivised deals but this may change as the market improves. As tenants seek more stores, they are likely to accept reduced capital payments and rent free periods from landlords. Where landlords have found it difficult to raise capital, or want to conserve it, rent free periods are more likely to be agreed.

While there have been a few new entrants, for example, John Lewis at Home, DW Sports and Best Buy, they will run into competition from the established retailers as they all expand. Koodza (part of Decathlon) have opened their first store and Boots' drive-through concept is expanding.

The electrical sector remains one to watch as DSGi's revised trading format and Megastores contrast with Comet's smaller 10,000/15,000 sq ft footprint and high street stores, and there is also the threat of the Best Buy/Carphone Warehouse combination. DSGi's combined store strategy with PC World sharing a unit with Currys will create further demand and asset management opportunities. Best Buy are keeping their retail offer and business model to themselves but their delay in the first store opening at Thurrock at the end of April this year, in competition with the new Currys Megastore and existing Comet, means a true comparison cannot yet be made.

The market expects to see smaller format DIY stores over the next few years, for example Focus' new 15,000 sq ft store that will open in June 2010 in Congleton.

Forecast

ERV's and book values will have a major effect on asset management strategies. Headline rentals remain important but tenants will continue to want capital contributions and long rent free periods. Where there is strong demand, values may get back to where they were in 2008 but this will be rare. Home furnishings has regained some lustre but the category killers, who have survived the recession best, will emerge stronger to drive the market.

Retailers Activity

The recession has brought some retailers to their knees e.g. Land of Leather, Allied Carpets (part of the business survives) and Au Naturale. Others have survived only by Company Voluntary Arrangements, e.g. JJB Sports and Focus DIY, while at the same time others have grown and are looking to the future.

Value retailers have chosen their moment to expand and take advantage of the property market, e.g. B&M and Home Bargains. Poundstretcher are back in the market and there has been a welcome return from Matalan, who opened three stores in 2009, after publicly stating that rents were unsustainable in recent years. Six more are planned in 2010.

John Lewis at Home opened their first store in Poole during October to great acclaim and have secured two more. They will not compete with their own department stores but clearly the business sees opportunities in these "in-fill" areas and such acquisitions will be more important as new town centre stores are delayed e.g. Croydon, Purley Way.

Successful businesses that secured new financial resources in 2008 have expanded, e.g. Dreams and Dunelm. A new distribution warehouse has allowed Dreams to open more stores in the North. Dunelm have been prepared to negotiate hard and not do deals if the terms have not been attractive enough. That has not stopped them from opening eight stores in 2009 but there is now clear evidence that competing retailers for similar sized stores will reduce opportunities in some towns, particularly as ASDA Living are on the acquistion trail.

If The Range and Hobbycraft were reported as "two of the UK's best kept secrets" then the writer was not in the retail warehouse market. They have been active players and a new format or corporate activity will maintain that position. Pets at Home have been another success and thirty stores a year means that they are usually top of the requirements list.

Gradually, the better located "old" units are being filled and the market is now looking for new development opportunities and, where it is economic, asset management to create the right space. This demand may come from the electrical sector where the Best Buy fascia will feature on at least five retail parks by the end of the year. It will include their rivals Currys/PC World as they seek to expand and improve their portfolio, building on the rebranding success of 2009 - 60 locations for combined stores have been identified.

What the market has not seen yet is take up by the DIY retailers. Four fascias of varying range, corporate make up and a mature marketplace, may mean opportunities are limited, but they remain a major part of the existing stock and must be prepared as the UK comes out of recession. Kingfisher results reported a doubling of profits to 31 January and they are investing in the new "Trade Point" while Travis Perkins are trialling the Wickes Kitchens & Bathrooms in two smaller stores.

The "high street" retailers show no sign of reduced expansion into 2010. TK Maxx want more stores for the fashion and Home Sense fascia. The Borders units are gradually being taken up whether it is by a HMV/Waterstones combination or the relatively new entrant H&M. Next and Next Home are expanding and fashion parks provide the right retail environment for New Look, Arcadia, River Island, JD Sports/Bank and Peacocks.

2009 & 2010 Unfold

QUARTER 1 - 09	QUARTER 2 - 09	QUARTER 3 - 09	QUARTER 4 - 09
• Land of Leather fails. • Baugur files for bankruptcy protection. • Stylo Barratt CVA falls on stony ground. • Best Buy delay openings to Spring 2010. • B&Q turns 40. • Expansion of value retailers.	• JJB CVA sails through. • Dave Whelan back in the market with DW Sports & Leisure. • DIY rallies, including sales of kitchens. • Decathlon considers small stores for Koodza • Birthdays failure and purchase by parent, Clintons	• Focus survives via CVA. • Allied floored but newco starts again. • DFS looking good at 40. • Furniture/furnishings recovery. • Pets at Home active expansion and opens 30,000 sq ft store. • Carpetright is not taken private and is trading well	• John Lewis open first "at Home" store. • Boots expand drive through pharmacy. • Blacks CVA. • Hilco buys Habitat. • Borders administration. • Hobbycraft prepares for sale in Q2. • Dunelm maintains expansion plans.
"Christmas trading worst in 14 years." "Retailers best kept secrets include The Range and Hobbycraft."	"Mixed fortunes but recovery starts". "Landlord and tenant relationship changed"	"Recession ending ?". "Good retailers will emerge stronger".	"Early Christmas sales as VAT goes up on 1/1/10." "Supermarkets still trading well"

QUARTER 1 - 10	QUARTER 2 - 10	QUARTER 3 - 10	QUARTER 4 - 10
• Positive but cautious outlook to the retail market. • Pets at Home bought by KKR. • Matalan is not sold and New Look's IPO is pulled. • January sales poor due to the snow. • DSG have a good Christmas • Go Outdoors raise money for expansion • Au Naturale fail.			
"Officially out of recession." "Bumpy Road ahead"			

Occupational Marketplace

Short Term Flexibilty?

Current Issues in the Occupational Marketplace

Landlords, e.g. Prudential, are more receptive to monthly rents by agreement on existing leases (occasionally, for a period of time) and on new leases, CVAs, re-gearing, etc. It is no longer a big deal. Of more interest is the length of term and assessment of rent at rent review. Land Securities are pioneering their Clearlet contract.

Short term lets and break clauses after five years or less, together with rent reviews fixed, geared or capped on a percentage basis, other than Open Market Value, show a disconnect from the traditional retail property investment model. Letting agents and their clients are working closely with the fund managers and their valuers.

Several issues and questions have arisen from such negotiations:

Short Term Lettings

- The landlord accepts the current uncertainties but has to find a tenant in the short term and lets accordingly. In some cases this will mean a "rates and service charge" only deal.
- The landlord accepts the current uncertainties and decides to keep the unit vacant until demand improves. Alternatively, the landlord will agree to a mutual break so that they can re-let at the right time for them.
- Can a retailer plan their business on such short term occupation, or does re-gearing a lease prior to expiry, for a term of ten or fifteen years, show that for the best locations tenants want security of occupation?
- A retailer can "test" the location before making a decision to occupy on a longer term, e.g. Sports Direct and Steinhoff.
- Such flexible leasing negates the 1954 Act only if it is "contracted out". Not all tenants want this but can they have it both ways?
- A "pop-up" shop targets a particular time of year or event.
- During this period Open Market Value (OMV) is difficult to establish/agree on, or indeed write into formal valuations without caveats. Does one temporary letting affect the rental value throughout a retail centre in the same way as one letting set a new rental tone in 2007?
- Where a tenant wants an incentive to occupy but equally the right to break the lease after a short period of time, then the landlord will say no, or argue that part of the incentive is repaid if the contract is broken.
- Should any incentive be a capital payment or an extended rent free period?

Rent Review Agreements

- Fixed rent reviews to an agreed percentage, or in line with a nationally recognised index e.g.

RPI, means that tenants can plan their business for the future, without the threat of large rental increases "in the market" undermining their own business model.

