ROLL UP ROLL UP!
WELCOME TO THE
CHASE & PARTNERS C&P
RETAIL PROPERTY REVIEW 2008

CONTENTS

* 01 - Market Overview
* 02 - Current Issues in the Occupational Market
* 04 - In Town Retail Agency
* 06 - Retail Warehouse Agency
* 08 - Retail Investment
* 10 - Food Superstores & Supermarkets
* 13 - Professional & Valuation
* 14 - Town Planning
* 16 - Further Information & Contact

2008 Retailer excuse watch # 1
“Summer exam results and the Olympics were a distraction for customers”

MARKET OVERVIEW

RETURN TO CONTENTS

Graham Chase FRICS FCI Arb FlnstCPD

The commercial property market has now been in recession for some 18 months. Property companies and pension funds are moribund and only able to sit and watch as values continue to fall while yields rise as quickly as interest rates have been falling.

The retail property investment market has probably seen a fall in transactional business of up to 50%. There has been some effective demand, but this is generally for lot sizes below £50million. There is no tangible market for larger investments, with valuers having to assume "virtual" purchasers for prime dominant shopping centres and retail warehouse parks. As the auction houses have demonstrated, appropriately priced, secondary small lot sizes have a more enthusiastic market than larger prime schemes.

Yields for prime retail stock now lie somewhere between 7.5% and 9% depending on the precise characteristics of each individual investment. Even at these levels, the problem facing the market is that debt is simply not available to fund the non-equity element of the purchase. In the past, £100million of equity would have purchased at least £500million of assets to give a spread of investment product and risk. Today, the investor has to consider putting 100% of their non equity into a single basket, or at best accepting a low 60% gearing, plus up to 3% arrangement fees and interest at LIBOR plus 2%.

The weakness of the investment market only provides a pre-cursor to the consumer market difficulties, which since September have seen an acceleration of falling confidence as retail sales figures tumble by between 3% and 10% for many retailers. Capital market failures usually follow consumer market downturns, but we now have the unusual position of negative consumer confidence responding to the failure of capital markets. Arguably the world economic problems we now face are the direct result of a property market failure led by the "sub prime" mortgage lending exposure in the USA.

As high profile corporate failures in the high street gather pace, jobless figures predicted to rise to a staggering 3 million before the end of 2009, profits in the corporate sector expected to fall by 15%, house prices predicted to lose between 10% and 20% of value to show a total decline of 35% since the peak in 2007, and UK GDP in real terms potentially to go negative during 2009, the threat to income streams on retail property investments and falling rental levels is clear. This is not good news for established property companies who are now bearing the brunt of the significant valuation downgrading of their portfolios.

With Bank of England figures as at the third quarter of 2008 showing lending on all property to have leapt to an all time high of some £240.129 billion (£189.1 billion Q3 2007), the decline in market conditions could not have come at a worse time. The level of outstanding loans on real estate is three times that in Q1 2002 of £73.296 billion. With many property companies transacting business based on high levels of debt finance now in negative equity territory, the banks nervous of crystallising losses, and a market with limited buying power, the strain on the status quo is palpable. It makes sense for banks not to call in their loans, but they now have their own pressures as businesses, and it is in this arena that conflicts are bound to arise. The pinch will be felt when it is time for existing loan books to be renewed or renegotiated. The trick will be to improve returns without sending the principal into administration.

> Good retailers, although cautious, are now looking at opportunities which have not been available for years. The fact is that many of the failing retail companies were weak, even when consumer spending was at its height. Markets such as this always find the weakest link.

On the other hand, this is the time for cash-rich and new investment companies with no baggage to take advantage of re-benchmarked investment and occupational markets. Good retailers, although cautious, are now looking at opportunities which have not been available for years. The fact is that many of the failing retail companies were weak, even when consumer spending was at its height. Markets such as this always find the weakest link.

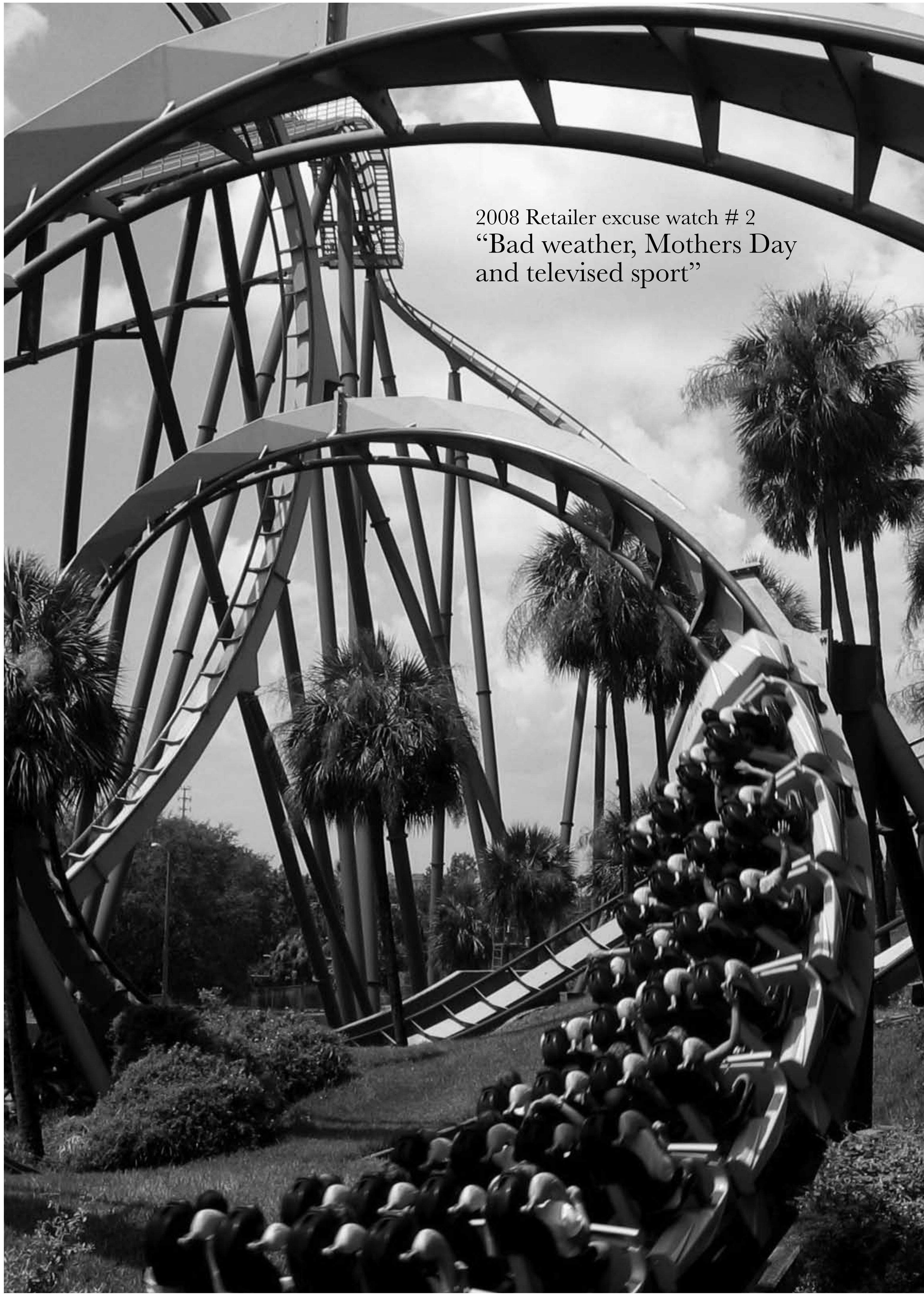
With interest rates rapidly heading towards zero, the spectre of the Japanese syndrome of a decade ago, when bank deposits resulted in negative interest, could be the catalyst for encouraging investors back into the property market as buyers. Even if a shopping centre loses 25% of its income stream, a purchase at a yield of say 8% will provide a better return than cash on deposit in the bank, although the capital loss is not an encouragement. Sovereign wealth funds previously identified as white knights have so far stayed off-shore as the currency arbitrage has provided too great a risk. However, with Sterling having lost 27% in its average value over the past 18 months, some may consider the UK in currency terms as cheap, although the correctness of such a view is undoubtedly still subject to significant risk.

> 2009 is clearly going to be tough, but unlike 2008 when all the news was bad, there will be signs of regeneration in the property market. With values having been re-benchmarked at more sustainable levels, this will provide opportunities for good retailers in the high street and in retail parks to pick up opportunities which may not have been available in the past.

As to Government policy, it is clear that the action taken in October following the Lehman Brothers' collapse to recapitalise the banks and avoid a failure in the security of the general public's savings was the only option available. For the time being a significant banking failure has been avoided. However, we now have a position where the cost of the bail-out is high, not only to the tax payer but also to the banks who have, in theory, been saved from themselves. At a time when interest rates are at an all time low, they are paying a penal interest charge of 12% on those sums which they have borrowed from the Government to boost their balance sheets. They also have a few Civil Servants turning up at their Board meetings, which cannot be comfortable. This financial equation does not look a positive one. How will those banks who have taken the Government's shilling be able to work their way out of this predicament, when they are expected to lend money at interest rates significantly less than they are having to pay back to the Government on their very sizeable state loans?

> Perhaps we will see a number of larger equity players pool their resources in order to buy into the cheaper, bigger investments and at the same time spread their risk...

