



Andrew Jones Head of Retail

Retail Sector

Leadership in Retail

- £7.7 billion invested
- £11.5 billion total property under management

Our strategy for the retail portfolio is determined by our customer-led focus. We have built good relationships with the larger retailers and continue to aim to provide them with the right space in the locations they prefer. This is being achieved through rigorous reshaping of the retail portfolio and recycling of capital into selected assets with the best prospects, to enhance retailer mix and drive rental growth.

Our prime portfolio has **strong defensive qualities:**

- high occupancy of 99%;
- an average lease length of 16 years unexpired; and
- 14% reversionary income;

an excellent position on which we can continue to apply our management.

Since March 2007 we have continued the repositioning of our portfolio, with £2.2 billion of sales of assets where we anticipated weaker potential for growth in market rental value or with few asset management prospects to enable us to create growth. This is consistent with our strategy of making asset specific decisions on whether to buy, sell or hold. We are discriminating between individual assets; for example, not all out-of-town is expected to perform well and in-town shopping centres and high streets have widely differing appeal.

Out-of-town – 80% of the retail portfolio, £6.2 billion:

- 203 retail schemes, including the Superstores and Meadowhall shopping centre;
- providing a total of 21 million sq ft;
- arranged in 1,761 retail units; and
- with an average lease length to first break of 15 years.

Our portfolio has a particular bias to out-of-town retail with emphasis on **retail parks** with Open A1 planning use (82%). Such use classification permits a wide range of retail operations, from food to fashion, and enables us to be flexible in offering asset management initiatives to deliver the size and configuration of trading space required. We also aim to be responsive to changes in those requirements as the retailers amend their formats to meet their own customers' preferences. For example, there has been increasing

retailer demand for smaller units in out-of-town shopping parks and we have been active in changing unit sizes (extending or subdividing) and providing imaginative new formats for customer services, perfecting the tenant mix, and including new and varied catering outlets.

We are the largest owner of UK **superstores**, other than the operators themselves. The operators are gaining an increasing share of consumer expenditure through broadening product ranges, especially non food, while maintaining their customer appeal of convenience and accessibility. In an increasingly restrictive planning and regulatory environment, which is limiting new supply of these assets, the retailers are committed to full lease lengths of over 20 years. The superstore investment profile of rental growth with secure income flow is an attractive element of the portfolio.

The **Meadowhall** shopping centre of 1.5 million sq ft is also an important component of our out-of-town portfolio – probably the best scheme of its kind in the UK with exceptionally strong ongoing customer appeal. We are building on these strengths, positioning Meadowhall for attractive low risk growth through active management and ongoing refurbishment and development.

In-town – 20% of the retail portfolio, £1.5 billion:

- six shopping centres, in total 2.2 million sq ft;
- 36 department stores, in total 5.6 million sq ft;
- 23 high street shops; and
- 11 supermarkets.

Our in-town **shopping centres** are located within large catchment populations, well anchored and generally the dominant retail scheme in the area, and of sufficient size to enable proactive asset management, including new income generating customer facilities and possible future development. The **department stores** are fully let to Debenhams and House of Fraser with an average lease term of over 30 years. Income growth from these assets is underpinned by provisions in the leases for guaranteed increases in rent; gross rents will increase by some £6m (14%) over the next five years since the year end, continuing our refinement of the portfolio, we are continuing to sell stores where ERV growth is expected to be muted.

Asset management

Our active management has continued this year to drive rental growth. We have achieved:

- 1.1 million sq ft of retail park lettings at 10% above ERV, including a high proportion in the second half of the year, and we have some 400,000 sq ft more under offer;
- 450,000 sq ft of lettings at shopping centres, including over 240,000 sq ft at Meadowhall with a new flagship store for Topshop and new lettings to New Look and Sportsworld;
- 171 rent reviews agreed at 4.6% above ERV and producing an overall uplift in passing rent of 24%;
- across the retail portfolio a 7.1% like-for-like income growth (versus IPD of 3.5%), led by retail warehouse parks at 11%; and
- 2.9% ERV growth overall compared to IPD of 2.1%

and we will continue this intense focus on management in the current year.