- Landlords will value the income on their assessment of such indices and whether OMV will be in line with it. If they think it will "underperform" the market place for such an investment, they will sell and invest their money elsewhere. The purchaser may be happy to have a fixed or capped increase but will value accordingly.
- A "low" initial rent makes it hard for a landlord to accept a capped rental increase and negotiations revert to a short term lease.
- There is little evidence of upward and downward rent reviews but lots of evidence of retailers wanting to pay a sustainable rental level for their business. The market will avoid those retailers who take a large capital payment as an incentive to pay an "over the odds rent". Such a company is more likely to fail when that capital no longer supports the business.
- If there is a market norm in the retail market sector, the last few months have seen more deals agreed with upward only rent reviews at the end of five years to OMV but capped at 2.5% per annum. The landlord will then argue for OMV at the end of ten years i.e. without a cap or the lease ends.
- As tenant tension comes back into the market this is likely to be one of the first points renegotiated, either to an increased percentage or that the tenant has a break clause after the rent review.

Turnover Based Rents

To balance the arguments above, some negotiations are progressing on a turnover related basis but there are issues there too:

- Turnover only is disliked by landlords. They need a base rent to value but what is OMV? Is it the base rent because that is what the tenant will agree to pay (and no one else will pay it) or are book values, underpinned by valuers, being maintained at a notional OMV on the assumption that turnover is at a certain level? Are valuers the best assessors of turnover?
- It allows deals to be progressed in a difficult market. Both sides are uncertain but the rent will increase if the tenant trades well.
- It allows for rent to fall from year to year if trading decreases, so it answers some of the questions about upward and downward only rent reviews.
- Administratively, for both landlord and tenant, it is a hassle and there can be problems in transparency of individual store accounts.

Other Issues in the Marketplace

The property market has agreed to several Company Voluntary Arrangements (CVAs) since the first one, proposed by Stylo Barratt in Spring 2009, which was rejected for many reasons. Subsequently JJB Sports and Focus DIY entered into meaningful discussions with their landlords, confirming that anything other than a CVA would mean the company would go into administration (with all which that entails). They set out a credible business plan for the future and kept existing leases largely in place, while agreeing exactly what happened to those leases where the company no longer found it profitable to trade from the so called "dark stores".

The retailers' management and their advisors worked hard to agree a survival strategy and landlords made tough decisions. Tenant restructuring has become a "market place" of its own. Pre-packs have not gone away but the market disapproved of them and more CVAs are likely as tenants need to restructure to survive, although the "rules" continue to evolve. It is not an "easy option" for the tenant or the landlord and can only be done when the company is about to fail.

Issues arising out of CVAs are as follows:-

- Short term changes to existing contracts may be agreed, e.g. monthly rents for a year or two.
- The company is not destined to survive. Some landlords will not wave them through, or are avoiding tenants who have gone through a CVA until their trading results prove that they are making profits. Landlords will look carefully at the background and will not support every one.
- Other retailers feel aggrieved. They see other retailers in a competitive sector to theirs being "saved" and in particular ridding themselves of underperforming property.
- Every retailer has their bottom five stores which they would like to re-gear or surrender, but have to do that by negotiation rather than under the threat of a CVA. They argue, understandably, that the market shifts against them and that they are penalised for being a successful tenant.

If agents agree the best terms that they can for their respective clients, that will leave the valuers to establish Open Market Value (OMV). We refer to this above and some of the issues arising from the deals struck on terms very different to what was the norm until two years ago. Lack of tenant demand has meant that rents collected on some units are at a reduced level until such time as the park is fully let. Does such a deal lower the rental tone and OMV during that period?

Landlords (and tenants) are struggling to assess covenant strength. Report and Accounts from a year ago may not give a realistic and current view based on changes in occupational costs and turnover. Management accounts are being requested but a landlord cannot tell if a recent company sale will ensure the viability of a business e.g. Ethel Austin. Equally, watching signs such as credit insurance cover being withdrawn and company sales to corporate recovery companies e.g. Hilco, shows that others involved in that tenant's business have concerns. Head tenants have suffered loss when sub-tenants fail and retailers have lost out on new store openings where developers have failed.

New tenants will understandably not want to give any guarantees, but there will always be a balance between the risks of keeping a shop vacant against trying to help a tenant survive or thrive. Lack of demand will influence the risk taken.

Improving tenant demand will dictate when changes are made to the incentivised occupational terms that landlords have been offering. Terms offered in May 2009 have been withdrawn at the end of the year and an alternative tenant or better terms has forced some tenants to pay a higher rental on the date of exchange. Landlords have seen demand improve into 2010 but on the whole the market is still favourable to the tenant. What has changed for the better is the landlord and tenant "client" relationship. If retailing has been tough in the recession then so has being a Landlord.

> While the market will continue to swing like a pendulum, the recessionary conditions have highlighted some property fundamentals that could change. **This particularly refers to the Landlord and Tenant Act 1954 and we have said before that it is ripe for reform.**

Imminent lease expiries create opportunities. B&Q and Halfords are actively managing their estate by engaging with landlords well in advance. New and reversionary leases are being considered and it starts to focus the landlord's mind on the future of their holding in terms of occupancy, rent, lease terms, planning, competition and potential redevelopment. The retail park boom of the late 1980's with 25 year leases means that strategies for 2013 and 2014 are already drafted.

Out-of-Town Investment

Light... After The Darkness

John Shuttleworth on the remarkable turnaround in the retail warehouse investment market.

The events of the last 12-18 months are well documented and, rather than repeat the sequence of events that unfolded, it is a fair summary to say that we have been in a dark place. But where are we now?

During the course of the last six months, i.e. during Q4 2009 and Q1 2010, there has been considerable activity in the retail warehouse investment market. This has been driven by cash purchasers in the form of both private investors and the pension funds. A high level of demand, coupled with the limited availability of prime stock, has forced yields downwards and some seemingly very high prices have been achieved.

This high level of demand has been driven by a number of factors.

- Negligible returns on cash.
- Lower returns on gilts and equities.
- A weak pound and the exchange rate arbitrage.
- High inflows of money to the pension funds – at the rate of £3m per day in one case.

A number of investors have done extremely well as a result of this. They bravely bought up assets in Quarters 1, 2 and 3 2009 from those forced to sell and have now “flipped” these assets during Q4 2009 and Q1 2010, in some cases for staggering profits to those same forced sellers who are now back in the market and queuing up to buy again.

A striking example of this was Chancerygate's purchase of The Flare Portfolio from Invista in May 2009 for £37.5m, a net initial yield of around 9.2%, which they subsequently sold in December 2009 to a major UK fund at a price of £52.5m, reflecting a net initial yield of around 6.6% - a 40% profit on the turn within eight months.

There are other examples of this nature including the London & Stamford purchase of the Racecourse Retail Park in Aintree from Land Securities in June 2009 for £60.92m, a net initial yield of about 8.5% and which is now on the market for around £100m, which would reflect a net initial yield of about 5%. It will be interesting to see if the current market will support pricing at this level.

Out-of-Town Retail % Yields

	Dec 2008	April 2009	Sept 2009	Oct 2009	Feb 2010	Apr 2010
Shopping Parks	6.75 - 7.00	6.75 - 7.00	6.50 - 7.00	6.00	6.00	6.00
Open A1 Retail Parks	7.00 - 7.50	7.00 - 7.50	7.00 - 7.25	5.75	5.50 - 5.75	5.00 - 5.50
Bulky Goods Retail Parks	8.00 - 9.00	9.00	8.00 - 9.00	6.50 - 7.00	5.75 - 6.25	5.75 - 6.25
Solus Stores	8.50 +	8.75	8.50 - 9.00	7.00 +	6.00 - 7.00	6.00 - 7.00

In a general context, a year ago prime retail parks were changing hands at net initial yields of between 8-9% and now, one year on, a 5.3% net initial yield is the lowest yield paid in this cycle thus far, this being Blackrock's 'off market' acquisition of the Flowerdown Retail Park in Weston-super-Mare from Cranford Developments for £28.5m and the PRUPIM purchase of Stanley Green Retail Park in Manchester from Henderson Global Investors (Herald) for £47m. Yields have still not fallen to the previous levels seen at the height of the market in 2006/2007 but these prices still look expensive when considered in the context of the occupational market where demand is limited, vacancy rates are high and rental levels have fallen, with little to suggest that this position will change for some time to come.

Not unexpectedly the top prices are being paid for prime/dominant retail parks with an open A1 planning permission, a High Street tenant line up, or the prospect of achieving this and lot sizes of up to £30m. This reflects the ability to secure 'more attractive' retailers, stronger covenants, to have greater flexibility and increased prospects for rental growth. There remains demand for prime bulky goods retail parks where there is a bit more yield, but tenant line up is crucial with covenant strengths being very carefully scrutinised. Such has been the clamour for this asset class that investments with voids are changing hands but at prices that reflect risk and with three years plus guarantees on rents, rates and service charge. The current occupational market dictates that incentives at these levels will be required in any event and so although on the face of it this is generous, there remains considerable risk.

