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KEY POINTS

- How the definition of a prime location has changed;
- The need for greater alignment between the landlord and the tenant;
- What has been the shift in consumer spending (impact on OOT retail);
- Pure-play v omni-channel/physical retailers is not a level playing field;
- The crux – we need a re-set of rents/values;
- Reasons to be cheerful;

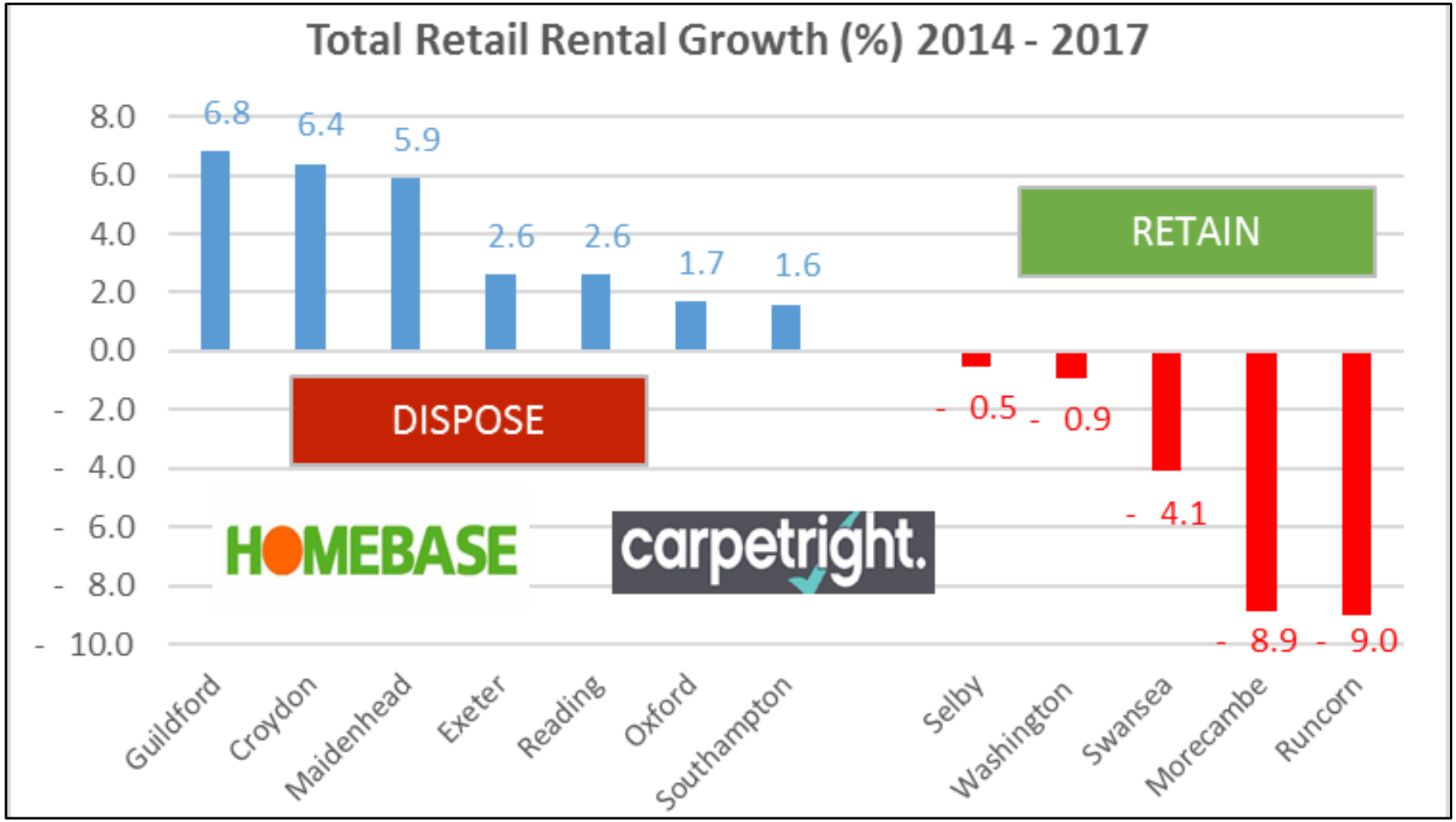
PRIME LOCATION?

What do these towns have in common?

- Exeter
- Oxford
- Poole
- Reading
- Aylesbury

- A prime location has been described as one which fulfils the “shopping mission”. At it’s simplest level, surely it should infer a profitable location.
- But, as an investor, how do you know?

