

## **There's Still Value in British Retail Market**

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There has been plenty of coverage of the appetite for British property this year which has included several high profile deals transacted by Irish buyers, representing both private investors and syndicated funds.

But there have been rumours recently, primarily linked with the rise in British interest rates, that Britain no longer shows good value. I believe this is not the case and by careful stock selection there is still good value there. I also believe Irish funds will continue to invest in the market, increasing their exposure compared to 2003. Economically, the Monetary Policy Committee (MPC) has reacted quickly to trends such as rising house prices, so much so that five-year forward-fixed interest rates have fallen from 5.54 per cent to 5.12 per cent over the last three months.

Inflation is well below the target rate of 2 per cent and there are definite signs that consumer spending and house prices have been tempered. Unusually, the MPC has even issued a statement saying that Britain has reached the peak of the interest rate cycle. There may even be potential for a downward shift in 2005. Overall, equivalent yields for property have fallen from 7.9 to 7.2 per cent over the last year and there is now little scope for arbitrage, especially in the retail market where highly geared investors have benefited over the last two years.

Consequently, achieving short to medium term capital appreciation from yield shifts alone is much harder. So, ignoring the long term investor who puts yearly performance lower down his list of priorities, where does the Irish buyer find value? Firstly, by identifying "rental growth hot spots" throughout Britain. It is no longer sufficient to choose by location or sector alone and rely on growth going forward to generate your return. The latest Investment Property Databank (IPD) figures back this up.

They show overall rental growth of 0.9 per cent per annum, which is hardly exciting. However, broken down, retail holds this figure up with rental growth of 3.6 per cent per annum, a rise of 50 per cent on last year. Even within this sector, retail in the Inner South East region showed 6.3 per cent per annum rental growth compared to 2.5 per cent per annum in Outer South East. Surprisingly, the biggest percentage increase in rental growth over the last year was in the office sector suggesting the beginning of a recovery.

Despite this, there are still discrepancies evident, with Central London offices still showing negative rental growth as opposed to Scotland and the North which showed rental growth of 2.1 per cent over the last year. These are general figures but highlight the need to be stock led and not sector or location led. Such is our confidence in the growth potential of the British market, Colliers Jackson-Stops along with our associate company Colliers CRE has recently been instructed as advisor to the Augusta UK Commercial Property Fund.

This is seeking to invest Stg£10 million there and to deliver a target return of 12 per cent per annum by identifying rental growth hotspots. It is a closed-end fund with a minimum entry level of €1,000. As a further example, Colliers has recently purchased a retail shop in Folkestone on behalf of a private investor who purchased the property as part of a pension fund.

This high street property was let to Edinburgh Woollen Mills with nine years remaining at a yield of around 5.5 per cent. The property is in a prime pitch, near a new shopping centre development which has just received planning and is anchored by Asda. The town has suffered through a lack of good shopping facilities and is now attracting some major tenants who should put upward pressure on rents. Colliers therefore believe there is good potential for rental growth when compared to similar towns. This indicates potential to improve the yield to over 7 per cent on review. Good value can also be achieved by looking at short leases. Shorter leases, although requiring more equity input, can provide superior returns across the sectors. For example, Colliers Jackson Stops is currently negotiating an office purchase in the South East that has six years of secure income left at a market rent.

The yield however is above 7.5 per cent. At the end of the term, there is good potential for reletting as offices as the location is excellent. Alternatively, a change of use to residential may be possible, with further development potential at the rear. Shorter leases on retail property will be more attractive to banks in terms of financing and, as with a small investment purchased recently on behalf of a client in Hemel Hempstead let for a further six years to Early Learning Centre, can show excellent reversionary potential.

The property reflected an initial yield of 6 per cent which should rise to nearly 7 per cent on review. The investment should also attract a yield re-rating on renewal, since the tenant is most likely to renew on a 10 or 15 year lease because of the excellent pitch. Value can also be added through active management and multi-tenanted properties across each of the sectors. Funding arrangements will often dictate the quality and strength of tenants required, as well as the importance of location.

A good example would be a secondary block of modern retail in Derby on the market recently with Laura Ashley and Thomas Cook, among others, as tenants, all with short term leases with reviews next year. The property was bought for around Stg£2.9m, which showed an initial yield of 5.7 per cent but a reversionary yield of over 7.4 per cent. The likelihood of all the tenants leaving at one time is small, offsetting the risk associated with multiple short term leases. There may be some risk that retail yields especially, may soften in some sub-regional areas, where historically prime yields have been higher.

To ensure your return is not adversely affected and value is obtained, proper advice is essential to highlight those locations that show good potential for rental growth. Alternatively, taking more risk in terms of shorter leases or active management can be very rewarding and as you can see above yields of well in excess of 7 per cent are achievable. As a result, the British market will remain a favourite with the Irish banks

and will continue to attract favourable lending terms. Jonathan Hillyer is an associate director at Colliers Jackson Stops.