LA16

Community Infrastructure Levy: Gosport Draft Charging Schedule

Post Hearing Questions 2

Issue: Supermarket Yields and Commercial Development Appraisal for Smaller Supermarket

Date: 21st May 2015

GOSPORT
Borough Council

The Inspector notes the recent correspondence from Barton Willmore in respect of the Inspector's request to the Council for updated commercial development appraisals for supermarkets.

In light of Barton Willmore's comments does the Council still consider that 5.5% is an appropriate yield value for this form of development? If so could they please provide further evidence to justify their position.

Furthermore, the Inspector notes that there is no current demand for new large supermarkets in Gosport and that the demand is from discount food retailers such as Lidl and Aldi. Given Barton Willmore's comments relating to store size, he would be grateful to receive an appraisal using a store size of 1700sqm.

Considering the above, do the Council still consider a CIL rate of £60/sqm to be justified or would a rate of £30-£40 be more appropriate?

The Council still considers that 5.5% is an appropriate investment yield to for all forms of supermarket development across the district at the current time.

This conclusion is taken from a variety of different sources including agents marketing particulars, conversations with agents active in the investment market and other market reports.

In the absence of directly comparable transactions, the valuation technique is to take an overview of the appropriate and available evidence and to then make an informed judgement taking into consideration the local factors and market conditions based on the evidence available.

An example of one of these sources is UK Supermarket Investment Report 2014 (pages 4-5) attached as Appendix 1. It is recognised that the discount food retailers are taking smaller stores. Also that the investment profile for an investment let to a discount retailer may achieve a slightly higher yield that an investment let to one of the 'big four' supermarket operators. Also it is noted that this differential is reducing.

A new larger format store let to either Sainsbury's, Morrison's, Asda or Tesco's would be expected to achieve 4.5% - 5.0% depending on the lease terms. Whereas we have taken a more conservative approach by using 5.5% to allow for these factors for the whole category overall. Based on the market commentary, investment yields for discount food stores are expected to reduce due to the increasing popularity as an investment vehicle.

An appraisal for a 1,700 sqm store has been provided with this response (Appendix 2). This shows a surplus of £10,958 after a £60 per sqm CIL charge has been deducted. The CIL charge at this level equates to 2.15% of the Gross Development Value which is considered to be a reasonable.

The sensitivity testing shows that just a very small 0.25% reduction in the investment yield to 5.25% results in an increased surplus of £325,817 before a CIL charge and £202,438 after a £60 psm CIL charge. This CIL charge amounting to only 2.05% of the GDV (Appraisal provided as Appendix 3).

The investment market and the economy generally continue to improve. Therefore we consider that by the time a current development is ready for the investment to be sold, yields will be at the lower end of the sensitivity testing and CIL charging will become more affordable.

Consequently we consider that a CIL rate of £60/sqm is justified and leaves sufficient buffer not to affect development from coming forward.

Appendix 1

UK SUPERMARKET INVESTMENT REPORT 2014

Prepared by MSCI in association with Colliers International

Colliers INTERNATIONAL

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INTRODUCTION

MSCI and Colliers International have continued their collaboration in market research to produce the fourth annual UK Supermarket Investment Report. As investors continue to target long-term, secure cash flows from strong covenants, supermarkets have dramatically increased in popularity in recent years, developing into their own specific property investment class. This report examines the main drivers behind their investment performance during 2014 as well as the factors influencing the decision to invest in supermarkets.

This report is divided into two distinct parts. The occupier market, transaction and investment market sections are based on Colliers International's analysis of 53 investment transactions and 102 occupier transactions which completed during 2014. The investment performance section is focussed on supermarket assets within the IPD UK Quarterly Property Index. As at the end of December 2014, the IPD supermarket sample contained 268 properties with a combined value of £6.8 billion.

EXECUTIVE SUMMARY OF 2014 REPORT

- Supermarket sector still coming to terms with impact of discounters, the growth of online food retailing and the over-provision of stores in some locations
- Clearly defined prime and secondary sectors of the supermarket investment market have now been established
- Transactional investment volumes in 2014 were £1.3bn (2013: £1.8bn)
- UK supermarkets provided investors with a total return of 7.0% y/y (2013: 11.0%)
- Average market rents were up 0.3% y/y with instances of over-renting in some areas
- Despite curtailed expansion plans there is still 3.64m sq ft of superstore space in the development pipeline
- Development focused on strong demographic areas and emergent locations such as East London
- Inherent strengths of the sector remain and there are strong, long-term returns available if the property fundamentals of assets are sound

OVERVIEW

THE INVESTMENT MARKET IN 2014

It was inevitable that the turbulence in the supermarket sector during 2014 would also be reflected in its property investment market.

In last year's report, we cautioned that simply 'buying income' was not the way forward in a sector where assets are influenced both by property fundamentals and also the operational viability of the stores which inhabit the spaces being traded.