Demand remains strong for stand-alone retail warehouse units – often given the more manageable lot sizes of up to £10m – particularly where the property is occupied by one of the stronger covenants on a long lease of 15 years plus. A number of investments let to B&Q have now achieved close to 6% NIY and pricing is currently below this in some instances.

The one sector that has not truly been tested in the current market are the major shopping parks, once most sought after but now viewed rather differently for two principal reasons. Firstly the lot size is prohibitive to all but a few. Any purchase would require significant levels of debt and debt remains hard to come by. Secondly, the rents on schemes of this nature are high at say £45.00 per sq ft plus and it is difficult to foresee significant rental growth from these levels for the foreseeable future. Despite their general success, shopping parks are not immune to retail failures and loss of rent at these levels is significant, as is the likely incentive package required by the next occupier - assuming one can be found.

In recent weeks an air of caution seems to have returned. The active investors, perhaps having bought one or two investments, are now taking a step backwards, believing that the prices being paid are too keen and keeping one eye on what may lie just around the corner with many commentators predicting a double dip recession.

While this is not something we would promote as inevitable, the warning signs are there for all to see.

- The banks have been extremely disciplined thus far with regard to their property loan books, but the pressure must be increasing to dispose of property assets.
- Overseas demand will fall as interest rates rise and the pound strengthens.
- The forthcoming general election – what cost a hung parliament?
- Increased taxation - Income Tax, VAT, Capital Gains Tax.
- The repayment of an unprecedented level of public debt.
- Public sector cuts – likely to be 10% minimum across the board.

For the time being the investment market is strong. There is good demand and improving prices being paid despite the weak fundamentals in terms of high vacancy rates and rental growth prospects. It is difficult to see how this can continue given what is to come and the signs are there that the market is a little too hot at the moment, with one or two funds pulling back from chasing acquisitions. That's the prognosis in the short term but let's not forget property should be seen as a long term investment, an outlook that unfortunately appears to have been lost in recent years.

In-Town Issues...

Mark Paynter gives his thoughts on the state of the market and the prospects for future development schemes in town centres.

Q Times are still uncertain, so will there be further casualties on the High Street?

A In terms of the supply/demand equation, retail failure still lurks just under the surface with Borders failing just before Christmas and others such as BB's Coffee, Threshers, Envy, Adams, Blacks, Coffee Republic, Ethel Austin, Suits You and Bay Trading all having failed or been subject to CVAs.

The major accountants have reported the likelihood of continuing failure, although as this report goes to press there have been no nasty surprises at the March quarter day.

According to the Local Data Company the rate of retail vacancy remains high but the rate of growth is now slowing. The in-town centre health check in February suggested that we are still seeing one store opening for every 1.3 store closures. Vacancy rates also vary widely from a reported 6% in Corby to 23.9% in Wolverhampton. The Local Data Company also suggest that the areas of Kent, Midlands and the North East are on average seeing a higher level of vacancy, whilst London and its suburbs have held up well.

Q What has been the effect of CVA's in the High Street?

A The CVA process has continued to put pressure on rents although this is more likely to be the case where the unit's trading performance was in the bottom two quartiles. Inevitably this tends to be in the weaker centres, although it can also be larger centres where rents were driven to unsustainable pre-crash levels.

Although CVAs have been contentious, they have probably reduced the amount of vacant stock compared to the last recession and potentially the supply/demand balance could return sooner than last time around.

Q So the outlook continues to look bleak?

A Not for everyone. Some retailers are continuing to do well and are making strong profits – such as John Lewis, Iceland and Primark.

Some retailers are looking to the future and are seeking to exploit opportunities to expand. They are also concerned about the development pipeline when the economy improves. In many locations outside London there are just not enough of them to drive strong demand for rental growth.

I would suggest that even those retailers with a secure footing are likely to remain cautious – at least until the General Election is past when they might have a clearer view of VAT, future interest rates, and prospect for future employment - particularly in the public sector. There seems little doubt that the prospects for an increasing tax burden on the consumer is also likely to hold back any bullish forecasts for rapid improvement in consumer expenditure, and therefore increased demand in the retail property market.

Q How is this now playing out in terms of tenant demand?

A Outside London, increasing vacancies and overhang of new stock have seen many landlords having to grant substantial incentive packages in order to buy in demand. A range of tenant deals are still available in many centres – whether they serve small or large catchments, and this has created 'tenant tension' in the better areas.

On the basis that the future development 'pipeline' has all but dried up and seems unlikely to start flowing again for some time (see below), the stronger retailers might need to look at their deal store before the better stock runs out. For example Primark have tied up a transaction to take 10 Bhs stores so remaining ahead of the game.

With vacancy rates in many town centres now reaching 15%, temporary deals for 'pop up' shops remain an important route for landlords to reduce void rates and service charge liabilities. It also provides opportunities for new entrants to the market such as Oxygen and Hype to test the market without major risk and expense. Hopefully some of these operators will become mainstream retailers with wide representation in the coming years.

The major fashion operators continue to seek big stores in excess of 7,500 sq ft, so providing a broader offer and a bigger market share through economies of scale.

However there is no doubt that the focus of demand has shifted away from smaller centres towards the major ones serving bigger catchments. These locations offer the best prospect of higher turnovers but without the high rental risks that may have been attached previously. Smaller centres are tending to lose out in major fashion representation, although there is still demand for space in sectors such as discount operators and foodstores.

Demand for space in these smaller centres is also being squeezed as multiple retailers now promote their online offers, so reducing the justification for nationwide representation outside of the top 100 centres. It is interesting to see the recent appointment at John Lewis of a new commercial director with overall responsibility for multi-channel retailing including property and development.

I recently used one major retailer's internet ordering system to secure a very competitive price point, picking the ordered goods up a few days later in their High Street branch. It provides the consumer with a massive stock catalogue, far bigger than is capable of being stocked in most high street units, but without any postage costs and a convenient option for collecting or taking back goods if unsuitable.

The main department and variety anchor stores are already struggling to add substantial floor space; this has already led John Lewis to develop its 'At Home' concept in order to advance the brand in the short term.

Demand for space in Central London and in the quality London suburbs remains strong with tourist spend in particular driving sales. We have seen 'best bids' being made on premises like the former Borders store in Islington.

Q Given the lack of finance and market turbulence, what do you think are the prospects for major town centre development in the short term?

A I am in no doubt that the traditional trader developer model from where we stand today looks challenging. Particularly as banking finance generally only comes through to allow a start on site once 60%-65% of the income is pre-let off plan, based on sensible rents and incentives.

Any one of those requirements looks difficult to achieve and such restrictions in the market must surely translate into low average residual land values if development is to stand a chance of being viable at an early date.

Those developers that were tied in to pre-recession values, along with high section 106 costs and large residential elements to their schemes, have started to fall by the wayside. We have recently seen Hammerson step in to take up the development management role on the former Thornfield Ventures scheme in Bury. Also the recent sale of a number of former Modus schemes to the Scarborough Development Group while the Trinity Walk scheme in Wakefield was bought out of administration by a consortium of AREA Sovereign Land and Shepherd Construction.

It is possible that some schemes might still work, but the question is at what cost? Some readers may recall The Galleria development on the outskirts of Hatfield in the early 1990s - some £160million of construction cost was eventually bought out following receivership at a figure of £10.5million. This may happen again unless the banks actually retain their current position for up to seven years as some are predicting.

Openings this last year include Centros' Bury St Edmunds scheme of 265,000 sq ft and Land Securities' St Davids Centre in Cardiff of 970,000 sq ft anchored by John Lewis. Also the Eldon Square extension of 400,000 sq ft and the new Southgate scheme in Bath of 470,000 sq ft.

We have recently seen the major proposals at Park Place, Croydon firstly "chopped in half" and then abandoned completely as the reality of its lack of viability has eventually become clear to the local authority promoter. The possible phasing of major schemes may be the way forward in some instances. Of course it is notoriously difficult to achieve in practice - particularly where residential is included.

A radical rethink is now required, by both developers and local authorities, if schemes are to come forward in a timely fashion once the overhang of vacant space recedes. Based on the timeline of the early 90's recession it could well be eight or more years before the majority of town centre developments are built and open.