2009 is clearly going to be tough, but unlike 2008 when all the news was bad, there will be signs of regeneration in the property market. With values having been re-benchmarked at more sustainable levels, this will provide opportunities for good retailers in the high street and in retail parks to pick up opportunities which may not have been available in the past. Investors are likely to be forced back into the property market as alternative investment options, particularly cash deposits, look decidedly unexciting and even costly. The big question mark is where will the capital, in the form of debt, come from? For the larger investments, with lot sizes in excess of £50million, if property companies cannot borrow the money they need, pension funds' monthly income is simply going straight out to pay off redemptions and maturing policies, and off-shore sovereign funds still regard Sterling as too risky a play, it is difficult to see how this conundrum can be resolved. Perhaps we will see a number of larger equity players pool their resources in order to buy into the cheaper, bigger investments and at the same time spread their risk, but with their focus and energy on their existing portfolios such an initiative will have to come from those equity providers who apparently are still sitting tight in the wings waiting for the right moment.



CURRENT ISSUES IN THE OCCUPATIONAL MARKET

THE TENANTS' POSITION

As retailers opened in November and December, they must have wondered whether the Heads of Terms, based on negotiations several months, before were now appropriate. Not just the headline rent and capital contribution but the lease terms.

During the "monthly" rent debate that started in April (see later comment), some property directors highlighted other issues that affected the contract between landlord and tenant including:

* rent review provisions
* alienation covenants
* user clauses
* service charge costs and administration

Any of the above could have a financial affect on the retailer, based on both time and money, that far outstrips the saving of a monthly payment schedule.

In cost terms, tenants are continuing to ask landlords to do more to the unit or fund the tenant doing works as part of their fitting out. Capital contributions were rising. Arguably part of this was to underpin the landlord's rental expectations. Unarguably rents will find a new lower base as landlords now cannot always call on such funds to pay tenants. At the same time tenants simply want to pay what they can afford.

Break clauses need careful drafting, but may help to secure a new occupier.

Rent reviews, or the determination of open market rental value, can be negated if the landlord will accept a rent on review that is agreed at a fixed sum or the rent cannot be below a certain figure, nor above a certain figure based on a statistic, for example, RPI i.e. the "cap and collar".

In the out of town market retailers want unconditional deals. They will shy away from signing up in advance of vacant possession being obtained or the grant of a planning permission. They want certainty of opening dates, for example, HomeSense, or consider that the uncertainty of trade in the future is not worth legally committing to now. A cheaper deal may be available by the time the conditionality is met. Turnover expectations may also have changed.

As regards the in town market there is nervousness on entering into conditional deals when the development market is contracting, leaving retailers committed but with no guarantee of the accommodation being built out.

THE LANDLORDS' POSITION

As the market worsened during the fourth quarter, there has been a change in how individual landlords have dealt with approaches from retailers "in distress". This is because of the different types of owner (i.e. pension fund, property company or a house management style) but in each case there has been a careful evaluation of the problem.

Most landlords prefer to engage with a retailer to work through the recession, but some have taken the view that any change will only provide a temporary respite, so that it is not worth changing anything.

Lawyers are being consulted to ensure that the landlords and tenants' liability is clearly understood, particularly in relation to any surety. Sureties going back to the development boom in the late 1980's are being checked for their validity. This then forms the basis of any negotiation.

With a tenant needing to secure a change quickly with the majority, if not all, of their landlords, then this is clearly difficult. Landlords were being secretive about such discussions but there is now evidence of landlords sharing information, even if making individual decisions.

Most large landlords are identifying a single point of contact to deal with each tenant over their portfolio.

Landlords will, to a certain extent, always be second guessing what may or may not happen to any of their tenants. Can improved occupational terms enable a retailer to survive a downturn, or will it be dependent more on the attitude in advance of the financiers and the continued spending levels in the shops?

CURRENT ISSUES IN THE OCCUPATIONAL MARKET

RETURN TO CONTENTS

MONTHLY RENTS

The debate is an old one brought up again during recession and is all about cash flow.

The lease is a contract and should be adhered to unless both parties agree to change it. A change to monthly rents will alter the risk profile of an investment and may need to be balanced e.g. the monthly rent is paid by direct debit or might be more than a twelfth of the annual rent. A number of landlords and tenants have renegotiated terms during 2008 and we applaud those who have reached such an accommodation. There has been general agreement that retailers with three shops or less can pay monthly.

It is not always straightforward. The financing of a new development or an investment purchase may depend on the tenant paying rent quarterly in advance and the financier receives their share of the money a few days later. Landlords very rarely own their properties outright and any loans will be serviced by the rent. If the amount and timing changes then the risk changes to that third party financier and the potential increases for banking covenants to be breached, and all that such an event brings forward.

The cynic might argue that there are then eight more times of the year when non-payment of rent could result in an administration, but we suspect that if a company cannot make a profit then paying rent monthly will not save them.

There is no reason why a landlord and tenant cannot agree to any timing of rental payments, and we have previously given the view that it is likely that the number of new contracts agreed on a monthly basis will increase, indeed they will become the norm.

We have heard comments that the Code for Leasing Business Premises or the Commercial Lease Code stipulates that rent is paid quarterly. This is not the case. In fact the Code encourages parties to make their Heads of Terms clear and provide differing pricing mechanisms. It can be found at www.leasingbusinesspremises.co.uk.

Retailers have been writing to their landlords asking them to consider accepting rent monthly. Some have argued that if landlords are helping out struggling tenants then they should be ensuring that the profitable ones survive at the same time and on the same basis. A compelling case perhaps in recession, but one that is likely to become more acceptable throughout 2009 and beyond.

VACANT RATES

Retail trade bodies, everyone in property and its Press, united to argue that the amendment to rating law from 1 April 2008 was an unnecessary and potentially damaging change. The counter-argument, that it would ensure occupation of void property by increasing taxes when unoccupied, was unlikely to work and has been disproportionately unfair at a time of recession. Even up to the date of enactment there was a financial storm brewing. Arguably, in a recession, business ratepayers would have been seeking some dispensation under the old void rates system.

Maybe the Government thought that all unoccupied properties were void rather than vacant. It is an occupiers tax, and those retailers with stores that have vacated for sound business reasons are now being penalised. If a shop is closed down because it is unprofitable, but the retailer pays rent while they try to assign or sublet, then it can't be helpful to add the burden of additional vacant rates.

The pre-budget speech in November, reducing void rates for properties of a rateable value of less than £15,000 was absolutely no use at all to the out of town retail market, and of very limited effect in the in town market.

The issue of empty rates will also start to affect an increasing number of tenants as failures increase. This could raise problems even for well financed retailers as they become liable under privity of contract on old leases or where AGA's have been signed.

We could also see smaller private landlords who bought into the investment property boom failing, as many purchases were financed off high loan-to-value ratios, leaving little room for manoeuvre if their tenants fail and empty rates take hold.

A number of fringe retailers are taking what are effectively extended temporary lettings of up to three years in length. This enables landlords to fill vacant units, and secure a trading fascia with a limited rent free period. The tenant may not be Gucci or Prada, but at least a level of income is maintained and empty rates are held at bay.

We may see more temporary lets, for example Computers 4 Africa and charity shops, or in some cases the property may be knocked down to avoid paying rates at all. The Government had not forseen the true implications of the changes to the rating legislation. Where there was equilibrium, there is now imbalance.

REGEARING OR RENEWAL

This debate has been going on for a few years but some retailers are using a regear as a way of raising capital in return for a longer fixed occupation. Renewals will be scrutinised but we suspect both parties will have decided what they want to do a year or more before a lease ends and negotiate in advance.

In the out of town market some retailers may pre-agree an orderly downsize by the end of the lease and landlords secure changes in planning permission with the tenants' help.

PRE-PACK ADMINISTRATIONS

"Pre-pack" means that a deal to sell the business has effectively been agreed before the retailer is placed into administration.

They are controversial as the retail chain emerges hours later, often with the same management e.g. USC.

It allows the "newco" to jettison the unwanted liabilities and start afresh with a "profitable core business".

If you were an unpaid supplier or a landlord of one of the unwanted stores, there is no doubt that questions need to be asked. Your contract or lease ends immediately and there is no recourse as the administration ended almost before it started.

One of the questions might be "is it moral?" The legal, and arguably moral battle, with the administrators of Powerhouse and their proposed CVA ended in victory for the landlord. Or does the property market have to put up with it in order to save jobs? The losers tend to be the suppliers and small support businesses.

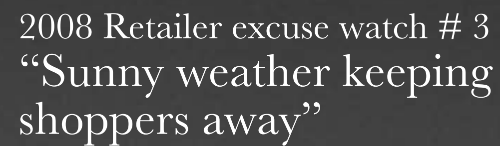
Certainly one might argue that, compared to the last recession, so far there are fewer groups of vacant units hitting the market. This is as a result of companies being saved even if some unprofitable units are abandoned. At least the majority of the portfolio keeps trading.

Either way, it changes the risk profile. Landlords would prefer to work with a retailer and seek a solution but they may now ask for more guarantees, sureties and insurance policies to underpin the income at the time of letting.

Retailers seeking such insurance are finding that the insurers have withdrawn from the market. The retailers can turn to their bank but they will charge a fee for a guarantee.

Should the property investment market rebase its assessment of risk and reward, with the threat of "pre-pack" administrations being in their opinion an "easy way" out for failed businesses?

The above won't help the pension funds, property companies, and developers but it will change their view on the risks attached to dealing with the retail sector. Short term solutions like this could have serious adverse effects on long term attitudes and investment. In a market where survival is the only consideration, long term considerations are rarely given even a short term thought.



