RESEARCH

Q3 2012

UK RETAIL

Occupational & investment markets

Knight Frank

HIGHLIGHTS

- The second estimate for Q2 GDP was not as negative as the initial figure which was revised up from minus 0.7% to minus 0.5%.
- July retail sales recorded reasonable annual growth, but the outlook for the retail sector remains challenging. The London and South East markets are relatively active but occupier demand in the wider UK is weak, as retailers streamline their portfolios and focus attention on their profitable stores.
- Knight Frank's research shows that shopping centre development will remain subdued for the foreseeable future, with activity continuing to focus on refurbishments and extensions to existing schemes. However, some in-town proposals are being re-invigorated.
- Investor interest is firmly focused on the better quality assets across the retail sub-sectors. Due to the limited availability of prime stock, transactional volumes over the first six months of 2012 were down 52% on the same period last year.

ECONOMIC & CONSUMER OVERVIEW

The Eurozone crisis and public spending cuts continue to dominate the news and the UK economy remains in recession, with Q2 GDP falling by 0.5%.

JULY RETAIL SALES PAINTED AN IMPROVING PICTURE, BUT CONSUMER CONFIDENCE REMAINS WEAK.

The figure, which was in line with analysts' expectations, was revised up from the initial 0.7% estimate. The decline in construction of 3.9% was a major drag on the overall figure, while manufacturing was down 0.9% and the service sector was down by a marginal 0.1%.

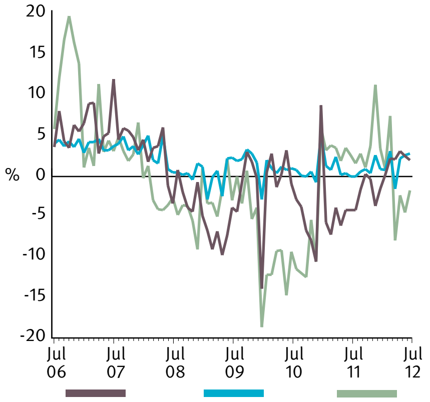
Annual growth in sales volumes for July amounted to a creditable 2.8%, albeit the growth was in part boosted by the early summer sales. Whilst the figure may point to an improving picture, the outlook for the retail sector remains challenging. A few retailers are reporting strong performances, although many are experiencing tough trading conditions. Generally, the change in regulation to suspend Sunday trading laws until the end of the Olympics and Paralympics should have boosted trading and benefited retailers.

London and the South East continue to buck the wider negative economic trend, with the capital boosted by better visitor numbers in the first half of this year. The Olympic and Paralympic games have also generated a degree of optimism, although the precise impact of the games on London's retail trading patterns remains to be seen.

The weakness in consumer spending seen in the first half of 2012 continues. GfK's UK Consumer Confidence Index showed no change in July, staying at minus 29, the same level as May and June, indicating that consumers still have concerns about their own finances and the economic outlook.

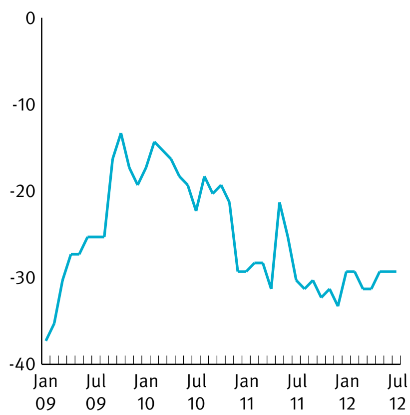
Consumers have cut discretionary spending in response to renewed concerns about the economy and the Eurozone crisis, which has eroded sentiment. Whilst some retailers had hoped for a summer surge in spending, the wet weather deterred people from the high street and the extra bank holiday in June did not boost sales significantly. However, parts of the leisure market such as cinemas and restaurants have been more resilient than expected.