In the current market the most likely form of development will either be led by a major supermarket or involve extensions to existing centres of between 50,000 and 100,000 sq ft which provide no more than 10-20 large spaced units where demand remains strongest.

For those longer term projects this is the right time to set returns and land values to ride the market back up.

Q Where does all this leave values?

A It is difficult to see an established tone based on recent transactions in most high streets and shopping centres outside of London. Demand remains inconsistent and each deal will be judged on its merits, whether it be the landlord's ability to finance a continuing void or the retailer's return on capital judged against the attractive deals on offer elsewhere.

A landlord's desire to secure a deal might also be driven by whether a particular fashion retailer is going to lift the tenant mix alongside and generate higher returns, rather than a more advantageous deal with a weaker retailer providing limited on-going benefits.

The temporary let and pop-up market where we are also seeing leases for two and three years is really a shorter term mitigation of void costs by landlords. Further, tenants are now making it clear that 5 year terms in prime locations are too short, especially when the landlord insists that security of tenure provisions are excluded. Fixed uplifts and turnover top ups might provide a landlord with some potential upside, but they really have their sights on securing vacant possession and re-letting when the market is moving forward strongly in two or three years time.

The bigger, stronger retailers are looking to lock down value over a longer term of up to 10 years. Although a landlord might see potential upside based on turnover, with base rents reviewable to 80% of open market value there are no guarantees.

No wonder landlords are also pushing for lettings outside of the Landlord & Tenant Act 1954, so that these concessionary terms are not set for a much longer term on renewal.

Q Will we see rents increase this year?

A We are seeing improving demand in some areas which will have implications for future rental growth, although the fundamentals of each centre will have to be researched carefully. King Sturge are predicting that average retail rents will fall by 3.1% in 2010, by a further 1.3% in 2011, with rents only starting to move forward again in 2012.

PWC have reported that some 18 to 22% of the space currently vacant will never be re-occupied. This provides a base for redevelopment or reconfiguration, but until the true loss of value of this type of space is reflected in book values we will never get to the start line.

We question whether some space really has a value as it is all very well making a 12-24 month void allowance but this still assumes that tenant demand will return to secure occupation and drive rents in the future. We would agree with PWC that some of the existing vacant space will never be capable of securing tenants and therefore, until values are written down to reflect the true picture, we hold back redevelopment or the reconfiguring of space which is capable of being re-let or converted to some alternative use.

In-Town Investment

Where do we go from here?

Keith Nelson on strong demand for prime stock and weak fundamentals in the in-town investment market.

Following the unprecedented bounce back in investment activity for prime well-secured property in October last year, the question on everybody's lips is whether the bubble will burst and the predictions of a double-dip will prove correct.

From a cursory glance the investment market appears to be out of step with the occupational market. For those with cash and an ability to work off loan to value ratios of 60% of current market value, 2009 presented investors with opportunities to secure retail property at sensible prices for the first time in many years. Those shrewd investors, who risked early entry into the market before autumn last year when yields went into freefall, have already been able to realise large returns on their investments with inward yield shifts of up to 200 basis points. The hardening of yields also produced some very quick re-sales, rejuvenating a market which had seen even prime properties failing to sell and a lack of stock being placed for sale.

The weight of money has been marked by a return of net deposits and in-flows of funds to the institutions, coupled with overseas investors seeing the UK as an established sophisticated market, providing relatively cheap opportunities. As a result many single retail properties and retail parades have sold and a number of shopping centre sales also completed including: Silverburn, Glasgow for £297 million to Hammerson and Canada Pension Plan; The Darwin, Pride Hill and Riverside Centres in Shrewsbury for some £61 million at 6% initial yield; La Salle Investment Management paid £100 million for The Mall, Bexleyheath; The Crown Estate purchased a 50% share of Princesshay in Exeter for £100 million. Further shopping centre sales are currently being progressed and more stock can be expected to come onto the market in the near future. However we have already seen a lessening in demand for stand-alone retail investments as many investors have snapped up perceived bargains early in the cycle.

A year ago prime shopping centre yields were around 7% and one year on they are circa 6%. Prime shops were 6.25% and today have reached 4.75%. Yields are still higher than at the peak of the market in 2006/2007. There is still some distance from the heady heights but the gap has narrowed considerably. It can therefore be argued that these new levels look expensive when considered in the context of the current occupational market and one has to ask whether the market has already become overheated?

More worryingly for any market is uncertainty, which looks set to continue for some time. Proposed public sector cuts and taxation increases, coupled with the spectre of a hung parliament as a real option following the forthcoming general election, does not create confidence. Against this background we would argue that property investment at present is high risk.

Of real concern is that the fundamentals are still not in place – the retail sector continues to struggle with reduced consumer spending and rental growth is consequently very unlikely. In secondary locations throughout the UK we are seeing a major re-pricing of rents and assets. As investors become more selective regional variations are playing a role in investor decisions, with the traditional strength of London and the south-east and other major UK conurbations returning to the fore. Rental growth has continued in central London as the fall in value of Sterling has had a positive impact on the influx of tourists with

bargain basement shopping in mind. Vacancy rates in the provinces may well be above 15% as an average, but footfall and turnover in Central London is up by some 5% and empty shops are a rarity.

Many investors have been seeking prime property across most sectors, let to strong covenants with at least ten years unexpired. Exposure to risk has increased, however, as retailers have taken the opportunity to negotiate more favourable lease terms, including break clauses and shorter leases thus exposing investors to more uncertainty. Furthermore, the focus of the major institutions on the top 100 centres is increasing the risk afforded to centres that fall outside of this classification, with the spectre of rental falls associated as much with the redressing of a centre's position within the retailing hierarchy as with the impact of a recessionary economy and weak consumer expenditure.

A number of owners of investments in this category have therefore taken advantage of this bubble to offload stock, which may look more vulnerable in a few years time even if the economy has recovered. On the other hand, some investors have taken a view on lease length as they perceive that retailers located in prime locations will want to maintain their representation and duly renew their leases. However, in today's unpredictable market rent-free periods and other incentives have to be considered in any appraisal, especially as funds to fit out are difficult to source both by the landlord wanting to give an extended incentive and by tenants who need to expand.

The secondary market has continued to struggle with increasing vacancy rates and we do not see any improvement in this sector for the foreseeable future. Many secondary shopping centre owners are at risk of defaulting on their loans and there is a lack of capital for undertaking asset management opportunities. Although this does present an opportunity for asset management strategies, both the speculator and investor must carefully consider the changes in retailer requirements and location factors. Positive approaches will require changes of planning to enable redevelopment angles to be considered. This has been seen as an opportunity in some failed shopping centres where alternative uses, such as food stores and hotels could result, coupled with a need to install community and social facilities which draws the catchment back to the centre such as health and medical centres, educational facilities and community project uses. The difficulty is assessing investor sentiment to non-core activities, which enhance the location but provide income streams which fall outside investor requirements. The recently-published BCSC report on shopping centres indentified that out of 820 shopping centres in the UK, some 155 were at financial risk by defaulting on loans with a total debt provision of £10billion – almost a third of the total estimated commercial property bad debt provision of £30billion as at the first half of 2009. With lending to UK real estate at a record level of £240 billion (£200 billion in all currencies), it is going to take the economy many years for the debt pile to find a sensible benchmark level.

For the time being, demand for good quality investment property stock continues to outstrip supply, even though many banks are not renewing loans made just three years ago at the height of the boom. Commercial lenders who became heavily exposed to property over the past five or six years are now starting to reduce their exposure to commercial property as other buyers and new lenders, together with mezzanine financiers come forward. The banks have been shrewd and in our opinion will continue to be so, only releasing product on to the market when they can secure adequate returns. We have already seen banks utilise asset management companies such as Hammerson, Delancey and Centros to provide the necessary expertise in managing out their over-exposure. Those cash rich investors are keen that the banks will release more stock onto the market during the next few months.

Underlying this newfound status for prime property is a considerable weight of money waiting to be placed. This may grow as UK PLC remains an attractive proposition for overseas investors, with the down side on currency arbitrage now regarded as limited – as sterling has returned to a reasonable level especially when compared to the Euro, which many regard as artificially high.

