RESEARCH

Q2 2010
SHOPPING CENTRE
Investment quarterly

Knight Frank

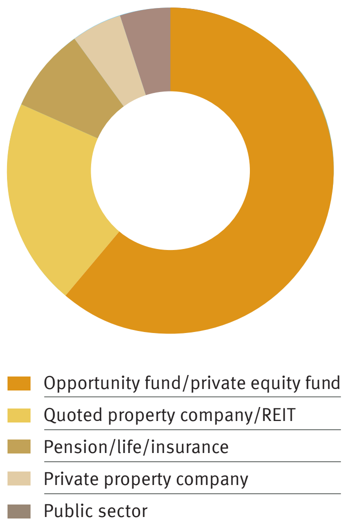
Outlook

- Transactional volumes were robust in the second quarter but, with limited evidence of more deals in the pipeline and a continuing scarcity of buying opportunities for prime assets, sales volumes over the remainder of 2010 are expected to fall from the levels seen in each of the last three quarters.
- As investors take stock of continuing risks in the economy and occupier markets, demand will remain healthy for prime shopping centre assets but will weaken for secondary product. We expect yields for secondary assets to remain stable in the near term before softening in the final quarter of 2010 as the supply of such assets continues to increase.
- June's Emergency Budget was greeted with a degree of relief by UK retailers, being seen as 'softer' on consumers than had been feared. With the hike in VAT arriving in January 2011, the budget will have little impact on consumer expenditure over the next six months and may even boost sales performance immediately prior to the tax increase. Longer term prospects look less promising.

Figure 1

Who is buying?

Q2 2010

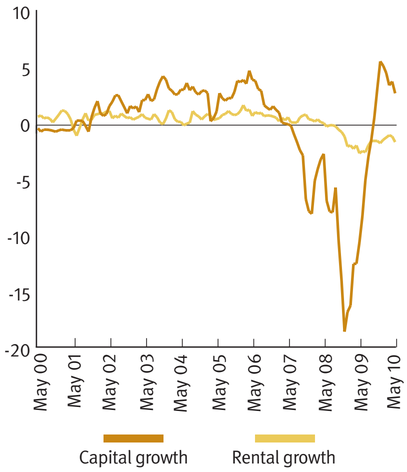


Source: Knight Frank LLP

Figure 2

Shopping centres: capital and rental growth

Three month % change

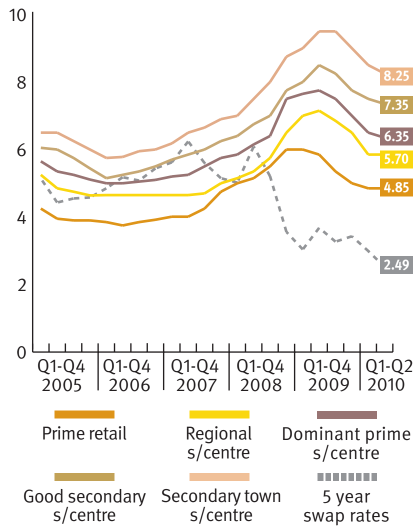


Source: IPD

Figure 3

Retail & shopping centre equivalent yields

Q1 2005 - Q2 2010



Source: Knight Frank LLP

Q2 shopping centres sold or under offer

Shopping centre	Purchaser	Vendor	Price (£m)	NIY %
Quattro Portfolio (Falkirk, Gloucester, Romford, Southampton)	Rockspring	The Mall Fund	137.0	7.60
O2 Shopping & Leisure Centre	Land Securities	Matterhorn Capital	125.9	6.00
N1 Centre, Islington, London	Henderson	Land Securities / Delancey	111.7	5.35
The Mall, Ilford	Meyer Bergman	The Mall Fund	71.0	7.90*
Bligh's Meadow, Sevenoaks	IGNIS Asset Management	Private	27.8	5.96