IN TOWN RETAIL AGENCY

INTRODUCTION

Retailer failures have become commonplace in the last 12 months, with 37 mainstream retailers having failed. With 14 retailers have gone into administration since the start of November in the usually profitable Christmas trading period with MK One failing for a second time. This level and speed of failure has not been seen since the recession of the early 1970's.

By way of complete contrast a record Zone A rent of £820 per sq ft was set in London's Bond Street and some 10 million sq ft of new retail development also opened this year including Liverpool One; High Wycombe - Eden Centre; Cambridge – Grand Arcade; Leicester - Highcross; Bristol - Cabot Circus; and London – Westfield. A number of major extensions to existing centres were also completed.

The above demonstrates some of the extremes we are seeing. As with all markets one needs to look behind the headlines reported.

Many of the companies that have gone into administration have been saved. We have commented elsewhere on Pre-pack administrations. Unfortunate landlords have to attempt to re-let those underperforming units that have gone back to them, and may also have to pick up the empty rates liability. Although there has been much criticism of the Pre-pack system, the result is that we have not seen the level of vacant unit availability in the market that there would have been had the companies failed outright.

Despite the general difficulties in the retail sector the West End of London market has held up incredibly well, recently assisted by the devaluation of the pound against the euro so that London prices are finally within reach of many of our European neighbours. Anecdotal evidence does suggest that even the West End market started to slow towards the end of the year.

The opening of many major developments may well have been secured this year, however the question is at what cost to the promoters with major tenants seeking ever increasing incentives to commit? Despite Grosvenor's reported losses on Liverpool One of circa £250million, the good news is that all three of the major schemes that opened, including Cabot Circus, Bristol and Westfield, London, appear to be trading well despite the malaise of the general market. Perhaps new developments of this scale, style and quality really do encourage the consumer to shop and spend in difficult times.

THE RETAILERS AND TENANT MIX

Turning to the general market, as always there are winners and losers, with many previously picky landlords having to cuddle up to newly acquired chums.

Primark, who opened nine stores in 2008, have been increasingly dominant, reporting operating profits up 17% to £233 million. Other discounters such as Poundland, Home Bargains and B&M Bargains are also acquiring units in schemes or locations for which they might not previously have been considered suitable.

As the mid-market customer gravitates more towards the value end of the market, so landlords will have to follow, adjusting their tenant mix to maintain the retail offer, customer loyalty and footfall. Traditionally discounters operated at a lower rental tone than the mid-market, and while their increased turnovers should allow them to support higher rental levels, this is unlikely to be reflected in better terms for landlords.

The mid-market sector has also seen massive price deflation, as evidenced by Marks & Spencer having two days of sales well before Christmas with many other retailers offering discounts of 50%, and some of up to 90%. As a result, the differential between the market sectors has become blurred. The question is for how long are these discounts sustainable, particularly at the levels of rent that were agreed in better market conditions?

Tenant mix issues are also likely to be driven by a landlord's requirement to maintain income levels and meet banking covenants, particularly with the introduction of full empty rates in April 2008. The negative effect on a shopping centre's net income, due to the loss of rental income, void service charge budget, and the payment of empty rates by the landlord, will also place increasing pressure on both landlords and their agents to fill vacant units.

IN TOWN RETAIL AGENCY

RETURN TO CONTENTS

MARKET CONDITIONS

Because of current economic pressures, in many administrations the NewCo is seeking to renegotiate existing lease terms for those units that operated at marginal profitability. Where landlords have other options to relet, they can afford to take a hard line in these negotiations.

There is serious concern that more failures will follow that of Woolworths, Zavvi, USC, Adams and Whittards who all collapsed during the Christmas period. Depending on which commentary you read, there are over 300 retailers on the "danger list". The mainstream retail market is likely to be significantly less than this figure, although 11 retailers in this category failed in the first four months of 2008. We expect the failure rate to be higher in early 2009.

Judgement of covenant strength is difficult to make, particularly where landlord or developer incentives are involved. From a retailer's point of veiw there has probably never been a better time to take new shops and negotiate deals with landlords and developers.

> Some 10 million sq ft of new retail development also opened this year including Liverpool One;
> High Wycombe - Eden Centre;
> Cambridge – Grand Arcade;
> Leicester - Highcross;
> Bristol - Cabot Circus; and
> London – Westfield.

In order to secure the best property, however, premium payments may still be required. By way of example, Tesco paid a premium of £7 million to Woolworths just prior to their demise for an assignment of nine leasehold stores. This shows that even in this difficult market, property of true quality in a competitive environment can still attract positive value.

In contrast we query how many loss making units are currently held by retailers who have not yet placed them on the market as the disposal terms are likely to be worse than the loss suffered.

THE DEVELOPMENT PIPELINE

Since the start of the year many proposed developments have been shelved or delayed: Lendlease withdrawing from Stockport and Croydon; Liberty International and La Salle delaying Westgate – Oxford; Centros delaying Portsmouth; Hammerson putting back the start of Stevenstone, Sheffield; and no signs of Minerva bringing forward their ambitious 1 million sq ft retail proposals in Croydon as bid rumours continue. One of the few schemes reported to be starting on site is Standard Life and Shearer Property Group's 330,000 sq ft scheme in Newbury.

> ...Tesco paid a premium of £7 million to Woolworths just prior to their demise for an assignment of nine leasehold stores. This shows that even in this difficult market, property of true quality in a competitive environment can still attract positive value.

Modus announced its intention to sell out of its five shopping centre development joint venture with Ciref and its wholly owned positions on schemes in Lincoln and Swindon, due to financing issues.

The result of this reduced, or delayed development is likely to be a significant gap in the provision of new space for the next five to seven years, until developers are confident that the market will support viability with sufficient tenant demand at affordable rental levels.

Retailers still need to add new, efficient, well-configured space to their portfolios. In recent years many of the major anchor and pre-let retailers have been well funded by developers. How will retailers cope with no incentives from developers? Will they be left to directly fund the refitting of old inefficient space, or sit tight in poorly performing units?

Certainly those schemes where development agreements have been signed in the last five years are unlikely to reach viability in the short term. Additionally it will be difficult to raise finance in the current market. The rush for retail led mixed-use developments in town centres to justify increasing land values and meet planning policy has only exacerbated viability issues with the demise of the apartment market in many major cities. With these markets unlikely to recover to the same level, it is difficult to see how this area of value might be recovered in the short to medium term. The days when major town centre development schemes could be appraised off yields at 6.5%, limited 12 month incentive packages, full rents and15% profit margins are well behind us.

> Retailers still need to add new, efficient, well-configured space to their portfolios... Will they be left to directly fund the refitting of old inefficient space, or sit tight in poorly performing units?

In order to bring forward new development at an earlier rather than a later date, perhaps a number of parties, including Local Authorities, need to reassess their positions. Less than 10 years ago we were able to secure viability on town centre schemes off a yield of 7-8%. With build costs starting to fall once more, perhaps we will reach that position again, but land values must fall further to close the gap.

The profits of many of the UK's main anchor store retailers are under pressure, such as John Lewis, Marks & Spencer and Debenhams, and their requirements for capital have increased, so the development market may well need to turn to other anchor store solutions if it is to move forward within the next five years. As can be seen from our separate commentary on the foodstore market, this is one sector which is pushing to deliver new stores.

Perhaps we will see a return of the type of developments we saw in the 1970's, with foodstores replacing more traditional anchor stores.

> The recession should, however, allow well funded developers to work up planning and the detail of the scheme so they can be brought forward quickly once the market returns.

There is no doubt that many schemes currently planned will need to be redesigned, possibly with leisure becoming more prominent. Some of the more marginal schemes may be mothballed for some years to come.

The recession should, however, allow well funded developers to work up planning and the detail of the scheme so they can be brought forward quickly once the market returns.

FUTURE ISSUES

Going forward into 2009 the storm sails will need to be set and the hatches battened down whether you are a retailer, developer or landlord.