The availability of debt from the banks is reported to be increasing. However, with stringent terms and unattractive rates imposed only the most stable investors will be able to take advantage of what may be on offer. Long gone are the days of free and easy finance, yet prime property continues to be strongly priced after a brief fall into the ether and many are now realising that the true opportunity to buy cheap has now passed. With the occupational market still under pressure and the ending of government fiscal stimuli and increased taxation expected, the latter half of 2010 may be more challenging. We have seen a more cautious approach from investors in the last few weeks indicating that some are concerned that the market is already overheated, but demand for those properties offering the traditional fundamentals remains and will remain strong.

Shop Property % Yields

	Dec 2008	April 2009	Sept 2009	Oct 2009	Feb 2010	Apr 2010
Prime High Street	6.00 - 6.50	5.25 - 6.00	5.50	5.00	5.00	4.75
Secondary High Street	8.00 +	8.00 +	10 +	10 +	10 +	9.00 +
Prime Shopping Centres	6.50 - 7.50	7.00	7.00	6.00	6.00	6.00
Secondary High Street	9.00 +	9.00 +	7.50 +	9.00 +	9.00 +	9.00 +

Professional

The Armageddon Argument

Ian Campbell considers some current issues in the field of rent reviews and lease renewals.

The post-Lehman era has seen increasing difficulties for the professional practitioner. Tenants have continued to put forward the Armageddon argument in respect of review dates after 13 September 2008 and there is some evidence from recent Arbitration Awards of substantial discounts being applied relative to pre-Lehman transaction dates. However we feel that the date of 13 September 2008 is too simple a cut-off point to apply and that where the fundamental qualities of specification and location still apply, rental increases may still be probable.

Indeed Chase & Partners have recently achieved an uplift on the Homebase unit at the O2 Centre, Hampstead where the review date of 29 September 2008 post dated the Lehman collapse by only two weeks, arguably a period when the market was in its most heightened state of flux.

One of the main issues that continues to dominate the out-of-town market is size of units. We have witnessed a reduction in demand for large stores at a time when there is an increasing supply of such units upon the market. While the fallout from the Courts and Allders collapses in 2004/2005 has largely seen that vacant space taken up, more large units have come to the market following the collapses of MFI and Woolworths (Big W), the Focus CVA and the surplus stores arising from B&Q's concentration on their Warehouse and Mini Warehouse format and the resultant general rightsizing.

We forecast that it will continue to prove difficult to establish rental increases on large stores where similar stores remain vacant in a town. Once this supply of surplus stores is reduced through reletting, breakups or redevelopment, then the

prospects for rental growth at review will improve, assuming the market gets back to "normality".

On the question of size, a constant trend in the arguments put forward by tenants is that whatever size unit one is attempting to value, it is never apparently one that is in demand. Retailers will point to a specific size requirement at any given point in time and will argue that without specific demand for that size of unit, the property becomes worthless. However, there are many examples of compromise in this regard, notably with regard to B&Q's Warehouse format, which has led to the standard single storey 104,000 sq ft requirement being replaced by two storey formats with decked car parking, such as at New Malden and Stevenage, (where opportunities for development are restricted). Similarly, a review of any retailer's portfolio at any one time will reveal a wide range of unit sizes, notwithstanding the supposed specific requirements, with unit size dependent upon individual locations and opportunities.

A perennial question which remains is how much one can rely upon the "hypothetical" willing tenant in the world of rent review, when no specific retailer requirement can be proven with certainty for a particular unit. Reliance on the "hypothetical tenant" must remain an argument of last resort as far as landlords are concerned and proof of actual tenant demand must be preferable.

A further area to which tenants have turned to establish rental discounts is that of the lease term at review. As with size, the hypothetical term is rarely the right length from the tenants perspective. They will argue that either five years is not long enough for them to invest in the property, or 15 years or more is too long for the retailer to commit to in current market conditions without a break clause.

However, such statements are contrary to the actions of several out-of-town retailers who have recently regeared leases for additional terms of 15-20 years in exchange for capital contributions and rent free periods. The conclusion is that where the retailer can negotiate sufficient levels of incentive then the length of term does not become such an issue.

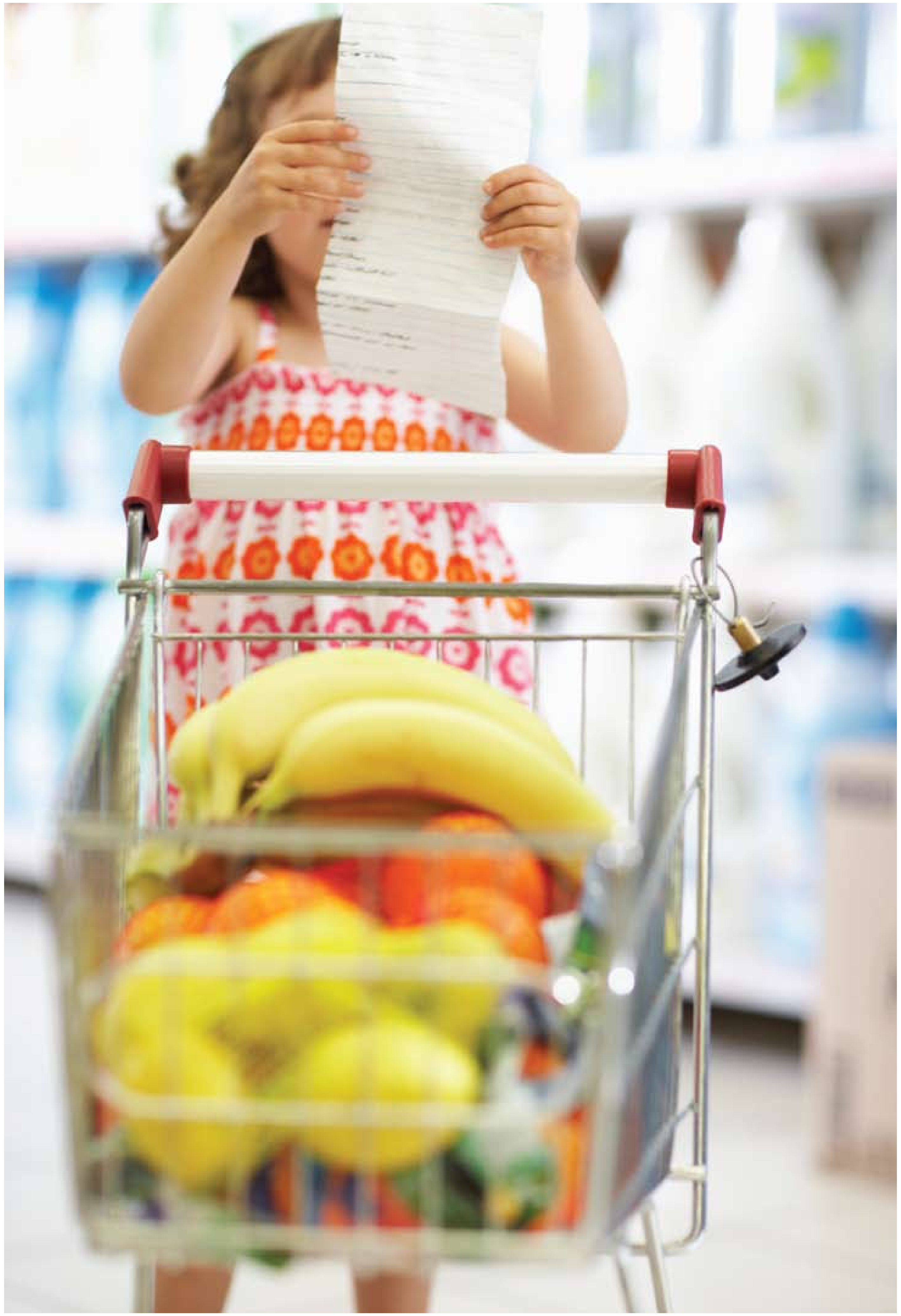
The late 1980's was one of the busiest periods in the development of out-of-town retail. As a result we are now about to enter the busiest period so far in terms of lease renewals on retail warehousing, as many 25 year leases come to an end.

However, as leases have approached their expiry date, there have been many examples of agreement in principle being reached between landlord and tenant prior to that date. Tenants have sought to make the most of their position in a weak occupational market, accepting rent free periods and capital contibutions in the process, whilst landlords have been desperate to maintain capital values by securing good quality covenants on long lease terms. Increasingly landlords have at best maintained rental levels at the same rate, and occasionally have had to agree rents at lower levels than previously passing.