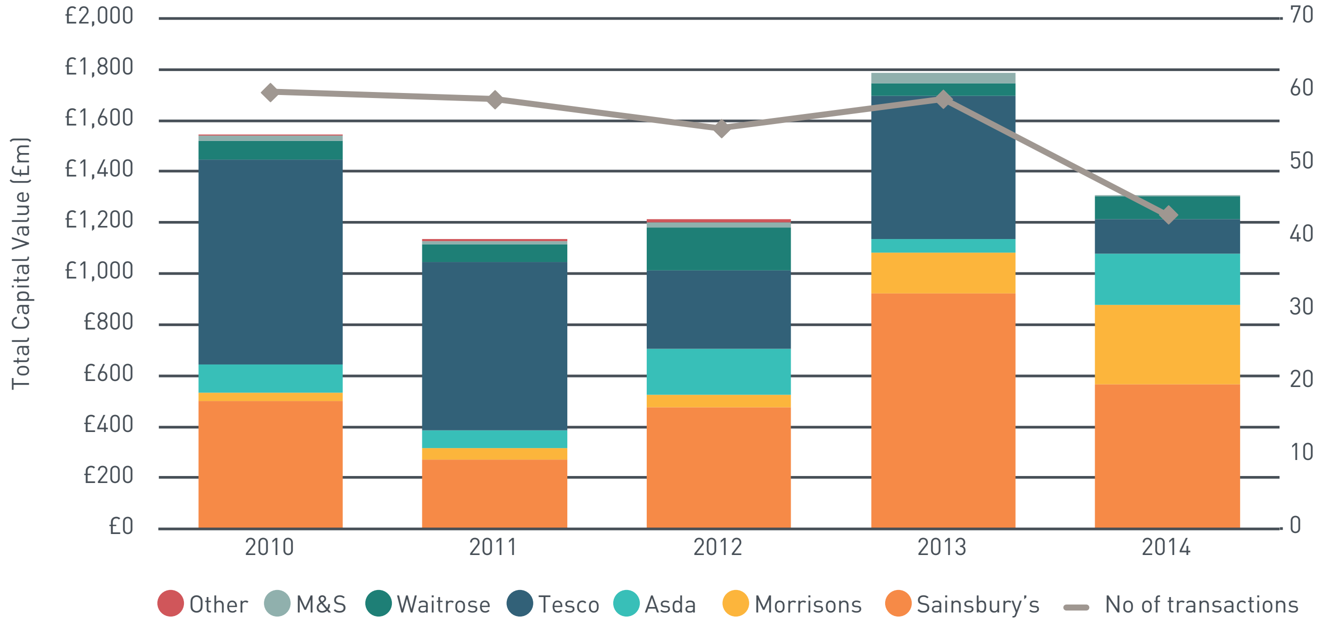
This point came into sharp focus last year as the Big Four battled with new competition, lower resultant margins and the growth in non-profitable internet retailing. Against this backdrop, the supermarket investment market has now developed a clearly defined secondary market.

TRANSACTIONAL VOLUMES DOWN

With the media full of headlines about the difficulties facing the major operators, it was hardly surprising that this affected investor sentiment, but 2014 still remained above the annual average of around £1bn of transactions.

Although transactional volume was down 27% to £1.3bn (2013: £1.8bn) there was still assiduous buying by investors. Deal volumes peaked in Q2 2014 at £500m and dipped thereafter as the depth of problems facing the operators became increasingly obvious.

FIGURE 1: SUPERMARKET TRANSACTIONS IN 2014, £ MILLIONS



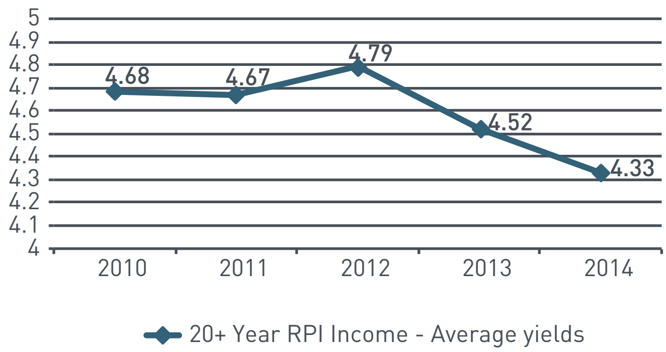
Source: Colliers International

This demonstrates the resilience of the sector and also the appetite for index-linked leases which underpin the majority of traded assets. This lease feature and the underlying continued covenant strength of the Big Four has ensured that there have not been investor defections on the scale that might have been envisaged.

PRIME REMAINS STRONG

It was the secondary market that bore the brunt of changed investor sentiment, whilst prime remained resilient.

FIGURE 2: AVERAGE YIELDS FOR 20+ YEAR RPI-LINKED INCOME, %



Source: Colliers International

Given the inherent uncertainty that has characterised the market in the past year, prime yields have not moved significantly, investors remain keen on strong, healthy, right-sized stores in good demographic locations. These remain liquid assets.

Yields have softened for flawed stores which are over-rented, face considerable competition or suffer from a lacklustre demographic. There is no longer an obvious replacement tenant and residual values have been adversely affected.

Institutional investors have responded by discreetly looking to exit from the poorer stores in their portfolios, more often than not at yesterday's valuation. The market is resisting this leading to a significant increase in supply. Conversely, prime supermarket investments remain thin on the ground which is also supporting their values.

TABLE 1: SIGNIFICANT INVESTMENT DEALS IN 2014

DATE OF EXCHANGE	TOWN	ADDRESS	TENANT	ACHIEVED £m	NIY	VENDOR	PURCHASER
JAN2014	London SE2	Cross Quarter, Abbey Wood	Sainsbury's	38.10	4.41	Development Securites	Canada Life
APR2014	New Malden	24-38 High Street	Waitrose	24.60	3.85	Eskmuir	SWIP
APR2014	Dulwich	Dog Kennel Lane	Sainsburys	68.00	3.95	Hermes	M&G
APR2014	Halifax	Sowerby Bridge	Tesco	19.45	5.00	Threadneedle	Blackrock
JUN2014	Worcester	London Road	Waitrose	20.00	4.44	Opus Land	Charles Street Buildings
JUN2014	Rustington	New Road	Sainsbury's	66.60	4.18	Store Properties	BP Pension Fund
MAY2014	Norwich	Hall Road	Morrisons/ B&Q	34.20	4.65	IVG	CBREGI
	Luton	Wigmore Lane	Asda	42.50	4.20	AXA	Henderson
NOV2014	London NW9	399 Edgware Road	Morrisons	40.17	4.65	Development Securites	Aberdeen
NOV2014	Rugby	385 Dunchurch Road	Sainsburys	59.25	5.00	BL/Harvest	Deutsche
NOV2014	Nottingham	Castle Bridge Road	Sainsburys	50.13	4.95	BL/Harvest	Deutsche
DEC2014	High Wycombe	Temple End	Morrisons	38.00	4.30	Morrisons	USS

Source: Colliers International

RENTS

The relationship between assets let on RPI-linked leases and those on Open Market rents (OM) changed during the year. Over the past few years, inflation has – through the RPI linkage – grown rents well ahead of open market rents.