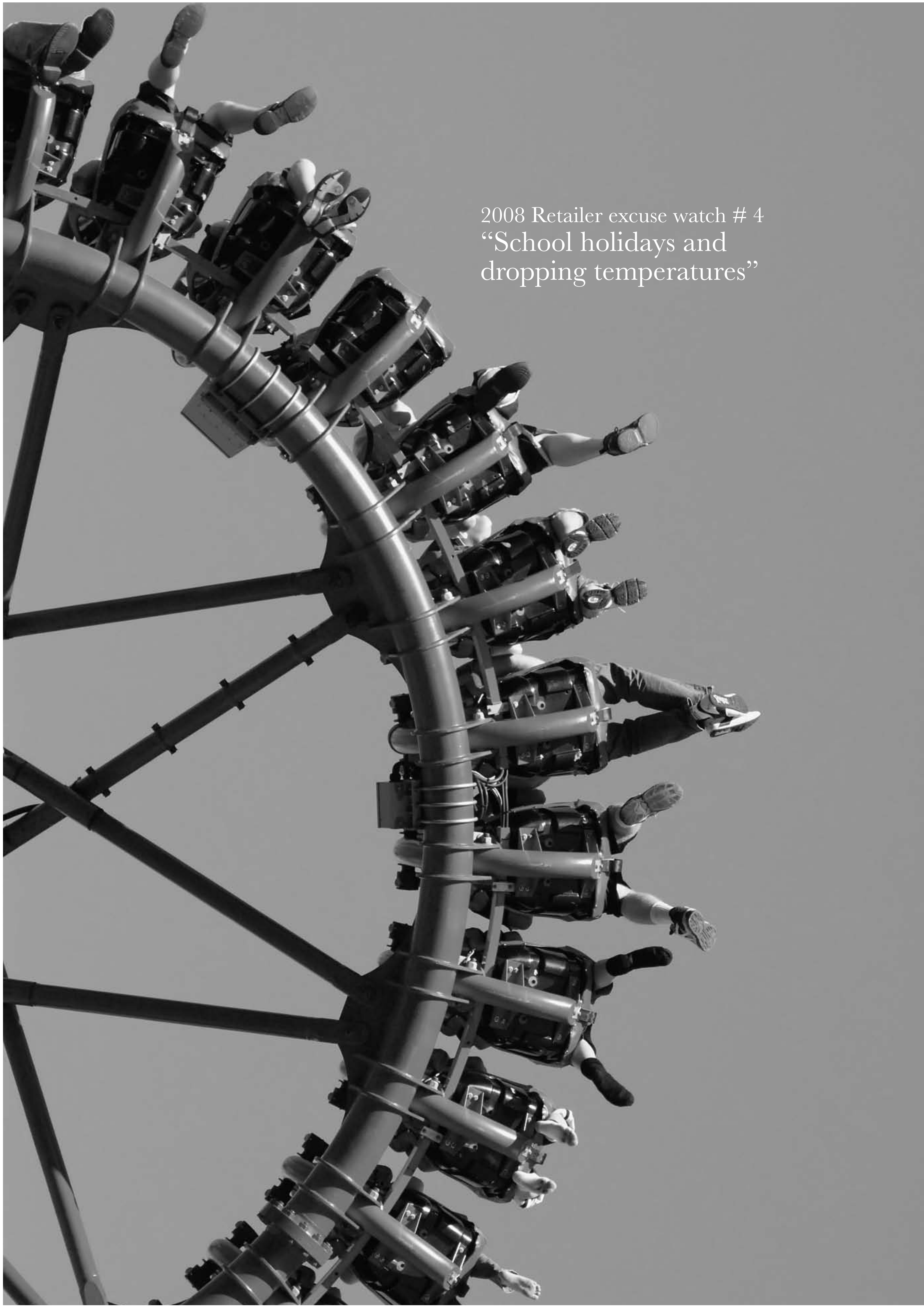
Landlords will need flexible letting and tenant mix strategies to secure income and reduce void costs, including shorter lease lengths and turnover-based rents. Asset management initiatives to drive rents will take a back seat until the market recovers.

> Less than 10 years ago we were able to secure viability on town centre schemes off a yield of 7-8%. With build costs starting to fall again, perhaps we will reach that position again, but land values must fall further to close the gap.

Developers will need to renegotiate to secure any chance of viability if the terms are already set. Those smaller schemes with single tenants, or foodstore anchors that can be prelet and still funded, may secure finance and be built out.

> Landlords will need flexible letting and tenant mix strategies to secure income and reduce void costs, including shorter lease lengths and turnover-based rents.

Tenants will continue to secure advantageous terms while there is an excess of new development stock. They will also need to keep a close watch on their potential privity of contract and AGA liabilities arising from the assignment of old leases



RETAIL WAREHOUSE AGENCY

ASSET MANAGEMENT

At the beginning of the year retailers were still being offered substantial premiums to surrender leases in order that landlords could relet the space at higher rents to show performance. Was that performance worth paying for with yields moving out so quickly? Has the tenant agreed to pay an affordable rent? Will deals of this nature still happen?

The threat of a new floor to rental values as vacant space is taken up will make it even harder to justify paying a tenant to surrender.

The concept of a "vacant" unit and a "void" unit will become more important to a landlord. A unit where the tenant has vacated, or where another tenant under an AGA, privity of contract or a surety is "on the lease", will mean a regular flow of income, even if unoccupied. The void unit, where there is no lease and no occupier and therefore no rent, will attract the landlord's efforts and resources.

Large premiums will be reserved to pay the right tenant occupying vacant space on a lease of over five years i.e. to fill the void.

> The concept of a "vacant" unit and a "void" unit will become more important to a landlord. A unit where the tenant has vacated, or where another tenant under privity of contract or a surety is given to the lease, will mean a regular flow of income, even if unoccupied.

THE DEAL TODAY OR "FILLING THE VOID"

Pre-letting for new development still requires the "old established" terms i.e. good covenant (including surety), 10 year FRI lease (15 years preferred) and open market rent, perhaps with potential for fixed increases. Such terms are needed to allow the funding arrangements to be agreed. The banks will be the determining factor.

For void units landlords will be prepared to be much more flexible.

Securing an occupier will be key. Lease length and rent will be negotiable as before but there will be more turnover-related rentals, tenant break clauses for leases of 10 years or more and increased demands from tenants for cash to pay their fitting out.

If providing cash is a problem for a landlord, then this will be dealt with by extended rent free periods.

What will happen in 2009 is that units will be let on retail parks at rents per sq ft that are below deals done in 2008.

Landlords will not accept surrenders unless there is a guaranteed back-to-back reletting and pay or receive only a nominal premium. Or they will accept a high reverse premium (partly because of the rates liability).

> If providing cash is a problem for a landlord, then this will be dealt with by extended rent free periods.

ADMINISTRATIONS

As an example, the following out of town fascias have been put into administration in 2008; Floors 2 Go, MFI, ILVA, Rosebys, Au Naturale, Sleep Depot, ScS, Bedworld, Texstyle World and Big W (Woolworths).

Other retailers have been in negotiations with their financiers and landlords to renegotiate terms with a view to avoiding administration.

We will not attempt to detail all these arrangements in this year's report but they include:

* paying rent monthly
* rental holiday for a period
* reducing the rent for a period
* reducing the rent for the rest of the lease

At the end of last year we said that a downturn in trade would cause problems in 2008 rather than fundamental structural problems and this has been borne out, particularly in the furniture and home furnishings sector.

The pace of change has been fast and particularly noticeable in the fourth quarter.

RETAIL WAREHOUSE AGENCY

RETURN TO CONTENTS

The term "Pre-pack administration" has become well known as retailers' concerns grow over their ability to trade through the recession. We would add here that such an arrangement is not an "easy option" and can only be successful if the administrator is convinced that this is the best route for the creditors.

Unfortunately a business, or part of it, is not always saved. About 100 of the 200 MFI stores were kept open so that a new business could flourish from such a reduced number of stores but after six weeks or so, despite everyone's best efforts, including most landlords, it failed. One of the best known names in retail warehousing has been lost.

RETAILERS WITH REQUIREMENTS

This is not an exhaustive list but retailers still expanding out of town include Steinhoff Groups' fascias, Laura Ashley, CSL, Dreams, Comet, Maplin, Dunelm, Mothercare, Kutchenhaus, The Range, Pets at Home (second stores in some towns), Countrywide Farmers, Halfords, Mothercare, Carpetright, Peacocks, Carphone Warehouse, Go Outdoors, Sports Direct and Smyths Toys.

Some others are taking advantage of empty properties, for example, B&M and Home Bargains and other "value" retailers.

The discount food retailers are acquisitive on retail parks and in particular Lidl and Aldi.

Others who have opened stores in 2008 and are taking a breather will look again when the time is right, for example Tesco home plus, Bhs Home and Marks & Spencer, just as Matalan and Decathlon are acquiring now that rents are more affordable. Asda Living opened a handful of stores at the end of 2008, including a trial 15,000 sq ft unit, and HomeSense are looking at another tranche of stores.

The above comments do not refer to the likes of Next, Boots, New Look and Clarks who have particular requirements on the open A1 parks. Boots are trialling a drive-thru concept.

A new market is emerging for temporary occupiers. The occupier can negotiate cheap flexible terms and the landlords have the rates paid.

Others who have opened stores in 2008 and are taking a breather will look again when the time is right, for example, Tesco home plus and Marks & Spencer, just as Matalan and Decathlon are acquiring now that rents are more affordable. Asda Living opened a handful of stores at the end of 2008 and HomeSense are looking at another tranche of stores.

DIY SECTOR

While we are not proposing a sectorial analysis of the occupiers, there is no doubt that the slow down in residential sales is having a disproportionate effect on the DIY sector.

B&Q opened a two storey unit in New Malden in June but still have vacant space they want to dispose of, and parent company Kingfisher wrote to landlords in December saying that B&Q would like to negotiate monthly rentals in the future on existing leases.

Homebase started the year by having their purchase of Focus stores cleared by the Office of Fair Trading, but wrote down part of their book value in September as trading levels reduced during the year.

Travis Perkins bought Tile Giant at the end of 2007 and looked at more stores for Wickes earlier in the year, but this is largely on hold until they can agree to pay "affordable" rents in the current market.

Focus have downsized stores, reduced costs and bought back the Payless brand, but are seeking monthly rental payments for two years as they too battle the recession and try to maintain a viable business plan.

HEADLINES IN 2008

QUARTER 1	QUARTER 2	QUARTER 3	QUARTER 4
* ACTIVITY IN THE MARKET IS RELATIVELY BUOYANT, SOME DEALS ARE STILL HAPPENING DESPITE POOR CHRISTMAS TRADING " Wickes announces expansion plans to double store portfolio." "Homebase acquires 27 Focus stores."	* FIRST DEMAND FOR MONTHLY RENTS SHOW SIGNS OF MARKET DOWNTURN * RESIDENTIAL MARKET SOFTENS " JJB Sports closes 72 stores." "Au Naturale goes into Administration."	* GROWING NUMBER OF RETAILER CASUALTIES UNDERPINS MARKET SENTIMENT. * FIRST BIRTHDAY OF CREDIT CRUNCH " ILVA and Rosebys go into Administration." "Discount/bargain retailers ramp up acquisition programmes."	* BAILIFFS ON STANDBY FOR 25TH DECEMBER 2008, THE OUTLOOK FOR Q1 2009 IS BLEAK " MFI closes down after MBO fails on same day as Woolworths." "Filling voids becomes the priority, rather than maintaining rental tone."

