SHOPPING CENTRES

INVESTMENT QUARTERLY **Q3 2016**

Outlook

Modest stock levels anticipated for Q4 2016/Q1 2017

In the wake of the June Brexit result, supply failed to materialise as the funds either closed or focussed on the sale of more liquid stock, and sales from other parties were put on hold pending market stabilisation.

Volumes for 2016 have been particularly low, where, aside from three large deals in Merry Hill, Grand Central Birmingham and Liverpool One, there has only been £839m of deals. There has in fact been only one deal over £25m that has both launched and completed in 2016.

We anticipate a continuation of this trend for the remainder of 2016 and Q1 2017, with very few schemes being marketed and a particular dearth of £50m+ lot sizes.

But recent economic news is more positive

Despite this lack of activity in the investment market, recent economic data has been more positive, with economists at Credit Suisse and Morgan Stanley removing predictions of a recession for the country. Overseas buyers continue to show confidence in the UK market, with a number looking at both Intu's scheme in Bromley and Land Securities/Delancey's Southside in Wandsworth. Whilst there was a yield correction in July post the Brexit result, sentiment and pricing has settled and partially recovered since.

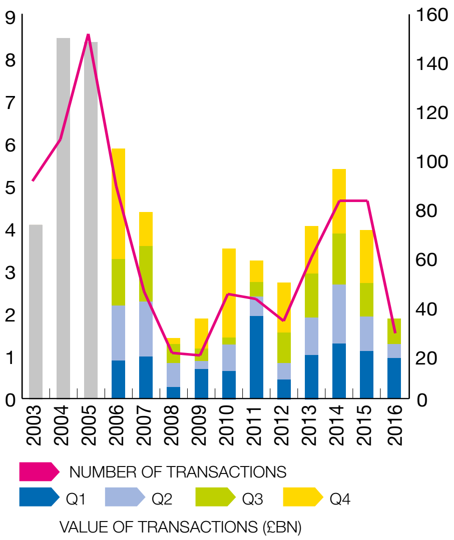
Retail sales hold up post- Brexit

Retail sales – the key barometer of consumer demand and the lifeblood of retail occupier markets – have proved reasonably resilient in the immediate aftermath of the Referendum vote. Fears of an immediate collapse have dissipated with strong July trading. The ONS reported year-on-year retail sales volumes up 3.9% and 5.4% in June and July respectively. August's figures were less positive but are likely to have been impacted by the ongoing hot weather and the Olympics than anything Brexit-related.

FIGURE 1

Shopping centre transactions

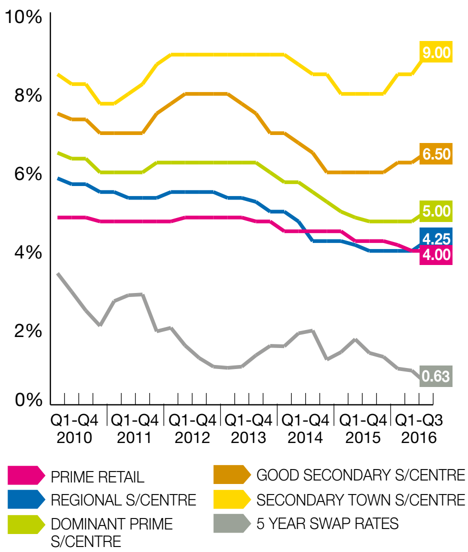
(LHS – Value of transactions, £bn)
(RHS – Number of transactions)



Source: Knight Frank LLP

FIGURE 2

Retail & shopping centre equivalent yields Q1 2009 - Q3 2016



Source: Knight Frank LLP

Q3 2016 shopping centres transactions

Shopping centre	Status	Purchaser	Vendor	Price (£m)	NIY %
LaMerry Hill, Dudley (50%)	Sold	Intu	QIC	£410m	5.20%
Whitefriars, Canterbury (50%)	Sold	Canterbury Council	CPPIB / THRE	£79m	6.00%
Manor Walks, Cramlington	Sold	Northumberland Council (Arch)	Hammerson	£78m	7.00%
Intu (Glades), Bromley	Under Offer	LaSalle Investment Management	Intu	£255m	5.50%

Source: Knight Frank LLP

MARKET COMMENTARY

Councils buck the trend amongst market uncertainty

A number of sales were withdrawn from the market in early 2016. A number of aborted deals post Brexit continued this trend, with buyers wary of investing into an uncertain market and an apparent widening gap between vendor and purchaser's pricing expectations.