Most recently open market rents have dropped back in some locations, but RPI – while also slowing in its upward progress – has still been increasing rents. This is leading to over-renting in some areas of the market, and is a phenomenon that the sector will have to deal with in the same way as the other retail subsectors.

DEVELOPMENT PIPELINE

Tesco's decision in 2014 not to fit-out out a new store in Chatteris to which it was committed on a 25-year lease was a watershed moment for the supermarket development sector and the forward funding market that enables it.

Forward funding in 2013 accounted for 20% by value of all supermarket investment activity. This fell to around 18% last year and there will be a significant reduction in supply and demand for these deals in 2015 until the occupational market reaches equilibrium.

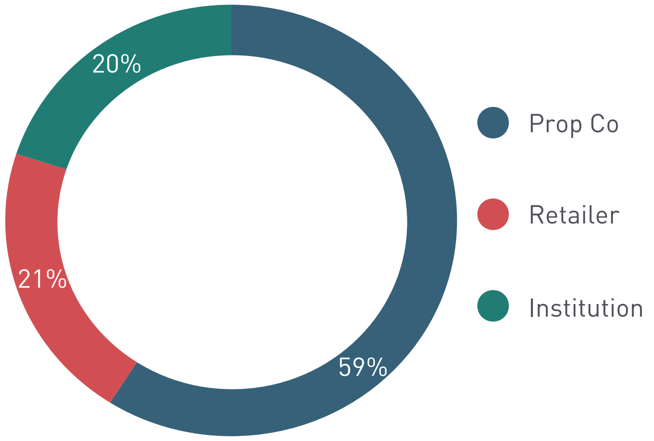
There are still incidences of forward funding but these are limited to the strongest of locations – primarily within the M25 – where the tenant's commitment is undoubted.

There are locations where the operators continue to expand. A good example is East London which is by no means over-provided and is demographically progressive. London is expanding and eastwards down the Thames corridor is an obvious direction for it to head. The emerging strength of locations such as Shoreditch, Dalston, Stoke Newington is now spreading to places such as Barking, Stratford and beyond. Affluent catchments also continue to prove attractive with new stores opening in locations including Guildford, Oxford and Bagshot later this year.

AN INSTITUTIONAL MARKET

The investor profile for the supermarket sector remains essentially unchanged. In 2014, UK institutions accounted for 86% of all purchasing activity, very much in line with 2013.

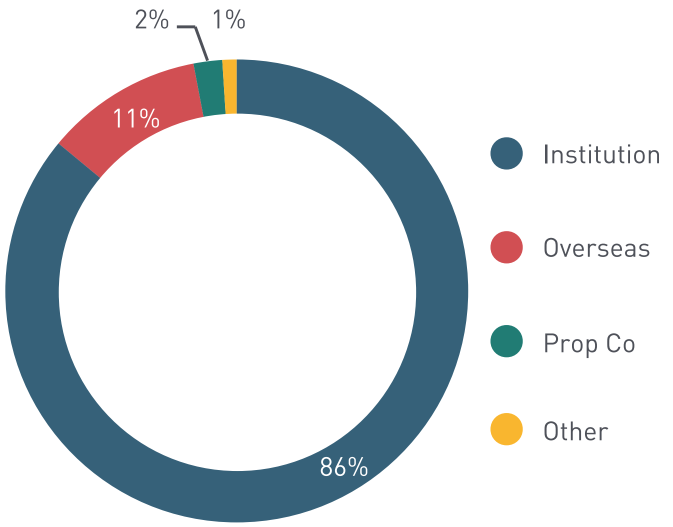
FIGURE 3: TRANSACTIONS IN 2014 BY VENDOR (% CAPITAL VALUE)



Source: Colliers International

Last year's report noted that the market had seen the arrival of overseas buyers predominantly from the Far East who were typically looking for less-than-prime stores at yields of around 5%. They ended up with 11% of the market in 2014 from a standing start, and we expect this demand will continue to build from a greater diversity of nationalities.

FIGURE 4: TRANSACTIONS IN 2014 BY PURCHASER (% CAPITAL VALUE)



Source: Colliers International

This year we will see a rise in sales by institutions as some investors look to reduce their exposure to the sector. With 2014 returns from supermarkets looking underwhelming in comparison to other property asset types, some owners will look to sell and an equalisation in valuations will lead to a number of these stores heading offshore.

SUPPLY

Prior to last year, Tesco and then Sainsburys had been the principal supplier of investment grade, sale-and-leaseback product, but in 2014 it was Morrisons who were dominant. A relatively late arrival to the party, they made up for lost time with the successful £500m program of disposals (of which £300m were food stores) that ex-Chief Executive Dalton Philips had outlined to their shareholders in March 2014.

The operators have now predominantly called a halt to sale-and-leaseback activity and we do not expect them to be a major supplier of product in 2015. Whilst this would normally mean a reduction in supply we believe the shortfall will in part be met by the disposal of stores held in JV's with others.

THE DISCOUNTERS

Barely a week went by in 2014 without the media reporting how the discounters were taking chunks out of the Big Four's market share. Whether this will be sustained is more of a moot point and there are indications that there will be a finite market share for the discount offer. What cannot be denied – and this may be the discounters' lasting legacy – is that they have forced down profit margins across the sector.

OUTLOOK

The problems that the supermarket sector has faced in the past year have perhaps been exaggerated.