NEW RETAILERS/FASCIAS/CONCEPTS

* Danish retailer Jysk opened their first store in Spring at a similar time to five new stores by HomeSense (part of TK Maxx).
* Pets at Home started rebranding and looking for smaller stores of 5,000 sq ft in some areas.
* Comet maintained their downsizing programme and mezzanine trading concept.
* PC World rebranded some stores but Currys have created a totally new look at Swindon and Wednesbury despite tough trading conditions.
* Kutchenhaus tried out Kutchenlab as a concession in MFI but opened a new full offer in York and plan more in 2009.
* Best Buy's search continues for their first opening in 2009.

CORPORATE CHANGES

Most of the changes occurred following administration, or as part of a Pre-pack, for example SEP purchasing ScS, the former owners of Floors 2 Go buying back part of the business under the Floor my Home banner, Date and Time acquiring some Au Naturale stores and Edinburgh Woollen Mill bought 77 Roseby stores to be rebranded as Ponden Mill.

Others did not happen, for example Carpetright's buyback at the end of 2007 and Pets at Home's rumoured flotation.

The year's biggest deal was between Carphone Warehouse and Best Buy. Despite having been done in May there have been no new store announcements yet for Best Buy despite rumours to the contrary. Another retailer biding their time?

JJB has been in the news since closing stores in April but, at the time of going to press, the business retains the health & fitness clubs but its disposal of stores and share deal with Sports Direct is under scrutiny.

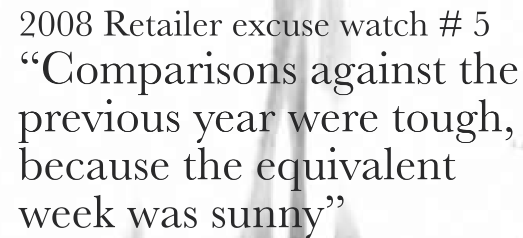
Corporate changes often mean assignments and sub-lettings are done. However, if the new retailer fails then the contract reverts to the original retailer e.g. Galiform guaranteed 26 of the MFI leases and are now liable for the rent. All retailers should check to see if they may have a similar problem.

PODS

Continued work done to release areas of car parking to build units for retailers and restauranteurs with requirements between 1,500-3,500 sq ft, as well as coffee and sandwich shops.

The drive-thru operators are also considering "drive-to" restaurants as suitable sites are scarce.

The car service, MOT and valet business IN'n'OUT has opened two more stores and are breaking down barriers with landlords and developers with their new concept.



RETAIL INVESTMENT

2008 began with renewed hope that the investment market would improve. Market activity had been seen in November and December 2007, reflecting the fact that yields had moved out and there was a perceived opportunity to pick up "bargains".

Examples of retail warehouse transactions at this time include: Apsley Mills Retail Park, Hemel Hempstead at £29.32m, reflecting 6.25% net initial yield; Tower Retail Park, Crayford at 5% net initial yield; Willow Beck Road, Northallerton at £7m reflecting 5.8% net initial yield and Great Western Retail Park, Glasgow at £59.5m reflecting 5.75% net initial yield.

It was soon apparent that this had been a false dawn. A global slowdown was underway, with growth predictions being severely reduced across the major economies for the rest of 2008.

Investor confidence evaporated rapidly, starkly illustrated by a 50% fall in investment turnover for the first quarter of 2008. This lack of investor confidence continued throughout the summer. The volume of investment transactions stagnated as uncertainty mounted and the economy continued to decline.

Market activity had been seen in November and December 2007, reflecting the fact that yields had moved out and there was a perceived opportunity to pick up "bargains".

The world's financial stability was shaken by the collapse of Lehman Brothers in September. This instigated panic on the global stock markets; LIBOR doubled overnight, its largest jump in seven years, while property shares tumbled. Bank of America bought Merrill Lynch, the US Authorities moved to take over mortgage giants Fannie Mae and Freddie Mac to prevent their collapse and they effectively nationalised AIG.

The financial markets became increasingly concerned about the exposure of the UK Banks, which forced the UK Government to provide a £50 billion bail-out package to recapitalise them, in addition to approving the Lloyds TSB takeover of HBOS and the nationalisation of Bradford & Bingley's mortgage book.

The effect on retail property investment has been substantial, with capital values having fallen up to 40% during 2008 from their peak 2007 levels. Moreover, all the major economic forecasts indicate that the global recession will bite harder in 2009 forcing property values even lower. Combined with the banks' continuing reluctance to ease their lending moratorium on property for the foreseeable future, this could potentially result in fewer transactions taking place during the year ahead.

Of the 20 shopping centre transactions in 2008, some 70% completed in the first half of the year. These included Coppergate, York; Marketgate, Lancaster; Kyle Centre, Ayr; Vicar Lane, Chesterfield and Peacocks, Woking. Many centres, however, have failed to sell, despite interest from investors, as the prices sought have not been realised. Because of reversionary elements in income streams it is difficult to be precise as to the yield profiles, but a good example is Eagles Meadow at Wrexham, developed by Wilson Bowden, where rumour suggests a true yield was achieved between 8 and 9% for the purchase.

More activity has been seen for much lower lot sizes of up to £5 million, where there are still a number of cash-rich purchasers who do not have to rely on borrowing.

In the retail warehouse market examples of transactions in the latter stage of the year included: Meadowbank Shopping Park, Edinburgh at £37.9m reflecting 7.25% net initial yield; Maskew Retail Park, Peterborough at £30m reflecting 7.65% net initial yield. Exe Bridges Retail Park, Exeter is understood to be under offer at 7.35% net initial yield. It is clear that there has been a sea change in yields from the beginning of the year.

More activity has been seen for much lower lot sizes of up to £5 million, where there are still a number of cash-rich purchasers who do not have to rely on borrowing.

However, all is not doom and gloom. Those with cash or access to money, will be able to take advantage of the market conditions that are likely to prevail for the foreseeable future. In this context, ironically, the

prospect of hard-pressed lenders calling in property loans to boost their capital assets is likely to result in more forced sales, and increase the availability of attractive stock coming to the market, which investors have to date been reluctant to sell.

As a result of these radical changes in market conditions, investors are now assessing capital value based on net initial yield as opposed to equivalent yield. This approach should be viewed as pragmatic rather than short-term.

The majority of investments that have come to the market in the past 12 months have been secondary. Investors have been trying to dispose of these assets to reduce gearing while retaining their prime assets, the conundrum being that prime assets are more likely to sell in the current market.

There is a disparity between the quoting prices for prime assets and their perceived value. Even these investments, therefore, are not selling and remain on the market. We are experiencing some confusion in the marketplace over the use of the words price, value and worth. Investors appear to have failed to recognise that price and value are market driven whereas worth is subjective based on a specific investor's perception.

We are experiencing some confusion in the marketplace over the use of the words price, value and worth. Investors appear to have failed to recognise that price and value are market driven whereas worth is subjective based on a specific investor's perception.

One type of investment that has become increasingly attractive to investors is well-secured long-term income subject to guaranteed rental increases, for example index linked. The issue here is that there is the potential for the properties to become over-rented in a falling market.

A yield gap has re-emerged between primary and secondary property, which had substantially narrowed in the bull run of recent years.

One type of investment that has become increasingly attractive to investors is well-secured long-term income subject to guaranteed rental increases, for example index linked.

The owners of retail property investments are becoming increasingly concerned about being able to maintain rental income, with a number of tenants, including MFI and Woolworths, having failed and with many others having a question mark over their ability to survive in the long term. This is perhaps most profound within the out of town retail market, where just 35 tenants account for 85% of all retail warehouse space occupied and where the failure of a single occupier will have serious implications for landlords in this sector.

With declining retail sales and the expectation of further business failures in 2009 leading to voids, we expect to see rents fall, in general terms, which in turn will further adversely affect capital values.

2009 may provide a once-in-a-lifetime opportunity to buy prime retail investment property.

As 2008 draws to an end, we pause to take breath and to contemplate what 2009 might bring. The results of the Christmas trading period and January sales are crucial and the first few months are likely to shape the year to come.

The price correction has resulted in what many perceive to be attractive buying opportunities, but given the uncertainty of the next few months there seems little appetite to buy now on the basis that prices may well be lower in six months time.

2009 may provide a once-in-a-lifetime opportunity to buy prime retail investment property.

