EXECUTIVE SUMMARY

The UK economy has continued its period of sustained growth, with BNP Paribas forecasting GDP growth of 2.3% for 2015.

- Consumer confidence now at its highest level for the past 13 years. This has been due to the more positive national economic outlook, but also due to a stronger consumer, with real wage growth filtering through.

- June 2015 retail sales increased by 4.0% compared with June 2014. Sales through online channels have continued to increase and outperform the market with 11.4% growth, representing 12.4% of all retail sales.

- Strong out of town take so far in 2015 - homewares retailers taking a large quantum of space

- Out of town retail investment for the first half of 2015 up 41% compared to H1 2014. We are anticipating a similar volume to transact in the second half of the year.

- Due to sustained investor demand for prime schemes, we anticipate Open A1 prime yields to move inwards by around 25 bps during H2 2015.
OVERVIEW

- The out of town retail sector has continued to outperform the high street in the first six months of 2015 across a variety of metrics. A strong UK housing market has boosted sales for bulky and homewares occupiers, whilst out of town retail’s large floorplate units and the suitability for Click and Collect has meant that fashion retailers are continuing to target the top shopping parks across the country.

ECONOMY

- First quarter GDP data came in below expectations and as a result we have reduced our growth outlook for 2015 to 2.3% from 2.7% in our previous forecasts. Thereafter, our outlook for GDP growth averages 2% over the medium-term.
- The impact of falling oil prices on consumer spending in the UK has given a dual boost to the consumer sectors. First, through its impact on inflation, it has in part underpinned the initial growth phase in real wages. It is more likely however, given that the UK is a net importer of oil, that falling household energy costs coming as a direct result of lower oil prices, has freed up more income to spend on other goods and services.
- The labour market remains strong, and despite a marginal 0.1 pp uptick in the unemployment rate in May the unemployment rate was 5.6%, compared to 6.5% a year ago. We believe that a full recovery in the labour market will mean a sub 5.0% unemployment rate. The most recent data pointed to growth in wages of 3.2% y/y, and going forward as the labour market tightens further as anticipated, the falling pool of available labour will lead to even greater wage growth inflation.

![GDP and Private Consumption Graph](image)

Source: BNP Paribas

- The UK consumer is feeling their most confident for 13 years according to the GfK Consumer Confidence Index. The index increased by 6 points to 7 in the first half of 2015. Post general election, we are feeling more positive and optimistic, both about the general economic situation, but also about our personal finances. It is likely that this, in conjunction with sustained low interest rates, will provide stimulus for further growth in retail sales for the second half of the year.

![GfK Consumer Confidence Index Graph](image)

Source: GfK
OCCUPIER MARKET

- According to the ONS, during June, retail sales in the UK increased by 4.0% compared with June 2014. With 27 months of positive sales momentum, this is now the longest period of year on year growth since May 2008.
- In footfall terms, the out of town retail market has continued its outperformance of both shopping centres and high street retail. The BRC/Springboard Footfall Index found that footfall in out of town locations increased by 2.8% y/y in June, the 18th consecutive month of footfall growth, further demonstrating the UK consumer’s preference for the format. The popularity of click and collect is one factor driving this trend and has been one which the out of town retail market has been able to capitalise on with ease of access and free parking.
- The return of occupier demand, albeit moderate has heralded the return of some rental growth in the retail warehousing sector. According to IPD, rents have increased by 0.3% y/y in Q1 2015. This has been driven by demand from homewares retailers.
- Whilst growth in the housing market has indeed slowed in the past months, the occupational recovery has been aided significantly, with consumers spending money on goods to decorate homes before selling, or on buying furniture and soft goods. This has been reflected in the recent sales figures from Carpetright and Screwfix.
- Conversely, the uptick in consumer confidence has resulted in a slowdown of sales for the discounters, all of whom reported comparatively muted growth in their most recent updates.
- Fashion retailers have been on the expansion trail once again, though taking a far more measured approach. Mirroring the high street market, fashion occupiers are being very selective where new stores are taken, targeting regionally dominant parks with significant lease provision. The retailers showing strong sales growth are those who have successfully integrated a multi channel platform. On retail parks, this has meant encouraging the use of click and collect. Indeed, the service has grown in popularity to such a degree that John Lewis announced that they will now charge for it on orders under £30, whilst Tesco have increased the minimum basket size for free C&C to £40.
- F&B remains firmly on the menu for landlords wishing to bring their parks in line with UK consumer expectations for modern schemes with a significant and relevant leisure component. Operators such as Ed’s Easy Diner, Prezzo, Pizza Express and Nando’s have been taking space out of town this year.
- As a result of this increased take up, vacancies have been declining across the market. However, this has not been across all segments of the market, with persistent vacancies at older secondary parks across the UK still prevalent.