Figure 1
All retail sales, household goods & automotive fuel



Source: ONS (volume year-on-year growth)

Figure 2
Consumer confidence index



Source: GfK NOP

Retailer trading performance

Retailer	Latest results/comment	Trading period
John Lewis	Like-for-like sales up 14.5%; internet sales up 40.3%	3 weeks to 18th August 2012
Waitrose	Like-for-like sales up 10.2%; online orders up 30.4%	3 weeks to 18th August 2012
Morrisons	Like-for-like sales down 1.0% (exc.VAT)	13 weeks to 29th April 2012
Tesco	Like-for-like sales reduced by 1.5% (exc. VAT and petrol)	13 weeks to 26th May 2012
Asda	Like-for-like sales up 0.7%	1st Apr 2012 to 30th June 2012
M&S	Like-for-like UK sales down 2.8%; food sales up 0.6%; online sales up 14.9%	13 weeks to 30th June 2012
Debenhams	Like-for-like sales (inc VAT) up 3.0%	16 weeks to 23rd June 2012
J Sainsbury	Like-for-like sales up 1.4% (exc. fuel); 'in line with expectations'	12 weeks to 9th June 2012
Next	Next brand +4.5%; Next Retail +0.2%; Next Directory +13.3%	26 weeks to 28th July 2012
Dixons	Group like-for-like sales down 3.0%	52 weeks to 28th April 2012

Source: Various, company press releases

OCCUPIER TRENDS

While the London and South East economies have been less affected by the downturn, occupier demand in the wider market remains weak, as retailers streamline their portfolios and focus attention on their profitable stores.

International retailers are still entering the UK market but are becoming more selective. In terms of rental trends, the market remains highly polarised, with Central London being one of the few areas witnessing any upward pressure on rents. However, elsewhere, the story remains less optimistic.

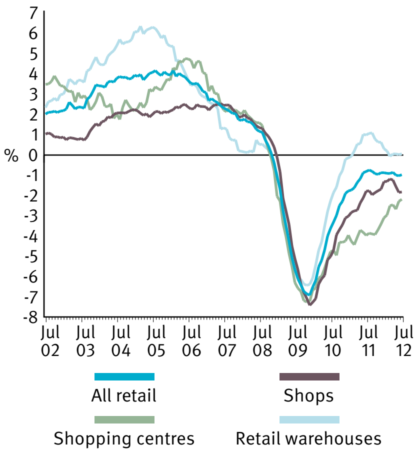
Recently, there has been a notable trend towards 'right-sizing' where retailers streamline their portfolios through expiries, break clauses or the use of CVA's.

Demand for the best shopping centres continues to exceed availability, supported by the lack of new space and continued demand for larger units, particularly in regionally dominant schemes. As a result, prime shopping centre rents have remained flat. In contrast, demand for secondary shopping centres is sluggish and rents remain under downward pressure.

The out-of-town market is in better health than 2-3 years ago. A combination of steady demand and limited new development has helped to erode the vacant space left by major corporate failures during the downturn. Demand for prime open A1 schemes has remained firm, although bulky goods schemes have seen vacancy rates edge up – driven by the closure of some DIY, furniture and consumer electronics retailers.

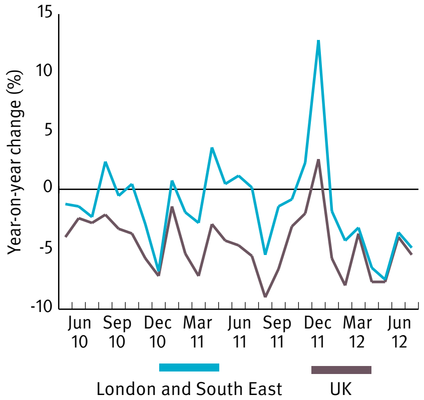
CONTINUED POLARISATION BETWEEN THE STRONGEST AND WEAKEST LOCATIONS.