Prime shopping centres and retail parks that are rarely available will almost certainly come to the investment market this year. At 7.0% or even higher, retail property yields now compare favourably with returns from more traditional investments such as under 4%

RETURN TO CONTENTS

SHOP PROPERTY YIELDS

TYPES OF SHOP PROPERTY	DECEMBER 2006 YIELDS	DECEMBER 2007 YIELDS	APRIL 2008 YIELDS	DECEMBER 2008 YIELDS
PRIME HIGH STREET	3.75% - 4.25%	4.75% - 5.50%	5.00% - 5.75%	6.00% - 6.50%
SECONDARY HIGH STREET	5.00% - 5.75%	6.00% - 7.00%	6.50% - 9.00%	8.00% PLUS
PRIME SHOPPING CENTRES	4.00% - 5.00%	5.00% - 6.00%	5.50% - 6.50%	6.50% - 7.50%
SECONDARY SHOPPING CENTRES	5.00% - 6.00%	6.00% - 7.50%	6.25% - 8.00%	9.00% PLUS

RETAIL WAREHOUSE YIELDS

TYPES OF OUT OF TOWN RETAIL	DECEMBER 2006 YIELDS	DECEMBER 2007 YIELDS	APRIL 2008 YIELDS	DECEMBER 2008 YIELDS
FASHION PARKS	4.25% - 4.75%	4.75% - 5.00%	5.00% - 5.25%	6.75% - 7.00%
OPEN A1 RETAIL PARKS	4.25% - 5.00%	5.25% - 5.50%	5.25% - 5.75%	7.00% - 7.50%
BULKY GOODS RETAIL PARKS	5.00% - 5.75%	5.75% - 6.25%	5.75% - 6.75%	8.00% - 9.00%
SOLUS STORES	4.75% - 5.25%	6.00% PLUS	6.00% PLUS	8.50% PLUS

on 10-year Gilts, the 4.6% average dividend on the FTSE 100, and the even lower interest rates on cash.

Investors want to enter the market while prices are still falling. Investors know that they may need to initially ride out a small hit to lock into performance through the upswing that will follow. The issue is how long an investor will have to "ride out" the bottom of the market before any eventual recovery? Timing is, as always, everything.

The results of the Christmas trading period and January sales are crucial and the first few months are likely to shape the year to come.

There have been numerous well reported vulture funds set up over the past 12-18 months, none of which have to date been particularly active, but the signs are there that they are now looking very closely at what is available with, at the time of writing, one or two major investment transactions being negotiated and agreed. For some, the right time to buy has now perhaps arrived.

At 7.0% or even higher, retail property yields now compare favourably with returns from more traditional investments...

The collapse of sterling has made UK property investment extremely attractive to overseas investors, but this will be subject to a currency which can demonstrate a robustness despite the underlying difficulties in the UK economy.

In conclusion, we feel that 2009 will present well placed investors with opportunities to secure retail property investments at sensible prices, reflecting realistic worth, for the first time in many years.

2008 Retailer excuse watch # 6
"The weather was cold"

FOOD SUPERSTORES & SUPERMARKETS

As for last year, the food supermarket sector is one of the few bright spots shining through in an otherwise depressing market. Of course, food retailers have the advantage that consumers have to eat but discounting and non-food product ranges are adding to the operator's armoury. Even a cursory glance at the business of food sales demonstrates the underlying strength of the business models employed, reflecting some of the most efficient and tightest managements in UK Plc. The overall UK Retail Grocery Market was valued at £133.3 billion in 2007 showing a 4.0% increase over 2006.

The Institute of Grocery Distribution has estimated that the UK Retail Grocery Market will continue to grow at an average rate of 2.9% over the next five years when it will be worth £138.2 billion by 2010 at current prices. There are not many retail sectors that can promote that type of growth in today's economy. That is not to say the sector is immune from failure - Fresh Xpress, who emerged from Kwik Save's demise in 2007, themselves went into administration. Some of their discount competitors took up the slack, but a number of old stores remain vacant, showing how far food supermarkets have moved on in terms of their location and size.

The race for space is being maintained, but new stores, particularly at the bigger end of the spectrum remain difficult to secure because of the tight planning regime. Over the past five years there has also been a lack of sites as residential land values often exceeded residual land values for food. With some of these housing development proposals now looking unlikely, perhaps some will find their way back to the food operators.

The majority of expansion by the big four of Tesco, Asda, Sainsbury's and Morrisons continues to come from extending existing stores, with extensions often larger than they have been in the past. Innovative designs are being employed, including two level trading and decked or under-croft car parking so as to increase market share and promote the operators expansion of product lines, particularly in non-food areas. The joint ventures between Sainsbury's, Tesco, Land Securities and British Land reflect this reinvestment and redevelopment/extension philosophy.

Where new space is being developed at an unprecedented pace is in the discount food sector. As consumers look for lower prices, so this sector has proved to be a winner.

The food market still suffers from lack of transparency in property terms, with very few open market letting transactions and limited investment sales. It is suggested that the Competition Commission changes, coupled with amendments to PPS6, will increase opportunities for developers and new entrants, both in terms of retailers and investors. However, we do not see this changing many of the fundamentals. The risks are usually too great for a developer to simply build out a new store without a tenant in place, and the major superstore operators have a good grasp of what they want and where they can achieve growth.

Consequently, it is still difficult to identify true market rents. IPD suggests positive growth over the past 12 months but this probably reflects inertia in the statistics as there does not appear to have been much change on the ground since our report last year. £30 per sq ft is appropriate for London locations and the very best prime superstores may now achieve more than this. Over £25 per sq ft is achievable for the rest of the south east for the best pitches and £20 per sq ft plus for prime stores in major centres elsewhere.

In the discount sector, rents have grown from £8 to £10 per sq ft just three years ago to between £12 and £16 per sq ft (or more) today. These operators are taking more occupational leases, not just acquiring freeholds as in the past, but they are often gearing rent reviews to a fixed percentage uplift. The danger here is that ultimately rents paid may be out of kilter with true market rental levels.

Yields have softened to reflect general market conditions but the defensive qualities of this sector shine through with yield falls of less than 50% of that experienced in other retail property markets. With their bond type qualities, yields in the region of 5% to 6% are still achievable. Against interest rates currently at 2% (at time of writing) and five and ten year swap rates between 3.26% and 3.72%, the yield on food superstores remain competitive and attractive.

For the anoraks, the strength of the sector is underlined in the statistics. Groceries account for some 12.8% of total household spending, third only after housing and transport. Food and grocery expenditure is almost 50% of total retail spend and 20% spent on food and groceries is transacted in convenience stores. Given that 75% of the market share is controlled by just four supermarket chains, Tesco, Sainsbury's, ASDA and Morrisons, it demonstrates how powerful these players are in our retail economy.

FOOD SUPERSTORES & SUPERMARKETS

RETURN TO CONTENTS

The breakdown of market share in the UK supermarket chains is as follows:

Retailer	Share %
TESCO	31.4
ASDA/WAL-MART	17.1
SAINSBURY'S	15.7
MORRISONS	11.2
SOMERFIELD	3.9
WAITROSE	3.8
ALDI	3.0
LIDL	2.3
ICELAND	1.7
NETTO	0.7

Source: TNS Data, market share summary, 12 weeks to October 5, 2008
Figures exclude Co-op and Farm Foods

The discounters have showed the fastest growth and now account for a 5.3% share in grocery spending, which is a record, but is still low in comparison with discount sales in France (11%) and Germany (38%). No wonder the majors are attempting to promote their own discount ranges.

One other aspect of the discounters is that they have been able to expand to the locations which previously the top four have avoided, often with support from Planning Authorities, who see this format of food retailing as one which is promoting a good quality local store facility.

Internet sales in the food sector have been slow and are only expected to rise to 3% of total food sales by 2012. As the youth of today becomes the purchaser of tomorrow with their IT abilities, this area is likely to grow at least in line with expectations and demonstrates that the impact on physical sales space is likely to remain limited. Consequently, the property market will continue to be a focus for food sales.

The Ocado home delivery operation which serves Waitrose continues to struggle, demonstrating how difficult it is to make money out of food delivery. By contrast, Tesco seem to be ploughing ahead with their delivery format which is the largest and regarded as the most effective in the sector, with a 30% growth in online sales since 2007. It still needs the property base within the catchment it serves.

The impact of the Competition Commission's recommendations remain mixed. Surprisingly, the Co-op's £1.6billion purchase of the 800 strong Somerfield chain has resulted in 126 properties having to be sold under the Competition rules before the purchase can be completed in early 2009. Two portfolios are going to Tesco and Waitrose, ASDA is believed to be pursuing a few and although the discounters are keen they cannot make bids until the big four have completed their deals. The bottom line is that the Co-op has only agreed the sale of 66 stores and has less than a year to complete the other 60 sales required. This perhaps makes a mockery of what has been happening in the banking sector, where mergers and acquisitions have not even passed by the door of the Competition Commission.

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

TESCO

In the UK they have over 2,000 stores and overseas they now trade from over 1,600 stores, from hypermarkets to express convenience stores, and are a truly global business.

Their focus for superstores is edge of town brown field sites, but much of the new space is for the small express convenience stores which can be located closer to their customer base.

Tesco have put considerable effort into developing green stores but this has not stopped them losing market share as their sheer size makes it difficult to expand at the same rate as in the past.

SAINSBURY'S

Showed the strongest performance figures in the sector last year and is well placed to expand further. They opened 14 new supermarkets, developed 21 extensions and are set to add 20 new stores in 2009. They currently operate 509 supermarkets and 276 convenience stores of 15,000 sq ft or less under the "Local" banner to give them a total portfolio of 785 stores. Total sales in their interim report were up 7.6% with like-for-like sales growth of 3.9%.

In April 2008, they launched their non-food TU home and clothing ranges as well as health and beauty to capture greater expenditure from their traditional food customer. Past attempts to sell non-food items by Sainsbury's have not always been as successful as is now hoped.

New store expansion is scheduled to grow at three times previous growth with 50 new stores scheduled for 2009/10 and 100 stores in 2010/11 across both the main supermarket and convenience model formats. 200 existing sites have been identified as having extension capability, which according to their analysis provides a 10 year pipeline in addition to Sainsbury's joint venture activities and new site acquisitions. Still plenty of growth to come from working the existing portfolio.

ASDA

Britain's number two grocer continues to grow its market share. In particular they have reported that 900,000 new customers are walking through their door each month, particularly from the ABC1 demographic groupings as well heeled consumers look for better bargains.