As a business sector, it certainly faces substantial challenges and, in the medium-term, some will pay the price for over-exuberant expansion.

Margins and profitability are down but, at its core, the supermarket business remains robust. Tesco has been the target of most negativity and yet is still a business that even during the chaos of 2014 achieved a £1bn+ profit.

So where does that leave the property investor looking to buy supermarket assets?

Areas of the market are definitely in motion. We think yields will deservedly hold fast for the prime, healthy product, where the investor is less sensitive to lease structure.

But returns for open market stores are being affected and the secondary market has more pain to come. The current average yield gap between prime and secondary assets is simply not wide enough to reflect the inherent risk profiles of these assets.

For all operators, it is the consumer's increasing predilection for online delivery topped up by convenience basket shops leading to the demise of the super profits generated by the traditional trolley shop that is at the heart of their problems. Grocery delivery is not an area where the operators can make profits – yet.

However, whilst we have discussed the internet's disruption of the occupational market at length, it is worth considering the positive effect Quantitative Easing will continue to have on the investment market for these assets in 2015. Gilt yields have hit record lows as returns on sovereign debt have fallen across the globe, and as the ECB embarks on its own Eurozone stimulus programme it is probable yields on alternatives such as property will remain attractive in comparison. In turn, within the property sub-sectors returns from supermarkets continue to compare favourably to those available in the Office & Industrial sectors.

So operators are heading into an era of lower margins. They are going to make less profit, and that has to be factored into the sector's underlying property investment market.

However, the inherent strengths of the sector remain and if investors can also get the property fundamentals right then there are consistent, long and strong returns on offer.

THE OCCUPATIONAL MARKET

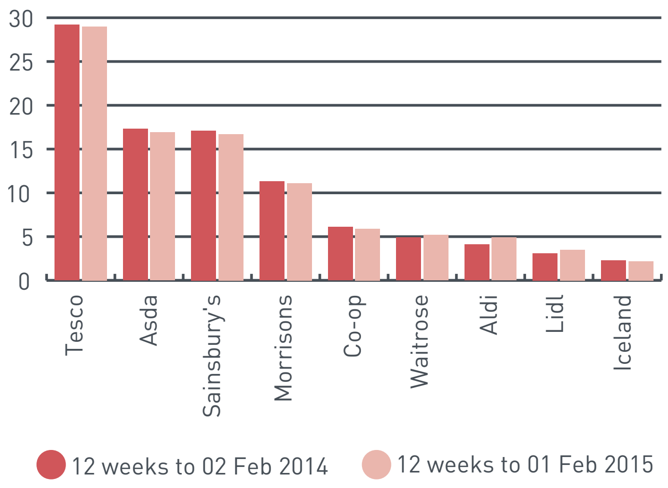
A NEW DIRECTION

Following a period of unprecedented growth during the "race for space", 2014 saw a continuing pattern of limited new superstore acquisitions as the major operators took stock of the new stores/developments they had acquired and the direction of the grocery sector.

The strong growth of the discounters continued, albeit at a slower rate than in the previous two years. The high-end operators also continued to expand, driving hard bargains in situations where they were the only operator for a site.

The changes in market share of the various operators are shown in the graph below.

FIGURE 5: GROCERY MARKET SHARE



Source: Kantar Worldpanel

The declines in the market shares of the 'Big Four' operators' put renewed pressure on the senior management, leading to changes in leadership. The new and existing management teams all announced major investments on price and cost saving packages to maintain/recover margins.

"Segmented shopping" grew apace, with shoppers visiting an average of four different grocery stores a month and almost half visiting two stores on the same trip.

Online deliveries continued to grow albeit at different rates thoughout the country, depending upon population and levels of affluence. The major operators continued to subsidise the cost of online deliveries from other parts of the business, putting further pressure on margins.

As a solution, click-and-collect was heavily promoted to meet shoppers' demands for quick, easy grocery shopping whilst avoiding the additional cost of the deliveries. New click-and-collect points were identified and acquired in underground stations and petrol filling stations.

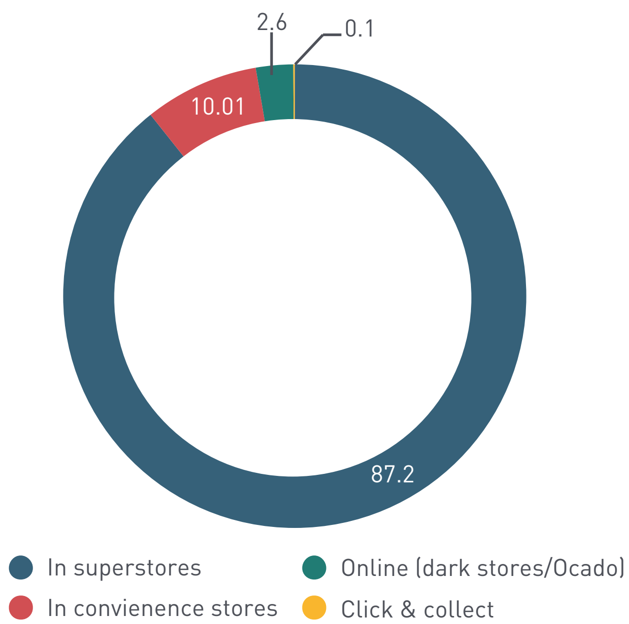
No new "dark stores" opened, with the majority of online fulfilment taking place in dedicated pods in the larger superstores. Online sales are still highest where an operator has a major superstore nearby. Bricks and mortar superstores are therefore needed not just to service the online offer, but also to drive online sales.

Following a review of the sites acquired during the years of heavy expansion, Tesco, Morrisons and Sainsbury's all announced major write downs in their the value of their property assets. Tesco announced the closure of 43 smaller, 1st generation or "Homeplus" stores along with the shelving of 49 of their largest development schemes. Morrisons followed suit with the closure of 9 small stores acquired from Netto/Co-op and some underperforming M-Locals.