We are therefore seeing a move away from the rigid statutory lease renewal procedures to negotiations which are more akin to those pertaining to open market lettings. There is also a lack of confidence among the parties in allowing the Court to decide terms, particularly when, after a lengthy process, the tenant can still walk away from the property rather than take up the new lease.

The PACT system has also not been adopted to the extent that was envisaged, with tenants wary of having rental terms determined by the same third parties who determine reviews at arbitration.

An inherent weakness in this system is also that there is no default option regarding the role of the PACT assessor as either Arbitrator or Expert. The result is that there have been cases where no agreement between the parties can be reached on the role of an assessor and therefore an impasse has occured. Furthermore, landlords have a need for certainty of term for valuation purposes and find that both Court and PACT processes are too protracted for their current requirements.



Food Superstores and Supermarkets

Strength and Resilience

For those who thought that £30 psf rental for a food superstore was a flight of fancy just a couple of years ago, the recent rent review agreement on the Sainsbury's at Islington at £31.50 psf demonstrates both the strength and resilience of this market, especially given the current economic circumstances.

The bond type qualities and security of this sector have always been recognised, but the lack of transparency on retail values with few open market transactions has constantly dogged the assessment of growth potential. With much of the information in very few hands, evidence is difficult to come by, particularly that which is relevant.

Even in Northern Ireland, where the market has been particularly difficult to penetrate, a recent arbitration award on the Tesco at Newtownabbey at a rent of £18.65 psf sets a new rental record which suggests that the yoke has been broken. Again, note it has been left to a third party decision maker to establish the market rent.

However, this should not be seen as a battle of wills but of an understanding of a market which, despite its established position, continues to suffer from an air of secrecy and misunderstanding.

Some foodstore operators have argued that the UK planning system has inhibited competition and allowed others to secure a monopoly trading position. The Competition Commission's recommendations for a 'competition test' as part of the assessment of future supermarket planning were not included in the new PPS4 issued in December and it will be interesting to see whether this ever sees the light of day - whoever is elected on May 6th.

What is certain is that the UK food superstore and supermarket businesses are proving to be perhaps more resilient during the downturn. Growth is still positive and will continue to be fuelled by the operator's appetite for new space, either from new locations or the expansion of existing portfolios.

As we commented on last year, internet sales in the food sector continued to show slow growth but Tesco have opened a dot.com-only store in Aylesford which has moved into profitability within a matter of months. Ocado, who are planning an IPO shortly, still, however, struggle to demonstrate how food sales via this medium can move into profitable territory, although one has to give credit to its committed and capable management team.

Against this background, it is not surprising that property yields for well located and good quality food superstores have moved to below 5% and are a favourite property stock amongst pension funds now benefiting from net receipts and looking for significant holdings. Standard Life Investments undertook its second sale and leaseback, purchasing the Tesco Extra supermarket in Shrewsbury for £46million and Sainsbury's have completed a sale and leaseback deal on their 83,000 sq ft store at Hayes with Aviva at a price of £55million, which reflects one of the highest prices paid for a single food store asset.

With this profile, sale and leasebacks will continue to be a popular option, particularly for Tesco and Sainsbury's as they seek to raise cash for further expansion.

Comparing the current market share figures with those contained in our report last year shows Tesco has lost market share to ASDA, Sainsbury's and Morrisons. Further, the Co-operative, who have now purchased Somerfield, are a real threat in convenience retailing, being not only good with food but also with property. They promote the fact that there is only one postal area in the UK that the new combined group does not have representation in, which is Buckingham Palace Road, London. No doubt they will see this as something of a challenge and, who knows, perhaps the Queen will be able to pop out to a local Co-op in the not too distant future! Certainly no other food retailer can boast such representation.

A quick round up of the individual food retailers is as follows:

Breakdown of market share

Retailer	Market Share % 2009	Market Share % 2010
Tesco	30.1	30.4
Asda	17.2	17.0
Sainsbury's	16.2	16.3
Morrisons	11.7	12.3
Co-operative	5.1	5.7
Waitrose	3.9	4.3
Aldi	2.9	2.8
Somerfield	3.3	1.7
Lidl	2.3	2.2
Iceland	1.9	2.0
Netto	0.7	0.7
Farmfoods	0.5	0.5

Source: Kantar Worldpanel 2010

TESCO

Tesco now have well over 2,000 stores in the UK which accounts for c.70% of group sales and profit, but it must not be forgotten that this retailer operates nearly 4,500 stores in 14 countries, making them the third largest grocery retailer in the world.

Some 2,000,000 sq ft of new space was opened in the UK last year. The company continues to release value through its property portfolio - completing deals worth £1.8 billion in 2009/2010 and achieving initial yields of between 5.0% and 5.2%. This reflects the strength of the company's covenant.

Green technology and carbon footprint is now a clear focus of their store development programme, with £100million spent on improving their sustainable credentials last year. Valuation of food superstores in the future will therefore need to take account of any obsolescence which may exist under this heading.

ASDA

The Asda/Walmart brand remains the number two grocer with 371 stores in the UK. As we predicted last year, they did purchase three smaller former Co-op stores, ranging in size from 10,000 to 17,000 sq ft and have submitted a planning application for a 28,000 sq ft store in Ware, demonstrating flexibility to suit the opportunity, which has not been a feature of this retailer in the past.

As for last year, Asda have not been an exciting expansionist in property terms, but their performance is solid and it is claimed their customer base continues to grow, with 2.5million more people walking through their doors each week than in 2007.

Sainsbury's

The key point with this retailer is that they have demonstrated that the reversal of fortunes has not been temporary or a blip. Last year they opened 38 supermarkets, 51 convenience stores and extended 13 stores. Despite this change in the portfolio, sales increased by 5.7% in 2009 over 2008 with this operator now having some 525 mainline supermarkets and 303 convenience stores of under 15,000 sq ft in size.

In terms of expansion, it is interesting to note that total gross new space added some 6.8% to the existing portfolio. This profile is likely to continue for the future. What is clear is that Sainsbury's is determined to continue their growth and expansion programme which has been successful, with March 2007 to March 2010 providing 12% gross new floor space – 20% above the original target of 10%.

MORRISONS

Following the merger with Safeway, some pundits put this retailer out to grass, which was a significant error. As the best performing supermarket like for like, they now have 425 stores across the UK comprising 11.9million sq ft and last year increased turnover by 6% to £15.41million. Of particular note is that the underlying profit shot up by 21%. They opened 11 new stores, converted 34 former Co-op/Somerfield stores and extended 13 of the existing portfolio, with a further 10 more stores to open in 2010 and another 10 in detailed negotiations.

The real thrust of expansion for Morrisons is the southern half of the country, with most of the recent acquisitions being focused in this area. In line with their Optimisation Plan, October 2009 saw a new regional distribution centre in Sittingbourne open, representing an investment of £108million.

Interestingly, some 89% of Morrisons' estate is held by the retailer as freeholds or long leaseholds. To date, they do not appear to have been put under any pressure to release capital from sale and leasebacks for the purpose of further expansion and they have rarely taken new leases as occupational tenants paying a market rent. Current activity and attitude suggests that this is not going to change.

Waitrose

Voted Britain's favourite supermarket by "Which?" magazine, their Chief Executive Mark Price also won Retail Leader of the Year at the Retail Week Awards. In July 2009 they also overtook Marks & Spencer in food sales for the first time in their 105 year history.

Last year we thought that the recession may hit them hardest, but their middle class customer base has proved more resilient than other sectors of the community with gross sales up by 9%. They now have 225 UK stores, having opened 25 new stores in 2009 equating to an additional 373,000 sq ft. However, this did include 13 acquisitions from the Co-op/Somerfield merger and also one former Woolworths' store.

What we did predict correctly is that they would open up convenience stores which comprise between 5,000 sq ft and 7,000 sq ft. They now operate four stores of this type at Nottingham, Bristol, Crouch End and Oxted and with a new signing for a smaller format store of 3,000 sq ft in Cambridge. They have also been moving into the motorway service area and opened five Welcome Break outlets in 2009 and a further three in 2010 so far, with three due during the remainder of this year.

Like Asda, they seem to be gaining increasing footfalls and within the last 12 months some 400,000 more people are claimed to be shopping at Waitrose compared to this time last year.