Eastgate shopping centre, Basildon

Investment market

The early part of the financial year saw considerable activity, when we contracted sales of £1.2 billion, before the onset of the credit market turmoil which effectively put the market into a 'no bid' position while investors reassessed their positions. Since the beginning of 2008 purchasers have started to return to the market, particularly 'high net worth' individuals and 'special purchasers', with some selective activity from funds which have particular positions to cover or are able to take advantage of opportunities. However, there is still considerable uncertainty in the market, and the flow of transactions is at much reduced levels as the lack of availability and/or higher pricing of debt takes effect. However, in our Q4 we sold over £750m of retail assets (included in the £2.2 billion total for the year).

These market conditions and resulting significant stock availability have contributed to all retail subsectors seeing outward yield shift over the year. Prime Open A1 out-of-town retail parks have been hardest hit, despite their better supply/demand characteristics and rental growth prospects, since the same adjustment applied to their lower starting yield level represents a larger percentage resultant mark down in value.

The similar level of yield shift which has been applied in the market to both prime and secondary assets does not, in our view, reflect their different prospects. While we expect some further degree of outward yield movement in the market overall, this should apply less to prime as investors reflect on pricing of the relative prospects for growth and the downside risks of secondary assets, such as the supply/demand dynamics with increased competition and reletting concerns. And we note that initial yields are increasingly the primary concern as investors require certainty of income.

The market repricing may provide us with some acquisition opportunities; we shall continue to be involved in the market on a selective individual asset basis. Prime is still the best place to be, although not immune from market uncertainties. Prime retail has stronger occupational demand, better retailer trading, stronger tenant covenants, higher occupancy and longer leases.

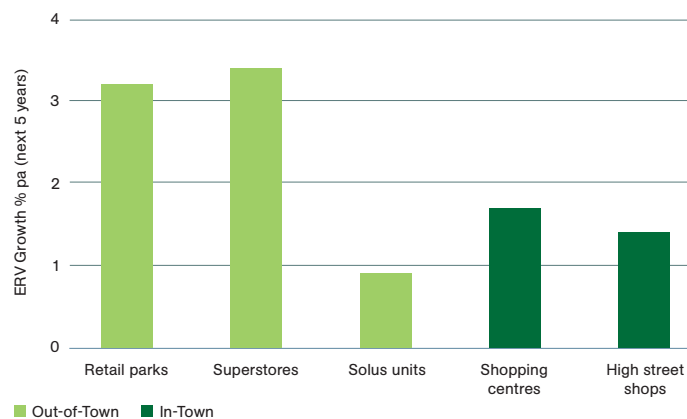
Occupier market

The retailers are finding the current market challenging; sales overall are still growing but under pressure in a competitive trading environment where performance is mixed. The bright spots at present are the food and entertainment subsectors, while DIY, furniture and electricals are having a tougher time. The fashion market is rather fickle with retailers seeing markedly different results.

Occupational demand for bulky or solus retail warehousing is subdued and there is a greater supply of this space which will at best dampen growth prospects and quite possibly lead to rental value reductions. In town units are also subject to thinner demand where greater supply from new shopping centre development, lease expiries and some tenant failures is eroding the supply/demand tension. Larger incentives to attract tenants and higher levels of voids are the result. However, the best accommodation across all retail sectors will continue to attract customers. Retailers continue to adjust their requirements; migrating from the high street to out-of-town and 'right-sizing' their accommodation in line with their changing business models. Our objective is to stay in close communication with the retailers and assist their strategies so we all maximise performance.

Going forward, outperformance will require continuing asset specific repositioning to reflect customer demand. The potential for asset management initiatives will be the principal route to deliver rental growth and so improving asset values. While the rental growth performance of our portfolio in our chosen subsectors has been ahead of IPD, having pursued our strategy of rebalancing the retail portfolio this outperformance should become more visible over the current year.

Rental Growth outlook continues to favour Out-of-Town



Source: Property Market Analysis (PMA)