Source: Knight Frank LLP
*Includes rental guarantees

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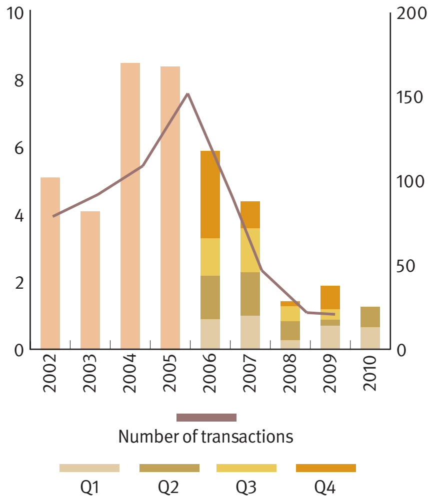
Figure 4

Shopping centre transactions

2002-2010 (LHS – Value of transactions, £bn) (RHS – Number of transactions)

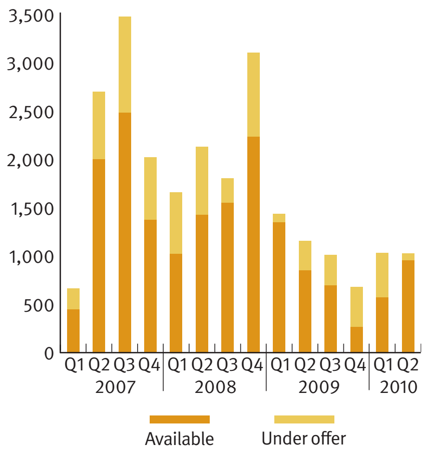


Source: Knight Frank LLP

Figure 5

Shopping centre availability

Q1 2007 - Q2 2010 (£m)



Source: Knight Frank LLP

Market commentary

- The number of shopping centres transacted rose to 15 in Q2, with the 26 shopping centre sales in the first half of this year already eclipsing the total for 2009 as a whole. Q2's total value of £624m was actually down a marginal 5% on Q1, with an average lot size of £41m also below the Q1 average.
- Henderson's £111.7m purchase of the N1 Shopping Centre in Islington from Land Securities and Delancey was the headline deal of the quarter. Reflecting a net initial yield of 5.35%, the deal demonstrates the continuing appetite for prime assets.
- Four of the 15 assets sold in Q2 were within a single portfolio. The Mall Fund, the market's most active seller over the past 12 months, sold their Southampton, Gloucester, Romford and Falkirk assets to Rockspring, presently one of the market's most active buyers, for £137m reflecting a blended net initial yield of 7.60%.
- Some investors are now choosing to exploit the recent recovery in pricing. For example, barely a year after acquiring it for £92.5m, Matterhorn Capital sold the O2 Shopping Centre in North London to Land Securities for £125.9m and reflecting an initial yield of 6.00%, an inward yield compression of 180bps.
- Supply levels are on an upward trend with availability increasing in each of the last three quarters to stand at £962.2m in quoted value terms, its highest level since Q1 2009. The number of shopping centres available has doubled from seven to 14 during Q2, but buying opportunities for prime assets remain scarce.
- With continuing uncertainty surrounding the outlook for the occupier market, investor sentiment has dampened in recent weeks. Prime yields appear to be stabilising, with prime regional shopping centre yields moving in only 15bps since Q1 to 5.70%. Yields for secondary town centre assets moved down by 25bps overall in the quarter to 8.25%.
- According to IPD, the rate at which shopping centre values are rising has eased in the last few months, as it has for other sectors, recording average month-on-month growth of 0.5% in May compared with 2.5% in December.
- The recovery in shopping centre values has also been more muted relative to other sectors, at 7.9% over the 12 months to May 2010 compared with 13.5% for commercial property as whole. Performance is not being helped by income, with shopping centre rental growth, on average terms, currently the most negative of the retail sectors.
- Official figures for retail sales show a reasonably steady pattern of growth in recent months following a very poor start to 2010. Although prospects for clear rental growth over the next 12 months appear bleak outside central London, landlords are buoyed by the fact that retail failures, Company Voluntary Agreements and pre-pack administrations have not featured in 2010 as they did last year. Meanwhile, tenant incentives are stabilising in weaker locations and are tightening in better performing locations where supply is limited.

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