Councils have been a key buyer this year, using their very low cost of debt (c2-2.5% all in on a repayment basis/c0.5% on an interest only basis) and targeting income as central government funding decreases and alternative investment classes continue to offer minimal returns. Local authorities have purchased 8 schemes including a 50% stake in Whitefriars Canterbury (£79m), Merseyway Stockport (£80m) and Manor Walks Cramlington (£78m).

Private Equity will be a key sales area

Centres held by Private Equity Funds will be traded as targeted hold periods expire and they look to avoid the erosion of returns through extended ownership. Shrewd PE investors will be those that wait long enough for the market to recover but not so long that a glut of stock is released to the market at the same time. Fortune may favour the brave seller who goes early.

Overseas buyers remain active

For Euro or Dollar denominated buyers who are willing to take a gamble on the recovery of the pound, this c10% drop in Sterling plus a 10-15% drop in market pricing, cheap and widely available debt, and a more stabilised occupational market should soon provide compelling reasons to consider investment into UK Shopping Centres.

Initial occupational indicators surprisingly positive

Much of the pre-Brexit scaremongering has proved ill-founded on the evidence of a number of key indicators to date. Financial markets have rallied, retail sales have held up, unemployment has gone down and manufacturing activity has rebounded. It is still early days but the post-Brexit collapse predicted in some quarters has simply not materialised.

'Business as usual' is the almost universal watchword amongst retail occupiers. Few would have welcomed the vote to leave the EU, but the result has given rise to an under-current of caution rather than outright panic. In practice, this has not prompted retailers to drastically re-draw their acquisition programmes nor revise property strategies. There is limited evidence of occupiers pulling out of deals in the wake of the Brexit vote.

However, the real tests for retailers will come over the next 18 months. Despite a strong July, August's figures provide something of a reality check. Retail sales will remain erratic and volatile. As ever, much will hinge on the performance over the key Christmas period and it will only be possible to assess the landscape with confidence thereafter.

Longer term, the key indicator to watch will be the value of sterling. If the pound does not recover versus the dollar, some existing currency hedges will lapse and this will put increasing pressure on retailers' sourcing and buying costs, which are often US dollar-based. The conundrum then will be whether retailers have the confidence to pass these costs onto the consumer.

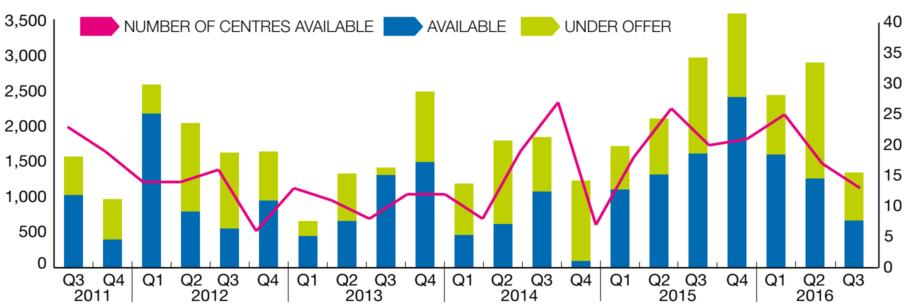
Margin increase is offset by falling swap rate in debt market

Whilst margins have increased by around 25 bps since the Brexit vote, this has been more than offset by the fall in swap rates by 60-70bps since the start of the year.

Senior debt is available up to c60% LTV on an interest only basis and over 60% LTV with amortisation. Lending margins range from approximately 170bp over LIBOR for 50% LTV rising as gearing increases, with fixed rates starting at around 220bp over LIBOR rising to around 250bp over LIBOR at a 60% LTV.

FIGURE 3

Shopping centre availability (LHS – Value of availability, £m. RHS – Number of centres available)



Source: Knight Frank LLP

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