Figure 3
Annual rental growth

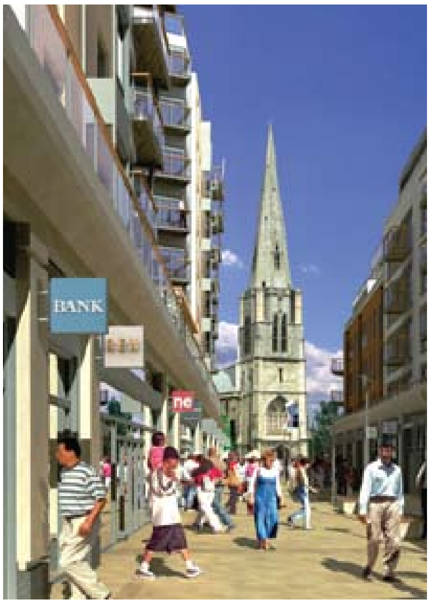


Source: IPD

Figure 4
Footfall in London and South East, UK

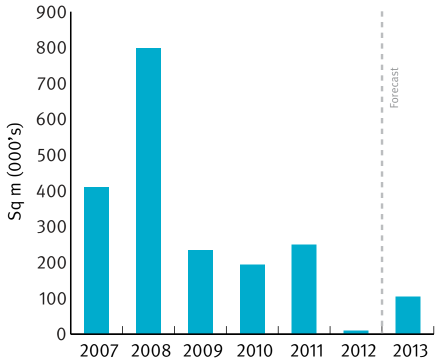


Source: Ipsos Retail Performance



THE 2013 SHOPPING CENTRE PIPELINE IS SHOWING ONLY LIMITED SIGNS OF IMPROVEMENT.

Figure 5
New shopping centre floorspace



Source: Knight Frank

DEVELOPMENT

Concerns about the UK economy and the Eurozone crisis continue to affect sentiment and the availability of debt funding. Development activity is unlikely to pick up significantly before 2015 at the earliest and the focus will remain on extensions and redevelopment.

Limited new space is forecast for 2012, with no significant schemes expected to be delivered in the second half of the year. February saw the opening of the Swan Shopping Centre in Yardley, which is anchored by Tesco.

Whilst the pipeline for 2013 appears to be better than 2012, new shopping centre space is limited, with only two new centres over 40,000 sq m due to open in 2013. Trinity Leeds will be the biggest new shopping centre to open in 2013 at 93,000 sq m.

New Square, West Bromwich, anchored by Tesco, will be the second largest opening of 2013 at 43,900 sq m.

However, we are beginning to witness a number of in-town schemes being re-invigorated, such as Westfield Bradford and Hammerson's Eastgate Quarter in Leeds. Arguably, those brave enough to venture in to the development arena now could benefit from the need for retailers to expand in the "right" locations. Food store and leisure development has also been continuing.

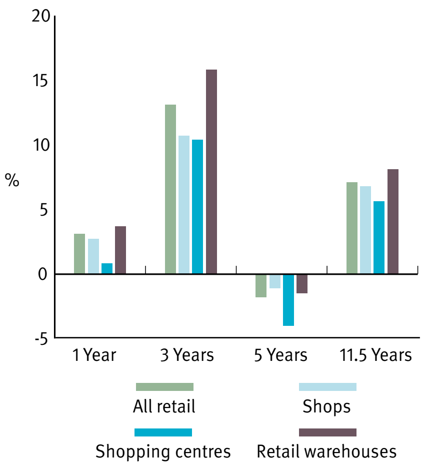
Major shopping centres in the pipeline

Scheme	Location	Size (sq m)	Date due	Developer
Trinity Leeds	Leeds	93,000	2013	Land Securities
New Square	West Bromwich	43,900	2013	Spenhill
Outdoor Pursuits Centre	Evesham	12,000	2013	Eagle One
The Old Livestock Market	Hereford	28,800	2014	Stanhope

Source: Knight Frank

INVESTORS CONTINUE TO BE HEAVILY FOCUSED ON THE BEST RETAIL STOCK.

Figure 6
Annualised total returns
(to June 2012)



Source: IPD Quarterly Digest

INVESTMENT

Investor sentiment continues to shift against most off-prime locations or stock with occupational issues. This has translated into reduced investment activity, with overall retail transaction volumes down 52% in H1 2012 compared with last year.

Following a strong start to the year, high street investment activity has fallen sharply in recent months. However, London remains active, with prime yields on Bond Street standing at 3.25-3.50%. Oxford Street yields remain at 4.00%, reflecting not just the strength of recent occupier demand for limited supply, but also its status as a “trophy” shopping street. We have also seen some trophy high street purchases in strong regional centres such as Cardiff, Leeds and Liverpool.

If anything, headwinds within the occupational market are strengthening and we anticipate more bad news from tenants in coming months. As a consequence, we have seen renewed pressure on shopping centre pricing, particularly in the secondary and tertiary markets where buyers remain very cautious. Indeed, we expect to see secondary yields push towards double digits by the end of the year.