MARKS & SPENCER SIMPLY FOOD

Marks & Spencer are evaluating carefully each trading property's performance in their 300 store estate. Although they opened 13 stand alone Simply Food stores between 2008 and 2009, they also closed 24 on the basis that they were either too small to attract sufficient pull or the local market was not big enough to sustain them.

Like Waitrose, Marks & Spencer have been looking at the motorists as the customer and last year saw them reach the 100-store milestone with their BP service station franchise, including a new opening on the M40 Beaconsfield Services complex.

Marks & Spencer's growth in the food market may have peaked, but there is no doubting their commitment to expansion and improving the portfolio in the future, which is likely to be promoted by the new Managing Director Marc Bolland.

The co-operative

Following the merger between the Co-op and Somerfield, this is now the fifth largest food retailer in the UK with 2,500 food stores and supermarkets. Like for like food sales were up by 5.5% year on year, following the re-branding and modernising exercise which has been applied to some 65% of the total estate already.

The question mark over this group is their ability and capacity to grow organically from a very significant base and intercept sales which otherwise will migrate to the majors and discounters.

ALDI

LIDL

NETTO

Iceland

farmfoods THE FROZEN FOOD SPECIALISTS

As we predicted last year, this is a market which has continued to expand exponentially. Arguably the best performer was Aldi which saw turnover in their UK and Ireland stores jump by 32.3% to £2billion as at 31 December 2009, with pre-tax profits increasing from £70million to £92.7million. However, the market is not all theirs. Lidl have 530 UK stores and therefore are larger in terms of their estate and continue to expand. Also to be considered are Netto, who in their previous year underperformed but this year have turned around completely and have been promoted as the fastest growing supermarket in the UK. That may be slightly optimistic, but they have grown from 182 to 200 stores in the last 12 months and intend to open 20 new stores in the future.

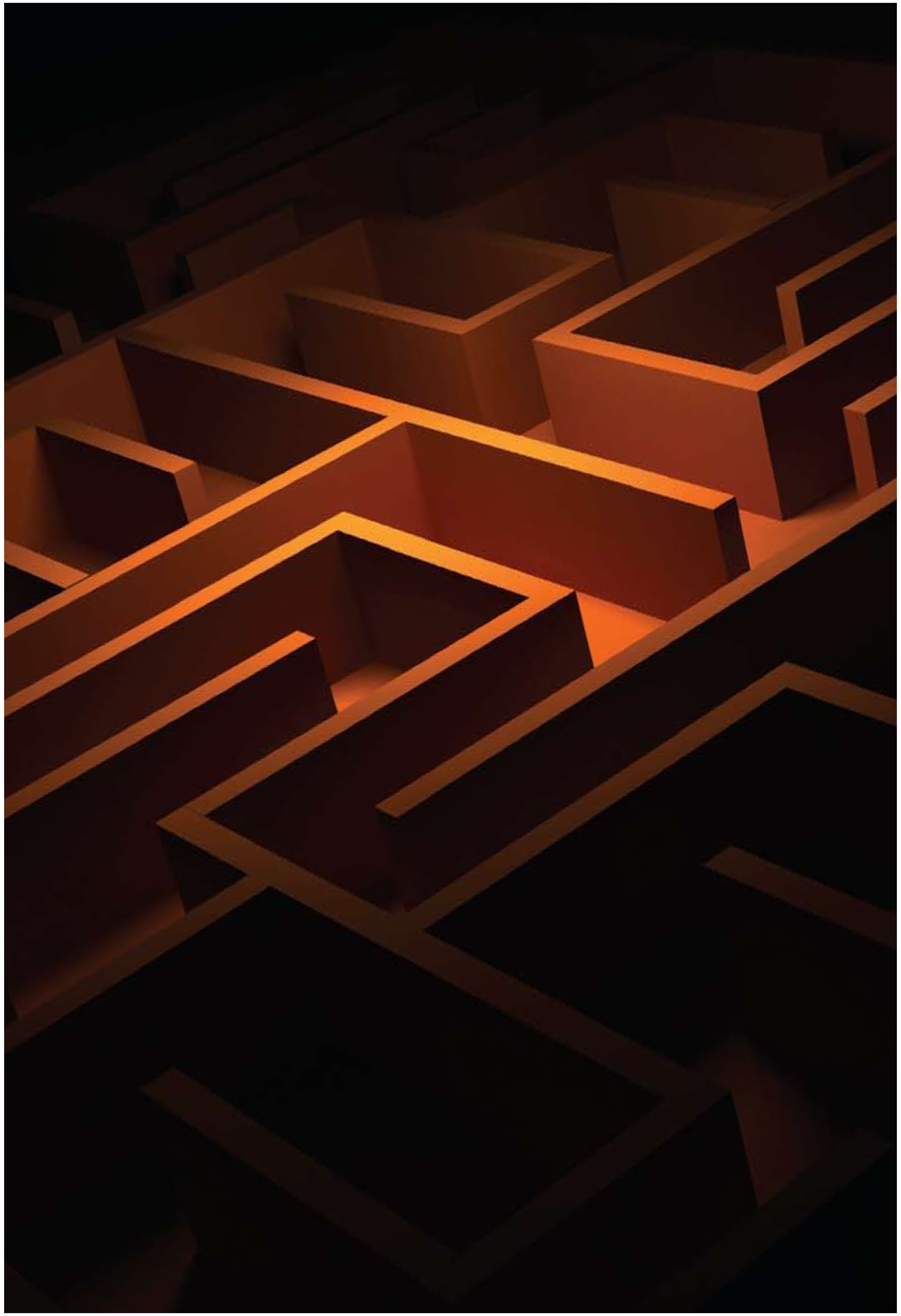
The sleeping giant now making a real move in profile terms is Iceland, who operate 682 stores under the Iceland fascia and 45 Cooltrader stores. Last year saw record sales up by 16%, making it the fourth consecutive year of double digit like for like growth and taking total sales to over £2billion for the first time.

They put themselves on the radar last year by agreeing to buy 51 stores from the receivers of Woolworths and they now plan to open between 20 and 30 new stores, which is their fastest rate of expansion since they purchased Bejam 30 years ago. In the meantime, Farmfoods keep expanding organically.

Conclusion

Growth in the food retail property market not only reflects the security of this type of business in an economic downturn but also strong management and a significant ability which exists within all the companies which operate within the UK. However, on the food superstore side of life, much of their business is protected through the restrictive planning regime and, therefore, it will be interesting to see if the Competition Commission's quest to open up the market will have any impact on the much more restrictive practices promoted by the Government's PPS4 policy issued on 31 December 2009.

Whether yields have now fallen too low in the investment market is a question that will be asked, but the last 20 years of low yields have proven to be well rewarded, both in terms of security and rental growth and we do not see this position changing in the foreseeable future for good quality prime property.



Town Planning

Welcome to The New Reality

The planning system has been in a state of flux for so long that we might now consider this to be the norm. Uncertainty in the plan-led system, LDF's progressing at a snail's pace and resistance to development in anything other than a town centre location are familiar issues for anyone involved in retail, either Local Authority, developer, owner or investor. However, the fall in values seen over the last two years has fundamentally changed the game and all parties must now review their expectations of what development can deliver.

For Local Authorities, the idea of planning departments being self financing - or even net contributors to council coffers - must surely be consigned to history. Departments which relied upon a steady stream of application fees to support their budgets have found this running dry as major schemes have been shelved. Similarly local authorities' regeneration ambitions, which relied on either delivery of a key scheme or Section 106 funding, have also suffered. A pressing need has therefore arisen for local authorities to reappraise how their regeneration objectives will be achieved.

Government policy, most recently expressed through the new PPS4, clearly elevates town centres to the highest of priorities and all retail development should be directed there in the first instance. There is no guidance, however, on what local authorities should do if there is no retail development to direct. In the absence of major retail-led schemes which might regenerate a town centre, local authorities will need to re-examine more prosaic matters, such as their development control policies, to ensure that development is not discouraged unnecessarily. The old modus operandi of protecting A1 floorspace cannot be consistent with the priority of protecting the vitality of town centres in an environment where retailers are going bust and non-retail operators, such as coffee shops and takeaways, are the most acquisitive. Now that redevelopment schemes are unlikely to deliver the vitality local authorities are charged with promoting, realism is needed in the application of policy.