Meanwhile, the major operators continued their expansion into the convenience sector to take advantage of the evolution of shopping patterns, where "little and often" top-up shopping trips supplement larger trolley shops.

It is interesting to note the percentage of shopping fulfilled in the various channels is estimated as follows:

FIGURE 6: GROCERY SHOPPING CHANNELS



Source: Experian

"THE DEATH OF THE SUPERSTORE IS GROSSLY OVER-EXAGGERATED"

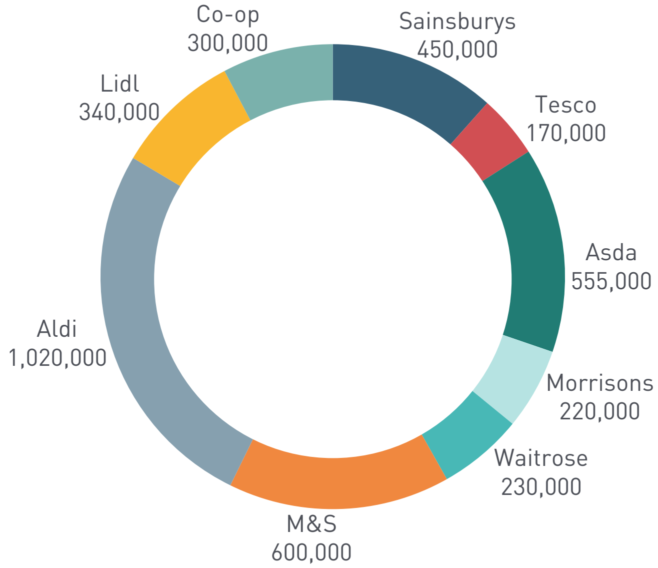
(MIKE COUPE – CEO SAINSBURY'S)

It can be seen from the above that despite the growth of the discounters, online and expansion into convenience, supermarkets remain by far the most common medium for shopping fulfilment. To quote Mike Coupe, the new CEO of Sainsbury's "We've seen a lot of coverage about the death of the superstores and I think that's grossly over-exaggerated."

Following the recent period of heavy expansion, the superstore business is not only mature, but has, in some locations, reached saturation. Stores have been acquired in locations which, in the cold light of day, are not going to generate the required levels of returns. The mothballing of Tesco's proposed store in Chatteris is a good example; it is a small, Fenland town in East Anglia – and not the type of location that is likely to generate Tesco's required returns of c.6%

However, the supermarket operators are still planning new superstores. For the 'Big Four' operators, these are down on previous years and generally not at the largest end of the scale, whilst the hard discounters are a real growing force in terms of expansion. The total estimated expansion plans for the current year are shown in the pie chart below.

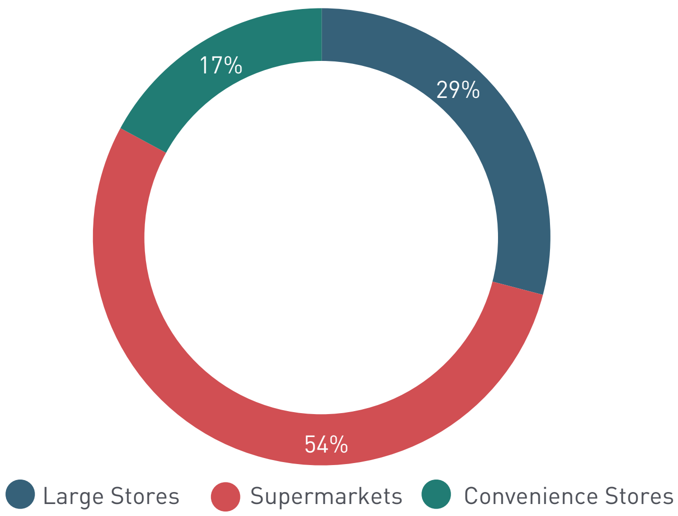
FIGURE 7: SUPERMARKET EXPANSION PLANS 2015 BY OPERATOR (SQ FT)



Source: Colliers International

This amounts to a total of around 3.9m sq ft of new space. The pie chart below shows that the majority of the expansion (c.54% of floor space) relates to small supermarkets (sales areas from 3,000 to 15,000 sq ft), with large stores accounting for 29% and convenience stores 17% of floor space.

FIGURE 8: SUPERMARKET EXPANSION PLANS 2015 BY STORE TYPE



Source: Colliers International

RE-GEARS

Importantly, many of the early sale-and-leaseback transactions from 2009 have been subject to high rates of inflation. With the slowdown in rents, in many cases, the rents increased by RPI are above market value. This creates a problem for the operator (as the store will no longer be generating the required returns) as well as the landlord, (as the over-renting will affect performance). The most obvious solution is a re-gear to open market rent in return for a capital contribution or extended lease term and we have seen one or two cases of this on a piecemeal basis. However, there is no joined up thinking that would make a real difference from the operators' viewpoint. A systematic approach on this would provide a solution on a scale that would be of significant benefit to the operators.

SIGNIFICANT OCCUPATIONAL DEALS IN 2014

With the reduction in the operators' expansion plans and most locations in the UK already well covered by one or, more usually, several of the major supermarket operators, there have been fewer new lettings throughout 2014. The following is a snapshot of the types of deals that have been agreed.