Their push is for increasing sales, however, in property terms their acquisition programme appears to be towards the lower end of the spectrum.

MORRISONS

As we reported last year they have bounced back after digesting the Safeway chain and are proving how strong they are as a trader. They opened eight new stores in the year, including one of the smallest for many years in Erskine at only 25,000 sq ft.

The strongest sales growth has been achieved in Scotland and the south of England, given that these are relatively new areas for this group, but it does demonstrate where this operator's ongoing growth will focus in respect of new stores over the course of the next few years.

WAITROSE

They have perhaps seen the change in the economy affect them more than their competitors as their aspirational customers seek more competitive pricing on food products. Given that Waitrose sales have grown by 46% in four years, it is not perhaps surprising that their expansion is beginning to show signs of peaking. However, Waitrose opened three new market town shops and are trying a new convenience shop format to see if that has potential for further roll out. A long standing extension and refurbishment of their Finchley Road London store demonstrates how popular this retailer is in the right location.

MARKS & SPENCER SIMPLY FOOD

This retailer has pulled the plug on effective expansion in the current climate and although there will still be new stores, the demand from this operator is limited. As in all markets, change does come quickly and we expect this quality retailer to review their expansion plans in the future when it is prudent to do so.

THE DISCOUNTERS

Discount retail is where the change in fortunes has been most noticeable and has been led by Farm Foods, who, with some 300 shops in the UK specialising in frozen food, saw sales rocket by 20.8% making it the fastest growing grocer.

A close second has been Aldi, whose sales jumped dramatically to give it 3% of total market share. A typical household spends £45 a month in Aldi compared to £126 at Tesco, so the differential is still significant. However, with the intention to open 50 new stores a year, this is a strong retailer with strong credentials and a growing customer base.

Lidl have opened a staggering 49 stores this year, and plan to open 50 more next year. The standard footprint of store averages approximately 10,000 sq ft net sales, but to open up new locations Lidl is to develop a smaller footprint of 5,000 sq ft. This is an "express" format and a handful are already open in London with more to come inside the M25 only.

Danish owned Netto is the only disappointment, with it's former MD Richard Lancaster resigning in early November and 12 staff made redundant in its property and distribution department as it scales back its expansion activities. It was expected to open 31 stores by the end of 2009 but this will now be 23, and plans for a new distribution centre in Manchester have been shelved reflecting modest growth in the business and even some declines. However, sight must not be lost of its current portfolio of 191 supermarkets in the UK and store numbers are set to grow year on year by at least 10% per annum. Nevertheless, it demonstrates that simply discounting goods for sale is not a formula for success on its own.

CONCLUSION

The range of food sales formats is widening, with considerable diversity of location size and retail sales. Food store operators are once again the anchors to high street developments as well as new local facilities, with operators moving closer to their customers.

Expansion by the majors in their large superstore formats is being maintained through extensions with a greater emphasis on joint ventures. Although food store operators continue to be freehold purchasers both for large and discount stores, the number of properties being taken on lease is gaining significantly, although open market rent reviews are playing second fiddle to fixed uplifts.

2008 Retailer excuse watch # 7
“Unseasonably cold weather affected sales in many branches”

RETURN TO CONTENTS

A MARKET AT WAR

In our 2007 report, we suggested that the balance of power was moving from landlord to tenant. 12 months later and the scales have, in many areas, swung in the tenants' favour as far as rent review and lease renewal issues are concerned.

We foresee a lengthy period of conflict between landlords and tenants, with both sides taking up entrenched positions, although with the ammunition stacked more favourably in the tenants' favour.

Over at Dispute Resolution House, the Arbitrators and Experts are hard at work trying to broker a truce, knowing that, as with all peace deals, there will be at least one party unhappy with the settlement and ready to rearm for the future in order to right the injustice of the current settlement.

An exaggerated analogy? Maybe, but there can be little doubt that we are about to enter an era of tenant resistance to rental increases both out of town and on the high street in a way not seen since the early 1990's.

There is little consistency across the board in the various retail markets, particularly out of town.

OUT OF TOWN RETAIL

In 2008 the out of town market saw an intensification of the conflict with tenants using all the arguments at their disposal, whether well founded or not, including:-

LEASE TERM

Apart possibly from an assumed 10 year term, any other length of term, whether too short or too long, is viewed as a reason for a discount on rental, yet there are many players who take longer terms or conversely want breaks after three or five years. There is little consistency across the board in the various retail markets, particularly out of town.

SIZE

Similarly, whatever the size of a unit subject to review, it will inevitably be the wrong one in the tenants' eyes to the extent that anything over 7,500 sq ft will be seen as a unit that is subject to little tenant demand and therefore warranting a lower rent.

PLANNING

Tenants will argue that DIY- only planning consents will warrant a discount given the weakness of that sector and the operators' changing requirements. Conversely, there is a reluctance to concede overage on rental for a unit with a full open A1 consent, unless the unit is on a park which has potential to be fashion orientated. The mezzanine issue rumbles on and there will be differentials between similar units which do and do not have mezzanine consents, or where low eaves height prevents installation of mezzanines.

CONFIGURATIONS/SUBLETTINGS

With increased pressure on occupational costs, the ability of the tenant to dispose of properties in the future becomes more of an issue. To this end the configuration of units is paramount, as is the ability within the lease, and possibly also the planning consent, to sublet in part or parts. However, on some units these expectations are unrealistic and evidence is not always as supportive as some would expect.

On a general note, the trend over recent years for fixed increases at review in order to hopefully limit rental increases may turn out to be a poisoned chalice. If rental growth slows markedly or goes into reverse, then the formula based rent may be higher than market rent.

- the configuration of units is paramount, as is the ability within the lease, and possibly also the planning consent, to sublet in part or parts.

IN TOWN RETAIL

Several of the issues in dispute are shared with the out of town market, particularly length of term and unit size. Others are more specific to the in town market.

LEASE TERMS

Assumed terms over 10 years continue to warrant discounts, normally 5%, and this trend is now creeping into units in prime locations. At lease renewal it is rare for landlords to be able to agree anything more than a 10 year lease with the tenant break at five years, or simply a straight five year lease. Of course tenants are usually keen to retain their security of tenure provisions under the 1954 Landlord & Tenant Act.

SUBLETTING

Inability to sublet shops in their entirety is seen as a disadvantage and where this exists, there must also be no restriction against subletting at less than passing rent in order to avoid tenants' arguments for discounts.

Double units with their accompanying high rental liability continue to prove difficult to let in the open market, a fact which is now reflected in substantial discounts at rent review.

SERVICE CHARGE

Escalations in service charge costs continue to impact on reviews, particularly where comparable evidence may emanate from lettings subject to service charge caps. Why have so many tenants signed up to arrangements where the landlord's surveyors decision is final without any arbitration provision?

DOUBLE UNITS

Double units with their accompanying high rental liability continue to prove difficult to let in the open market, a fact which is now reflected in substantial discounts at rent review.

OVERVIEW

2009 will see an increasing number of reviews referred to third party dispute resolution, whether by Independent Expert or Arbitrator. The rental growth throughout the period 2004-2007 will persuade landlords that an increase in rental over the five year cycle can still be justified, in the hope that rental increases can then help to stabilise their capital valuations, which have been hit by the recent major yield shifts.

Conversely, notwithstanding the existence of any rental evidence to substantiate rental increases, the tenants will be taking a robust "nil increase" approach across the board, in many cases without foundation. In the case of pre-September 2008 review dates, we foresee that the tenants' thinking will remain coloured by post-review circumstances, making resolution by agreement increasingly unlikely.

The rental growth throughout the period 2004-2007 will persuade landlords that an increase in rental over the five year cycle can still be justified, in the hope that rental increases can help to stabilise their capital valuations which have been hit by the recent major yield shifts.

Against this background of increased dispute resolution activity, the introduction from 1 January 2009 of the two new RICS Practice Statement & Guidance Notes for Surveyors acting as Expert Witnesses and as Advocates is timely, placing increased pressure on practitioners from both sides of the Dispute for honesty and accuracy and appropriate use of advocacy if the practitioner chooses to go down that route. We foresee an increased use of advocacy by Chartered Surveyors although the jury is still out as to whether this is good for the profession, but at least it will be more transparent and better understood.

We foresee an increased use of advocacy by Chartered Surveyors although the jury is still out as to whether this is good for the profession, but at least it will be more transparent and better understood.

2008 Retailer excuse watch # 8
"The wrong range of products in badly laid-out stores"

TOWN PLANNING

THE DCLG'S "STREAMLINING"

* PPS 12
* PPS 6
* Infrastructure Planning Commission
* Community Infrastructure Levy
* Eco-towns

2008 was yet another year of frustration and uncertainty in the world of town planning. The Government continued to review its policies and seek to "streamline" the system, Local Authorities struggled to progress their development plans and the private sector often found itself bearing the costs of some chronic inefficiency. Although the Government continues to promise a faster and more efficient planning system, the fact remains that the process has become administratively complex, riddled with uncertainty and prone to delay - particularly for proposals involving major development. This was recognised by the Killian-Pretty Review issued in November, which now makes 17 detailed recommendations to make the existing application process more efficient.

Earlier in the year the Government had itself recognised that the development plan system had become bogged down in its own bureaucracy. It issued a revised Planning Policy Statement on Local Development Frameworks (PPS12) and amended regulations governing the preparations of such Frameworks (LDFs) in an effort to reduce the administrative complexity that has bedevilled the operation of the system since its introduction in 2004.