The new reality for developers is that the balance of risk to return has shifted. In the past a town centre development scheme would have been led by the development plan, specifically by identifying the site on the proposals map with an associated policy supporting redevelopment. This provided the certainty for developers that the principle of their scheme was fundamentally acceptable. There are now few locations where such a situation exists. In most areas the local plan or Unitary Development Plan is out of date and the replacement LDF has, in most cases, only reached the Core Strategy stage – if that. As this contains only general policies which are not site specific it provides little comfort to a developer. The lack of support from the development plan increases the risk of a refusal and this risk must be borne by the developer.

Furthermore, with the amount of information required in support of major planning applications increasing all the time, the cost of pursuing a scheme is higher than ever. With an unhelpful development plan the likelihood of an appeal increases, as do the costs. With land and building costs remaining constant, the developer's profit falls and the balance between risk and reward starts to look unfavourable. In this way the planning system could be responsible for keeping potentially viable schemes on the shelf. At the extreme there is the risk that investors will be put off UK retail property by the planning system and will simply find other places to put their money.

For owners of existing schemes the outlook is very much dependent upon location. Owners of town centre schemes are now further protected from out of town competition and are therefore less likely to see their (remaining) retailers relocate out of town. For owners of restricted out of town retail parks the new reality is bleak. There will be no sympathy from Local Authorities regarding vacancies as long as the town centre is suffering its own problems. With less retailers to go around, many Local Authorities will be only too happy to see weaker retail parks give up their land for other uses - particularly if that also provides a "windfall site" which contributes to their housing land supply.

Indeed, we are already seeing some of the poorer retail parks - generally first generation stock – drift away from retail toward trade counter or industrial uses, or alternatively redevelopment for foodstores. Owners of such parks should not fool themselves – Local Authorities have other priorities and will not be concerned.

Any Respite from the Gloom?

Planning is not famous for changing quickly or dramatically, but the Conservatives' Green Paper published in February 2010 appears to be an attempt to do both. Above all, the Conservatives are promising a return to "localism" – chiefly through the abolition of regional government, the replacement of LDFs with a new local plan system, shaped in large part by local residents and limiting the ability of the Planning Inspectorate to impose changes. Other proposals include reintroducing the need test for retail development (though in our view it never went away), "flexible zoning" and third party rights of appeal. Whilst these measures might well speed up the process for producing development plans, we are less sure that those development plans will encourage development. On the other hand in weak markets some local authorities appear to be more amenable to investment opportunities and may be willing to interpret policies in a more permissive way if there are clear economic benefits.

Whichever party is in power, given the national financial circumstances, we do not expect local authority budgets to dramatically improve. This is already leading to pressure from within to appraise local authorities' (considerable) land holdings and release sites for development with a view to raising money. Planning departments are likely to come under pressure to ensure that their policies are aligned with these objectives. Expect some judicial reviews of local authority decisions in the next 12 months.

For developers, their best hope in the short term is for market conditions to improve and return the risk/reward balance back to a point where projects are worth pursuing. Even with a change of government the planning system will continue to be a source of delay, cost and frustration, with the new local plans system potentially presenting even greater barriers to development. As has been the case for some time, those developing town centre schemes will be best placed as they will at least have the general thrust of the "town centre first" policy behind them. That, however, is likely to be the limit of policy's support to the development community. Out of town retail development is likely to face a very hostile policy environment until such time as town centres recover.

Overall, there is a clear and urgent need for radical changes to the planning system if it is to support the fragile recovery. The current government shows no appetite for anything other than tinkering at the margins. The Conservatives' proposed changes at least offer the possibility of actually getting plans adopted, but we are sceptical regarding their ability to promote growth in their current form. Whoever is in power, **an economic recovery will have to occur in spite of the planning system.**

The Conservatives' Green Paper

It is generally recognised (except perhaps by the DCLG) that the LDF system has ground to a halt. With less than 15% of Core Strategies adopted five years after the system was introduced there can be little doubt about this. The Conservatives have described the system as "broken" and set out a Green Paper on how to fix it. Chiefly this involves a shift toward localism involving abolition of regional government, a return to a local plans system – arrived at through a process of "collaborative democracy" – and wider public consultation on development proposals, including "compensation" to affected parties. Even more radical ideas include introducing third party rights of appeal and requiring applicants for schemes to engage in a process of "collaboration in design" with local residents.

We have some serious concerns about these proposals. The Tories view that housing demand will be met by communities throwing open the doors for developers is wildly optimistic and the suggestion that all parties will reach a happy consensus – even "unanimous local support" – is hopelessly naïve. Furthermore, the idea of developers agreeing compensation with local residents in return for dropping objections looks like a strong incentive for those residents to object in the first place.

On publication the Green Paper appeared radical – a frank assessment of the current system's failure and a bold new approach in replacing it. Closer analysis, however, reveals a worrying lack of understanding of town planning, of its interaction with the rest of the economy and the property industry generally. The subsequent publication of the Tory election manifesto provided some context. In our view, the Green Paper was written to chime with some wider Tory election themes such as "broken Britain" and "empowering" local people – the manifesto's title itself is an "invitation to join the government of Britain". The fact that many of the Green Paper's proposals are counter-productive to its aims or simply unworkable in practice seems to have been less important than the need for the shadow Planning minister to be "on message". Our view on this is reinforced by the notable lack of attributed input from any major planning or property figure. If the Tories did receive advice from within the industry, those who provided it appear keen to remain anonymous.

This Green Paper represented a great opportunity to propose real reform, but instead the Tories have done nothing more than pander to their base support. Perhaps a move from opposition to government will change their perspective and later versions of this paper will be more workable, but as it stands this Green Paper is a great disappointment.

What we've been doing in 2009/10...

Yardley: Tesco
Development advice and expert witness services at CPO inquiry on behalf of Tesco Stores Limited. CPO confirmed by Secretary of State in February 2010.

Leicester: HSBC 2/6 Gallowtree Gate
Purchase of prize retail investment on behalf of a private client. Property let to HSBC until June 2021 with the purchase price reflecting a NIY of 5.279%the year 2009 / 2010.

Sevenoaks: Bligh's Meadow
Rent review and asset management services as well as acting on the sale of the investment.

Stevenage: The Forum
Asset management on behalf of CBRE Investors. Agreement for lease with Next on 12,000 sq ft, opening September 2010.

South Northamptonshre: Local Authority Consultancy
Town planning consultancy services to provide comprehensive retail study for principal towns, Towcester and Brackley in advance of significant planned housing growth.

Shepherd's Bush: West 12 Shopping Centre
Town planning advice and agency services for Land Securities as part of an ongoing strategy to regenerate the shopping centre.

Canterbury: Stour Retail Park
Agency and town planning services for PRUPIM. Letting to Peacocks in subdivided former MFI unit.

Loughborough: Willowbrook Retail Park
Asset management of Willowbrook Retail Park, Loughborough on behalf of Merseyside Pension Fund – new letting to Sleepmasters.

Guildford: Woodbridge Road (Guildford Gateway)
Investment sale of office scheme let to Secretary of State for Communities and Local Government. Sold for just under £6 million in February 2010 on behalf of Thurleigh Estates.

IN'n'OUT
National acquisitions on behalf of IN'n'OUT – Eight stores opened in the year 2009 / 2010.

Long Black Hospitality Group
Advice and agency services to new food and beverage retailer.

East Sheen
Rent reviews on parade of units for the owners, Conway Group.

Gudrun Sjoden
Agency advice for this Swedish retailer who currently trades in 36 countries worldwide and wishes to expand into the London market.

Cleo B
Agency advice on the expansion of this up and coming shoe designer/ retailer into the London market. First shop opened in Belgravia in March 2010.

Design: www.ferguson-creative.com April 2010 Printed using FSC approved paper

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Further information

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3	December 1996	End of Year Round up - Developments in the Retail Property Market
4	December 1997	End of Year Round up - The Retail & Leisure Property Market
5	May 1998	Rating of Commercial Property - Update 1998
6	December 1998	End of Year Round up - The Retail Property Market
7	July 1999	The 'Need' for Development
8	December 1999	End of Year Round up - The Retail Property Market
9	February 2000	Flexibility and the Sequential Approach
10	March 2000	The Need for the Sequential Approach
11	November 2000	Funding the improvement of Town Centre & Town Centre Management Schemes
12	December 2000	End of Year Round up - The Retail Property Market
13	December 2001	End of Year Round up - The Retail Property Market
14	December 2002	End of Year Round up - The Retail Property Market
15	November 2003	The Governments Response to the Proposed Changes to the Use Classes Order
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