Source: Various
INVESTMENT MARKET

- The momentum gained in the latter half of 2014 has shown no real signs of abating in the first six months of 2015.
- The total volume invested in H1 was £1.48bn, just under a 41% increase on the same period last year.
- The focus of investment has been targeted very much on Open A1 prime schemes, though we have also seen a significant volume injected into more secondary assets.
- This has been driven by the recovery in the occupier markets which is reinforcing positive sentiment.
- UK Institutions were responsible for just over half of all purchases in the first six months of 2015. Significant inflows into specialist retail funds has ensured that the institutions are not only pricing other investors out of the market, but also creating an environment whereby investors must look beyond prime retail warehousing to more secondary stock.
- The purchase of Rushden Lakes by The Crown Estate perfectly illustrated the focus of investor demand - a purpose built shopping park with a focus on experiential retail and leisure. The site was purchased for £70m at a 4.65% NIY, subject to certain letting conditions being reached by the developer.
- Aberdeen Asset Management’s forward funding of Biggleswade Shopping Park was the largest single transaction within H1 2015. The Open A1 scheme was purchased for £115.8m from LXB Retail at 4.75% NIY.

PRIME YIELDS

- Birstall Shopping Park, Leeds was purchased by L&G Investment Management from Hercules Unit Trust, Aviva Investors and Hermes Investment Management for £110.1m at 6.52% NIY. The Open A1 park has a strong tenant line-up including M&S, Next and River Island.
- Prime yields for out of town retail have remained unchanged in the first half of this year. Whilst we are not anticipating anything like the yield compression of last year, we do anticipate compression of around 25 bps by the end of H2 for prime Open A1 schemes.

KEY DEALS

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<th>Address</th>
<th>Size (000’s sq ft)</th>
<th>Purchaser</th>
<th>Vendor</th>
<th>Price Yield (£m) (%)</th>
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<td>Aberdeen AM</td>
<td>LXB Retail</td>
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<td>L&amp;G Investment Management</td>
<td>Hercules Unit Trust/Aviva Investors, Hermes IM</td>
<td>110.1 6.52</td>
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<td>Hercules Unit Trust</td>
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<td>The Crown Estate</td>
<td>LXB Retail</td>
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<td>160</td>
<td>TIAA Henderson Aberdeen AM</td>
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<td>66.6 5.10</td>
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Source: Property Data, BNP PRE Research
INVESTMENT TREND: Time to start looking at supermarkets?

2015 has been a year of quiet recovery for the supermarket sector. After the hegemony of the ‘Big 4’ was questioned last year following probing from the discounters, sales volumes have begun to show tentative signs of improvement. Largely this has been due to the supermarket price wars which were initiated last year in response to Aldi and Lidl’s undercutting of prices. But with real wage growth starting to feed through against a backdrop of improved economic fortunes, the UK consumer is beginning to feel better off for the first time in several years. Might this prompt a return to the Big 4, or have the discounters initiated an irreversible cultural change in our shopping mentality?

The trend towards discounting has been felt across Europe. In reality, the situation in the UK has not changed as much as in France and Germany. The discounters in France now account for around 12% of the market, whilst in the UK this figure stands at around 9% according to recent data from Kantar. Encouragingly, the main French operators have managed to claw back 3% of market share by cutting prices, squeezing suppliers and promoting the concept of convenience shopping. If the Big 4 continue with their price cuts and fully embrace the trend towards smaller basket/higher convenience shopping, the UK grocery market could return to a market composition with discounters losing market share.

The other inescapable factor within the supermarket subsector is the growth of online sales. In comparison to the impact which the Internet has had on other subsectors such as fashion and electronics, grocery has been largely unaffected. Ocado’s steady sales increases, along with Amazon Fresh’s success in the US have given a glimpse of what the future may look like. Forecasts from Verdict estimate that the number of online grocery shoppers within the UK will increase by 26.5% between 2014-19. This will clearly have further implications on the profitability of some supermarkets. Convenience stores will be less affected by sales being cannibalised online. Instead it will be the larger stores with weak or supply saturated catchments which will see their sales at risk. As this has already been an area which Tesco, Sainsbury’s and Morrisons have already invested in, this is an area where the major operators have a significant advantage over the discounters.

So with prospects for the main operators improving, is it time to start looking at the sector again from an investment standpoint?

Although the defensive nature of supermarket investment is well known, with investors taking solace in 20-25 year RPI linked leases in times of economic uncertainty. However, the spikes in volumes are often not driven by investor demand, but instead by the supermarkets themselves, with decisions made at a corporate level to release freehold stores in sale & leaseback transactions. In 2010, annual volumes were distorted by a £958m Tesco sale & leaseback, and 2012’s volume was largely driven by three large portfolio deals. Despite the market often being distorted by these huge releases, supermarket yield movements across the entire peak to trough of the last cycle were far less pronounced than any other retail subsector, whose yield profiles are far more volatile in line with investor demand.

Pricing for prime stock softened by 15bps at the tail end of 2014, as investors were spooked by uncertainty in the sector.

And although prime yields will not move to levels much beyond the range seen in the period 2006-15, pricing for units will continue to display vast geographical variances.

Aberdeen Asset Management’s purchase of two separate sale and leaseback Morrisons stores in January this year was evidence of this, with a store in Reading trading at 4.35% YI and a store in Darlington at 5.70% YI. Recently the domain of income focussed funds, it remains to be seen whether the lower yield volatility of supermarket investments will increase demand from retail funds who have a close eye on liquidity.

The question moving forwards will be one of stock selection - prime 15,000-50,000 sqft stores which are dominant in their catchment, or well placed convenience stores will offer the greatest security in a market which has further potential for significant change in the coming years.