Knight Frank



GOOD TOWN: BAD TOWN

Homebase		Staying Open	Rent pa	Closing	Rent pa
		Morecombe	£340,000	Croydon	£900,000
		Scunthorpe	£387,000	Exeter	£600,000
		Washington	£271,000	Southampton	£900,000
		Selby	£275,000	Oxford	£830,000

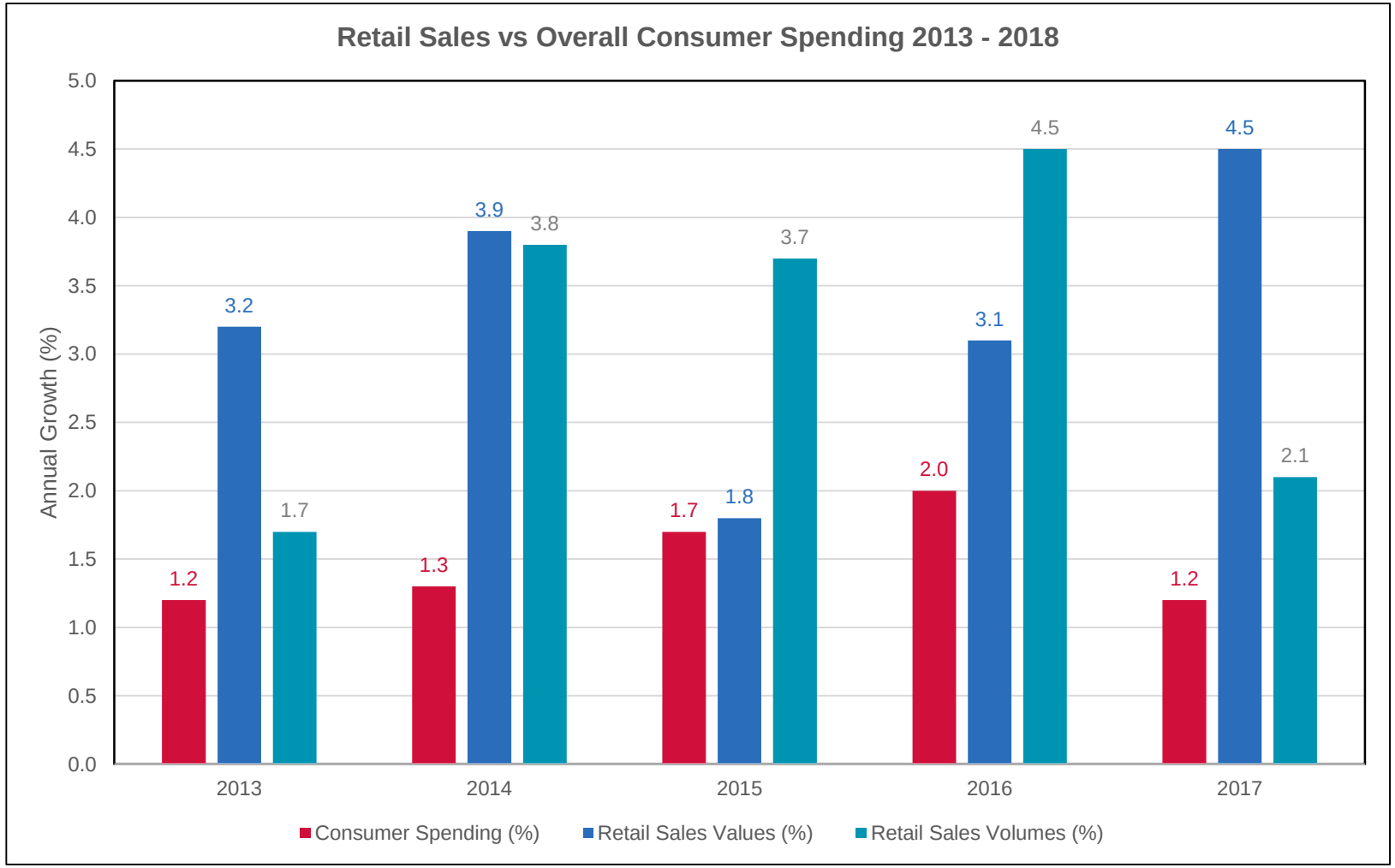
Carpetright		Staying Open	Rent pa	Closing	Rent pa
		Morecombe	£120,000	Guildford	£571,000
		Swansea	£180,000	Exeter	£283,000
		Selby	£70,000	Reading	£300,000
		Runcorn	£100,000	Maidenhead	£300,000

GREATER LANDLORD AND TENANT ALIGNMENT

ODEON PORTFOLIO OF 10 CINEMAS

- Assessed annual attendances – establish ticket sales;
- Additional retail spend – establish gross sales;
- Margin (at 25/30%) to establish EBITDA;
- Affordability ratio – rent at 50% EBITDA;

RETAIL/CONSUMER SPEND



SHIFT IN CONSUMER HABITS

- Consumer spending habits have changed rapidly; next Report and Accounts 2017

	Jan 18	Jan 17	Change
Next Retail (so stores)	£2.1bn	£2.3bn	(7.9%)
Online	£1.9bn	£1.7bn	+9.2%
Retail net margin	12.7%	15.3%	
Online net margin	24%	25%	

Triple whammy for property of rising costs, falling sales and a new competitor in town.