TABLE 2: SIGNIFICANT OCCUPATIONAL DEALS IN 2014

Location	Tenant	Date	Transaction	GIA	Rent per sq. ft
Stonecot Hill, Morden, Surrey	Asda	Nov 2014	Letting	10,700 sq ft	£32.71 psf
Sundon Park Luton	Aldi	Oct 2014	Letting	16,500 sq ft	£17.00 psf
Broadheath Altrincham, Cheshire	Asda	June 2014	Letting	70,000 sq ft	£14.30 psf
North Worle, Weston-super-Mare	Sainsbury's	March 2014	Rent Review	73,797 sq ft	£21.50 psf (from £21 psf)
Bourge's Boulevarde, Peterborough	Waitrose	Feb 2014	Letting	40,493 sq ft	£16.86 psf
Clifton Moor, York	Tesco	Jan 2014	Rent Review	109,662 sq ft	£27.85 psf (from £25 psf)
Trinity Road, Uttoxeter, Staffordshire	Waitrose	Jan 2014	Letting	36,500 sq ft	£17.50 psf

Source: Colliers International

GOING FORWARD

In 2015 and beyond, we see the market continuing to evolve as follows:

- Few large superstore lettings, in a generally saturated market
- Potentially more closures of underperforming smaller, 1st generation stores
- 'Big Four' operators reducing store sizes and bringing in concessions/other uses as they review their non-food ranges
- Discounters continuing to grow, seeking larger stores but at a lower rate
- More "convenient" stores of 10,000 to 15,000 sq ft offering wider range of convenience type foods
- No major expansion in dark stores as most online fulfilment continues to take place in superstores
- More "click and collect" collection points
- An increase in lease re-gears presenting an opportunity for investors and operators alike.

IPD SAMPLE SIZE

The standard retail sample with which supermarkets are compared to in this report differs from that used in other MSCI data publications, as supermarket assets have been removed to allow for a direct comparison between the two data sets. Standard retail covers standalone shops, bars and restaurants, while all retail also includes shopping centres and retail warehouses, as well as supermarkets. This report has been produced on a held sample basis, excluding developments and transactions.

Both the supermarket sample and the standard retail sample are sourced from the IPD UK Quarterly Property Index as at the end of Q4 2014.

Table 3 shows a breakdown of the capital value and number of properties for supermarkets, standard retail excluding supermarkets, and all property assets in the IPD UK Quarterly Property Index.

TABLE 3: SAMPLE SIZE, AS AT DECEMBER 2014

	Capital value (£million)	Number of properties	% of total UK IPD assets
Supermarkets	6,773	268	5
Std Retail (ex. Supermarkets)	14,999	1,699	11
All Property	139,975	9,746	100

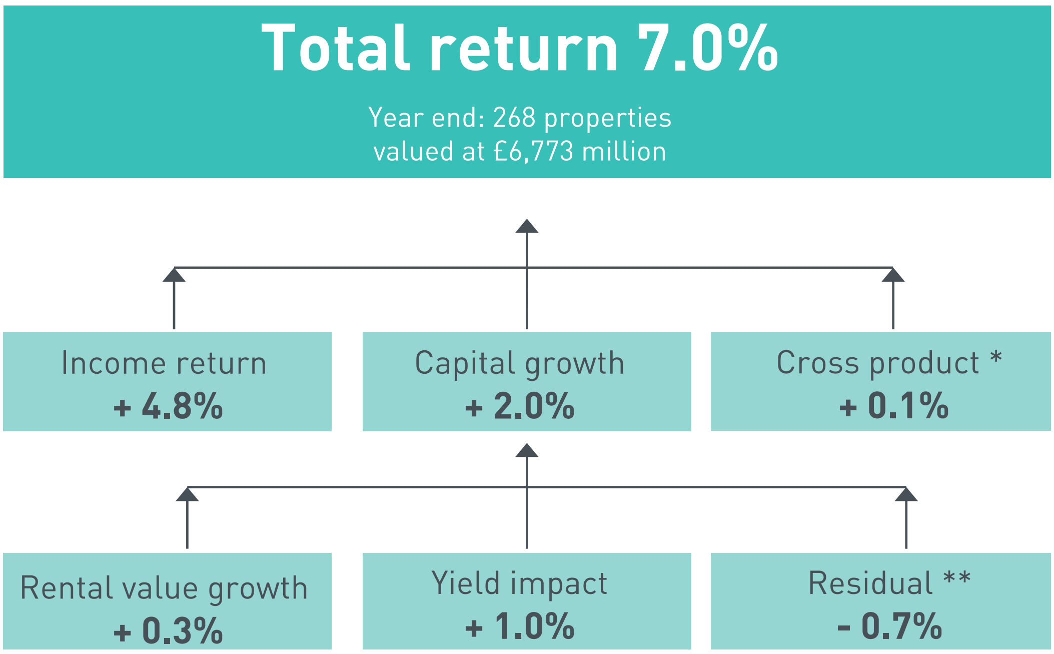
Source: MSCI

INVESTMENT PERFORMANCE

The year 2014 marked a significant turning point for the UK commercial property market, as sustained growth in both capital values and rents spread nationwide. Total returns for the UK market hit their highest level since 2005 and rents grew for all key property sectors as confidence returned to occupiers. Broadly positive economic news further boosted the attractiveness of investment real estate as the expectation of future rental value growth spurred on investors to bid more aggressively and consider riskier income streams.

Supermarket total returns moderated in 2014, falling to 7.0% from 11.0% the previous year. The 2013 return had been comfortably ahead of standard retail and all property, but a cautious outlook on supermarket trading and ongoing occupier concerns meant that the segment underperformed other property types in 2014. Standard retail excluding supermarkets returned 16.4%, up from 9.6% in 2013, making last year's performance for that segment the strongest recorded since 2005. **Table 4** illustrates the headline performance figures for supermarkets in 2014.