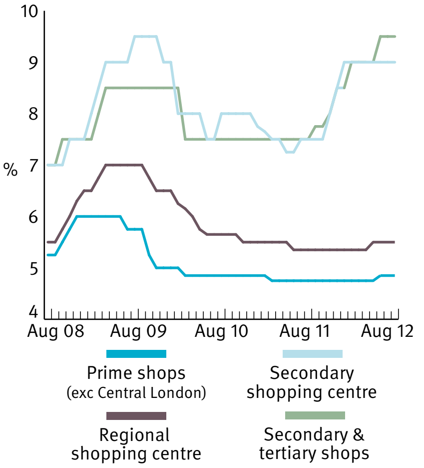
Investment activity in the out-of-town market is also well down on last year. So far in 2012, availability has been much more limited, with the majority of deals being sub-£35m lot sizes where pricing has correctly reflected the quality of the asset, mainly focused in the 'off-prime' market. Further occupational 'tension' may create opportunities to trade in Q4.

Major retail investment transactions

Property	Purchaser	Vendor	Price (£m)	NIY (%)
Festival Place, Basingstoke	TIAA-CRES	Grosvenor	280.0	6.5
Kingfisher Centre, Redditch	Capital & Regional and Oaktree Capital	Scottish Widows	130.0	8.0
Ocean Terminal, Edinburgh	Resolution Property	Forth Ports Ltd	90.0	7.5
190-196 Piccadilly, London	The Crown Estate	Aviva Investors	87.0	4.4
Castle Mall, Norwich	InfraRed Capital Partners	The Mall Fund	77.3	7.8
St Johns SC, Liverpool	InfraRed Capital Partners	Land Securities	76.4	8.5
Broadwalk SC, Edgware	Scottish Widows	Carlyle Group	68.0	6.0
Coliseum Retail Park, Enfield	BlackRock	Standard Life	46.0	6.9
Gallows Corner, Romford	SWIP	Resolution	44.0	6.0

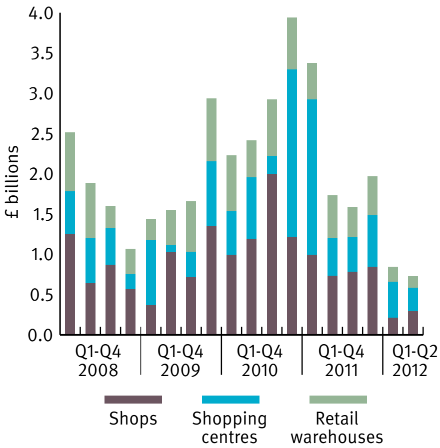
Source: Propertydata.com, Knight Frank

Figure 7
Prime retail yields



Source: Knight Frank

Figure 8
Retail investment volumes



Source: Propertydata

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India
Indonesia
Macau
Malaysia
Singapore
Thailand
Vietnam

The Gulf
Abu Dhabi, UAE
Bahrain
Dubai, UAE
Qatar

Commercial Research
Darren Yates, Partner
+44 (0)20 7861 1246
darren.yates@knightfrank.com

Anthea To, Senior Analyst
+44 (0)20 7861 1236
anthea.to@knightfrank.com

Leasing
Oliver Langston, Associate
+44 (0)20 7861 1569
oliver.langston@knightfrank.com

Investment
Bruce Nutman, Partner
+44 (0)20 7861 1107
bruce.nutman@knightfrank.com

Development
Ian Barbour, Partner
+44 (0)20 7861 1223
ian.barbour@knightfrank.com

Alex Munro, Partner
+44 (0)11 3297 2425
alex.munro@knightfrank.com

Leisure and Out of Town
Andrew McGregor, Partner
+44 (0)20 7861 1531
andrew.mcgregor@knightfrank.com

Valuations
Graham Spoor, Partner
+44 (0)20 7861 1539
graham.spoor@knightfrank.com

Peter Barnard, Partner
+44 (0)20 7861 1281
peter.barnard@knightfrank.com

Management
Howard Woollaston, Partner
+44 (0)20 7861 1140
howard.woollaston@knightfrank.com

Lease Advisory
Jeremy Elphick, Partner
+44 (0)20 7861 1590
jeremy.elphick@knightfrank.com

Planning
Richard Walters, Partner
+44 (0)20 7861 7717
rich.walters@knightfrank.com

Building Consultancy
David Mills, Partner
+44 (0)20 7861 1118
david.mills@knightfrank.com

Business Rates
Keith Cooney, Partner
+44 (0)20 7861 1111
keith.cooney@knightfrank.com

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