RE-BALANCE OF PURE-PLAY V OMNI CHANNEL/PHYSICAL RETAIL

It is not a level playing field, whilst Amazon and ASOS pay virtually no business rates or corporation tax.

- **2 things could/will happen:**
- **“Tax” pure play e.g.**

1. Flat levy on every online delivery
2. 15% VAT in a store; 20% online;

- **Property costs to be reduced e.g.**

1. Overhaul business rates; (JSainsbury pay £550m in rates - more than after tax profits);
2. Reduce rents – whilst OOT retail is designed for the omni-channel environment, a reduction in property costs via rent is an “achievable gain”;

RE-SET RENTS/VALUES

Shopping centre investment volumes have fallen off a cliff (<£1bn so far this year) v industrial investment £5bn & “alternatives” at £6bn;

Investment turnover in OOT retail is down from £4.5bn 2005/06 to £2.5bn 2016/2017 and likely to be < £2bn 2018;

Our core market of the UK institutions have shunned the retail sector of late;

Relative performance against logistics, regional offices, “alternative” sectors etc would support this view, but there is a solution;

It is a price/rent correction…..

RE-SET RENTS/VALUES

How did we get to where we are?

Was it:

- Greedy landlords with a carefree attitude to retailer profits;
- Rigid UK lease structure;
- Retailers over-expanding/over leveraging, especially those private equity owned;
- Unscrupulous agents with just an eye on the fee;

Actually a combination of all 4

RE-SET RENTS/VALUES

If I can tackle one of them, which may be unpalatable:

UK lease structure is unique:

- 1954 Act
- 10 year + terms (tenant takes some blame)
- Upwards only rent reviews

Some or all of the above, could soon be a thing of the past.

RE-SET RENTS/VALUES

Taking two of these – the next solution:

- Payback on new store openings = 24 months;
- Average lease term negotiated on expiry = 7 years (2017); 5 years (2018);
- They no longer need 10 year and leases;

Whilst we may not have downward reviews, yet, lease expires will deal with that:

- Next renewed 19 leases 2017- net rent fell by 28% with a capital contribution of c £250k per store (average);
- Next will renew 29 leases 2018- net rent to fall by nearly £2.5m (27% decrease);

BEWARE: 2019 -2022 will see >3,000 lease expires

IMPLICATION/EXTENT OF RE-PRICE

Typical out of town park, SAY:

- Quoting £14.00m at 6% NIY
- ERV (net effective rents) at 90% of current passing rents: 6% becomes 5.4%;
- **BUT** tenant break in 2020, so allow 6 months rent free to remove: 6% has become 4.85%;
- IRR at quoting (assuming 5 year hold) = 4.3%;
- At 6.5% NIY, it's a healthier 5%;

But, you will have a fully let scheme at the end of the process, probably with a longer WAULT than you acquired, and hopefully a contented tenant line up.

BUT there are any positive things about OOT retailing and therefore as a mature/long term investment strategy:

1. It is genuinely omni-channel;
A. 64% of all online M&S sales picked up at store;
B. 50% of all Next Directory orders are collected at a store, and 80% of the returns;

2. Sales penetration of classic OOT products remain strongly store-based:

Homewares	DIY	Furniture
82%	88%	80%

BUT electrical 50% and clothing falling at 65%

3. Vacancy rates still relatively low at 6%

4. Large sites offering higher density usage and a increasingly diverse usage e.g. A3, leisure and hotel

5. Alternative uses e.g. M7 Alpha portfolio (especially urban logistics)

6. Relatively low obsolescence and CAPEX for the owner

7. Free parking space and accessible sites

CONCLUSION

- Most retail warehouse sheds/ parks are truly “internet compatible”, & will surely be fully exploited by all retailers;
- Of the top 12 retailers in the UK, only 2 are pure-play (Amazon & ASOS), the rest are an increasingly sophisticated multi channel offer;
- Stores play a role in > 90% of all retail sales & internet sales are highest where there is a strong store presence;
- The OOT investment sector will almost certainly out-perform our retail cousins, therefore offering the best diversification strategy;
- There is stock coming, probably re-priced, so be prepared;
- BUT retailers need to increasingly improve the shopper experience e.g. Gino D’Acampo in Next etc.
- Landlords need to collaborate with their tenants to create the right environment.
- AND we need to all accept that what was worth “Y” yesterday might be worth “Y” (less a bit) today.