TABLE 4: SUPERMARKET PERFORMANCE SUMMARY 2014, % YEAR-ON-YEAR



* Cross product: capital gain / loss in reinvested income
** Residual: impact of delays in income stream, mainly effect of over-renting

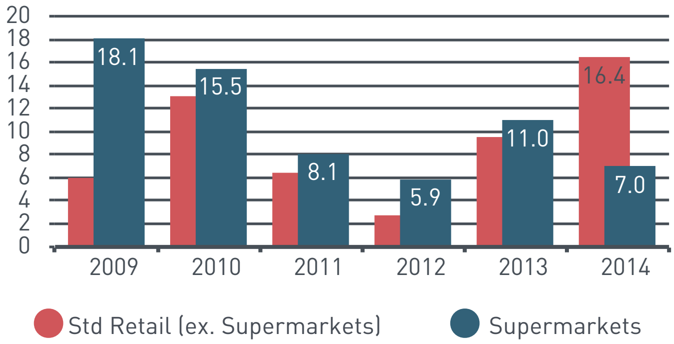
Source: MSCI

Overall in 2014, UK total returns from real estate hit 17.9% year-on-year (y/y), outpacing both UK Equities which returned just 0.5% and UK Government Bonds which returned 12.9%. UK Property Equities outperformed all major asset classes with a return of 24.3% as analysts took an optimistic view on future rental expectations given improvements in the economy, including the broader retail sector.

Investor returns were higher for all major property sectors than in 2013, industrials leading the market with 23.3% y/y, followed by offices on 22.3% y/y and retail on 14.0% y/y.

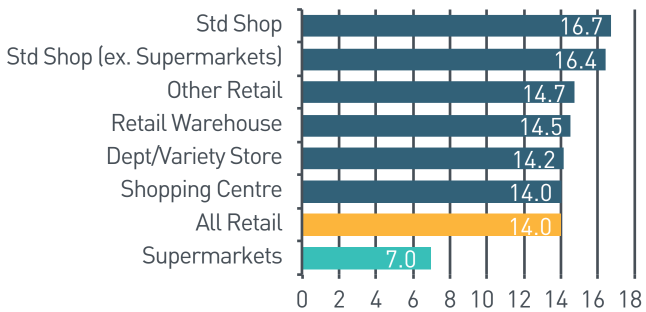
Therefore the weakening of supermarket returns in 2014 contrasted with the general market trend, but conversely in many previous years when the broader market was weak, such as 2009, supermarkets went against the grain, significantly outperforming as investors homed in on the long-term secure income streams which dominate supermarket leasing. The recent decline in supermarket investment performance is illustrated by **Figure 8**, which highlights the contrast with improving returns for standard retail.

FIGURE 8: SUPERMARKET TOTAL RETURNS 2009-14, % YEAR-ON-YEAR



Source: MSCI

FIGURE 9: HEADLINE TOTAL RETURNS IN 2014, % YEAR-ON-YEAR



Source: MSCI

PERFORMANCE BY RETAIL TYPE

The broader retail sector can be broken down to six specific types of retail property as illustrated by **Figure 9**. In 2014, standard shops led performance with a total return of 16.7% y/y, reflecting improving conditions on Britain's high streets after six difficult years. When supermarkets, mostly small in-town "express" style stores, are removed from the standard shop sample, returns for the high street fall to 16.4% y/y, indicating that local supermarkets have traded recently and become increasingly popular among investors.

After the high street, other retail was the next strongest performer with a total return of 14.7% y/y. As for the broader retail market, this represented a significant improvement on the 11.5% y/y returned in 2013, although the acceleration was less pronounced due to the relative strength of this retail type in previous years. This retail segment is primarily made up of non-traditional retail units including restaurants and pubs, predominantly in leisure and entertainment use.

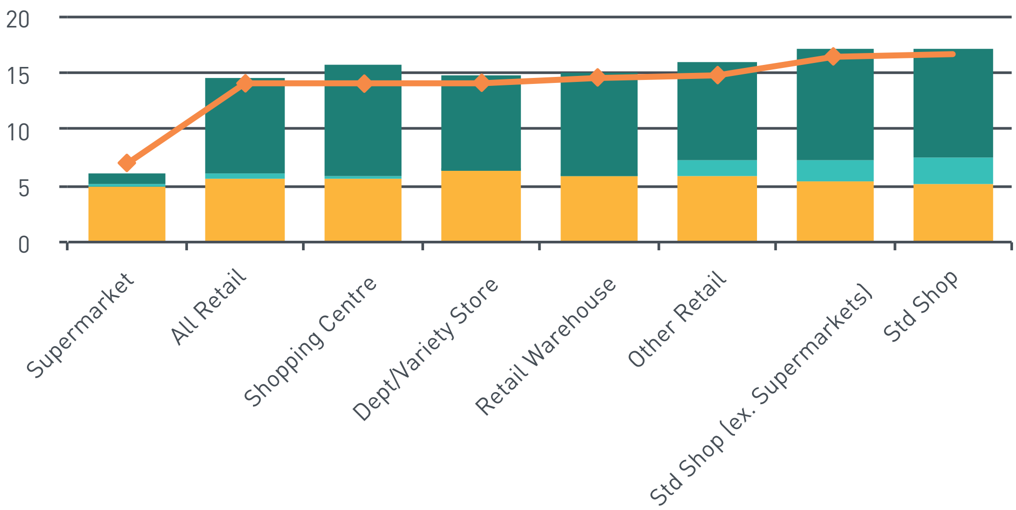
Previously, in 2013, supermarkets had provided returns more in line with other retail, as both comfortably outperformed all retail, within which standard shops had returned 9.5% y/y and retail warehouses 7.4% y/y. The marked weakening in returns during 2014 was contrasted noticeably with the resilience of the supermarket segment immediately after the crash. The other retail property types are now experiencing the kind of bounce back in performance that supermarkets witnessed in 2009 and 2010.

The majority of the total return generated by supermarket investments in 2014 came from income, as shown by the income return of 4.8% y/y. This is the lowest income return of any standard retail property type, reflecting the low perceived risk associated with the income from supermarket occupiers and the comparatively long leases signed.