PPS12 places a greater emphasis on "deliverability" and places an onus on planning authorities to demonstrate that any sites being promoted for development are actually viable. This injection of realism is welcome, and should prevent situations where development on the edge of, or on out of centre, sites is frustrated by a local authority seeking to bring forward an unviable site in a town centre (see our Property Briefing Paper No. 28).

In July the Government issued the long-awaited proposed changes to PPS6, Planning for Town Centres, the most significant of which was the removal of the test of 'need' from the procedures for assessing planning applications. The Government now concede that this was always a blunt instrument which had the unintended consequence of restricting competition and protecting existing retail sites regardless of their location. Less positive are the proposed additional tests of 'impact' which are ill-defined and only add complexity and further administration (see our Property Briefing Paper No. 27).

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Curiously, neither PPS12 nor the proposed changes to PPS6 made reference to the findings of the Competition Commission, which suggests a lack of "joined up thinking" at the Department for Communities and Local Government (DCLG) (see our Property Briefing Paper No. 26).

Ironically, perhaps the clearest acknowledgement of the crisis in the planning system came from the Planning Act 2008 which received Royal Assent in November. This introduced the Infrastructure Planning Commission (IPC) to take decisions of national importance out of the hands of elected local authorities. The Government has clearly recognised, in the wake of the Heathrow T5 fiasco, that the current system is simply incapable of taking the big "political" decisions which have to be made on airports, power stations, ports and railways. Few would disagree that there needs to be a more coherent approach towards the planning and delivery of major infrastructure projects. However, the IPC does not absolve the Government from its responsibility to articulate a clear policy on the provision of future infrastructure of potential national importance – something successive administrations have been singularly unwilling to do on so many matters in recent times.

Cynics might also suggest that the IPC is not only an attempt on the part of Government to 'depoliticise' decisions on major infrastructure, but also a means of circumventing the planning system it has itself created. This begs the question: if it's not good enough for the Government, why should the rest of us have to put up with it?

TOWN PLANNING

RETURN TO
CONTENTS

Something else we will soon have to put up with is the Community Infrastructure Levy (CIL) – essentially a development land tax – introduced with the Planning Bill. The Bill merely contains the framework, with regulations containing the all important detail to be published in Spring 2009. CIL is intended to provide an additional source of funding for meeting infrastructure needs arising from new development, where that development is contemplated by the Development Plan. However, as we have seen, it will be some time before LDFs have progressed to the point where they can contemplate any development whatsoever, and in any case CIL will only be chargeable where the LDF includes a charging schedule as a Development Plan Document (DPD). The first CIL payment to be made is therefore many years away, but the uncertainty it will create in an already bleak market is likely to be fatal. Significantly, the link between CIL and increases in land value arising from planning permissions was withdrawn at the last minute, but nevertheless we retain our long-standing concerns regarding CIL's impact on project viability (see our Property Briefing Paper No. 29).

In November the Killian Pretty Review was issued. This provided a thorough and objective review of the planning application process and made 17 detailed recommendations on how the system could be made more efficient for all its users. The question now is whether, in the light of current economic pressures and the need to stimulate development, the Government will in the coming year act positively on the recommendations to reduce the unnecessary bureaucracy and delays that now bedevil the system, or will it allow the Killian Pretty Review, like other similar initiatives before it, to be lost in the "long grass" of the DCLG.

RECESSION AND THE POLICY RESPONSE

* Town centres still first
* Protection for large vacant units

Despite all the above, the Government was not the greatest threat to development in 2008. The UK's slide into recession at the end of the year has already taken its toll and has the potential to be more damaging in 2009.

Unfortunately, we believe that calls for Government at all levels to adopt a more relaxed attitude in its "town centres first" approach, in the hope of stimulating development, is likely to fall upon deaf ears. Owners of out of town retail parks pleading poverty as yet another retailer hands back their keys are unlikely to find local planning authorities sympathetic to their plight. Indeed, as vacancy rates in town centres escalate, the likely policy response among most planning authorities will be to "circle the wagons" around town centres, protecting them to an even greater degree from outside competition.

As well as growing vacancies in secondary and tertiary locations, we might also begin to see an increasing number of voids (including some substantial units) appearing in primary locations in town centres. Even under existing policy, the presence of a large vacant unit on a prime site would be justification for local authorities to refuse most out of centre schemes. Faced with growing vacancy rates and declining vitality in town centres, the Government might well seek to further protect town centres, perhaps through clarification of the new tests of impact proposed for PPS6.

Local Planning Authorities might also be justified in defending vacant large-floorplate units in town centres from subdivision and/or change to other uses. The lack of such units in town centres in the past was one of the main drivers of out of town retailing, and losing these units would reduce the opportunities for large anchor retailers to locate in town centres in the future. Subdivision would only create more small units, of which most town centres have already have an ample supply. As a result some local authorities may well seek to protect these important large units, even at the expense of seeing them lie vacant for some time. For large-format retailers, this at least means there may be opportunities available when the market recovers, even if it means frustration for landlords and acquisitive smaller operators.

There is currently little evidence to suggest that the Government might be minded to alter its "town centres first" approach in an effort to mitigate the effect of the recession on out of town retailing. As matters stand the planning outlook for out of town retail park owners seeking to relax conditions on existing parks in the hope of accommodating new occupiers into recently vacated space is bleak.

WINNERS IN A DIFFICULT MARKET

* A2-A5 market
* Local Authority DPDs

Of course, there are always winners even in a downturn. In our view there is a significant opportunity in secondary areas for non-retail uses such as banks, restaurants, pubs and take-aways. While local planning authorities are likely to continue to resist the loss of A1 units from the primary retail frontages in their town centres, growing vacancy rates throughout centres may mean that some might be forced to take a more relaxed view on the infiltration of A2, A3, A4 and A5 operators into secondary areas than they have been willing to do in a more buoyant market. In this respect the combination of greater availability of units, falling rents and a more permissive planning regime creates good conditions for expansion.

> In our view there is a significant opportunity in secondary areas for non-retail uses such as banks, restaurants, pubs and take-aways.

For local authorities, the requirement to demonstrate that their strategies – be they for housing, future infrastructure or new retail and commercial development – are deliverable, becomes extremely difficult in the current market. A new initiative by the Planning Inspectorate and the RICS to appoint experts in assessing viability of proposals both at the DPD stage and at planning inquiry is a refreshing and welcome step forward which is likely to assist the planning system by identifying the art of the possible.

As far as retail schemes go there are already plenty of existing retail schemes which are not currently viable, never mind potential development sites. On the face of it, a town centre site which, in a good market, would be viable may no longer be so and the fact that such a scheme is no longer deliverable could well lead to certain Core Strategies, Area Action Plans and/or Site Specific Allocations DPDs which include such sites to be found "unsound" at Examination in Public. Some authorities may find themselves being sent back to the drawing board.

POSITIONING THROUGH PLANNING

* LDF Core Strategies
* Costs for developers
* Planning ahead

The administrative burden of gathering data for the "evidential base", multiple public consultations on each and every DPD, assessing each document for its contribution to sustainability and then producing a document which can stand up to scrutiny at an Examination in Public, is clearly proving very challenging for many under-resourced local authority planning departments. Indeed only 8% have managed to successfully adopt their LDF Core Strategies, three years after the Act which introduced them was passed.

The result is a growing policy vacuum where old local plans are increasingly out of date and their replacements are still at an embryonic stage and carry little or no weight.

For developers, this increased complexity translates into much higher costs associated with submitting planning applications, just when deteriorating market conditions have brought the viability of many schemes into question. This is, in our view, where the real cost of added complexity will be felt. In previous recessions, developers were able to secure outline consents for new development at relatively low cost, and these consents would then endure for five years. This allowed developers to plan during the downturn so that they were well-placed when the market improved. Under the new system, however, even outline applications must be accompanied by a mass of expensively-assembled supporting information and the lack of clarity from the development plan means that the outcome is increasingly uncertain.

Nevertheless, those developers who are prepared to invest their time and money can still be rewarded, and Chase & Partners have helped many clients this year to improve their portfolios (see our online case studies). As the market deteriorates in 2009, it will become even more difficult for developers to justify the financial commitment, but those who do will reap the rewards of being well-positioned when the market rebounds.

2009 Retailer excuse watch # 1

watch this space...

FURTHER INFORMATION & CONTACT

RETURN TO CONTENTS

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1	October 1996	PPG6 Retail Warehousing: Towards Consesus? Matter of Control!
2	November 1996	The Sequential Test: Opportunity or Problem?
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
16	December 2003	Draft Planning Policy Statement 6. Planning Town Centres
17	December 2003	End of Year Round up - The Retail Property Market
18	April 2004	Making Better Use of Supermarket Sites - The London Plan
19	April 2004	Mezzanines
20	December 2004	End of Year Round up - The Retail Property Market
21	December 2005	End of Year Round up - The Retail Property Market
22	December 2006	End of Year Round up - The Retail Property Market
23	May 2007	Planning for a Sustainable Future
24	August 2007	Planning Gain Support
25	December 2007	End of Year Round up - The Retail Property Market
26	March 2008	Competition Commision
27	July 2008	Proposed changes to PPS6: Planning for Town Centres - More Questions than Answers
28	August 2008	LDF Allocations: Decision Time
29	August 2008	Community Infrastructure Levy
30	December 2008	Retail Property Review

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For contact details of our Team or to read our previous briefing papers and/or case studies please click on our web address below. For our latest Property Week article please click here ✱

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"Retailer excuses" sourced from SnapShop and The Guardian.

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RETURN TO CONTENTS