The remainder of last year's total return came from minor positive contributions to capital growth from both yield impact (a proxy for investor sentiment), and rental value growth (a sign of occupier confidence) at 1.0% y/y and 0.3% y/y respectively. Supermarket rents tend to grow at a slower pace than traditional retail investments due to the dominance of inflation linked leases. Nevertheless, the 0.3% y/y growth in 2014 was the lowest recorded for this market since the IPD Quarterly Index began in 2001.

Of the various other types of retail investment, shopping centres saw the greatest improvement in investor sentiment during 2014 with a yield impact of 10.0% y/y, confidence returning to this segment in the wake of some significant investment transactions through the year and improving consumer expectations. Standard shops and retail warehouses saw similar improvements in investor sentiment, with yield impact the primary driver of total returns here as well. Only other retail and standard shops witnessed above average rental value growth, at 1.4% y/y and 2.3% y/y respectively.

FIGURE 10: DRIVERS OF TOTAL RETURN IN 2014, % YEAR-ON-YEAR

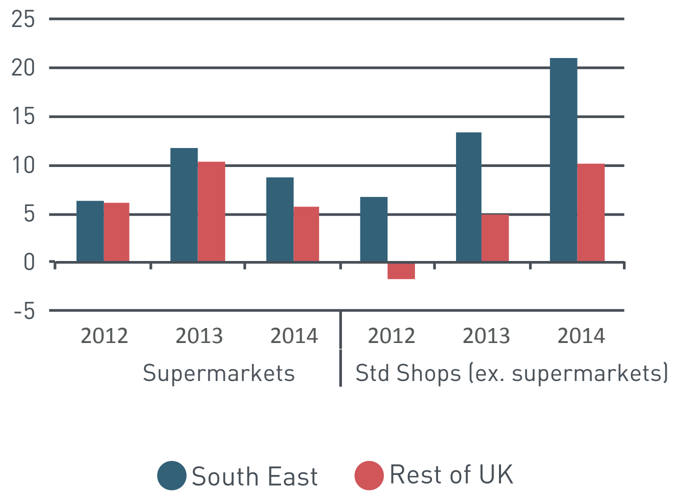


Source: MSCI

PERFORMANCE BY REGION

The influence of the London economy has consistently boosted the performance retail in the South East since the market crash of 2008, leaving the rest of the country lagging. The latter months of 2013 were a significant turning point for the broader UK market as positive return trends finally spread out from London, with values returning to growth for the majority of markets. Similarly, the retail performance gap between the buoyant South East market, which includes London, and the rest of the UK narrowed with the strong returns recorded in 2014.

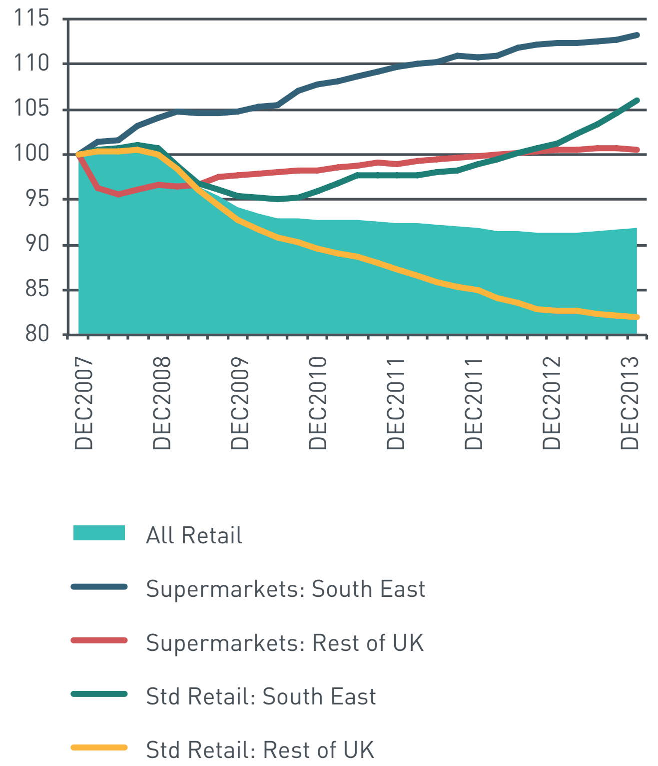
FIGURE 11: TOTAL RETURN BY REGION IN 2014, % YEAR-ON-YEAR



Source: MSCI

The performance gap between supermarkets in the South East and the rest of the UK has always been less pronounced than for the broader retail sector, as supermarkets are less affected by regional trading and economic patterns than are non-essential retailers. For 2014, supermarkets in the South East returned 8.6% y/y, down from 11.7% in 2013, whereas stores in the rest of the UK returned 5.6% y/y. This 300 bps spread was the largest divergence in recent years and mainly resulted from the volatile performance of supermarkets in the final months of 2014. **Figure 11** illustrates recent performance trends for supermarkets and standard retails by UK region.

FIGURE 12: RENTAL VALUE INDEX BY REGION, DECEMBER 2007 = 100



Source: MSCI

In 2014 occupier demand was more bullish around London than elsewhere in the UK, part of the reason that the strongest returns were recorded in the South East. Rental values here for both supermarkets and standard retail have recovered strongly since the market crash of 2008, both exceeding their previous cycle peaks, in contrast to standard retails in the rest of the UK which are yet to return to sustained rental growth. In 2014, rents fell by a further 0.9% y/y for rest of UK standard retails but grew by an impressive 4.7% y/y in the South East.
Likewise, rents fell by 0.1% for supermarkets in the rest of the UK while growing by (an albeit more modest) 0.8% y/y in the South East. However, such declines are more attributable to the weakening occupier and trading sentiment associated with upheavals among some of the major supermarket operators, rather than regional demand trends as such. Rental growth movements since the capital value peak in Q4 2007 are displayed in **Figure 12**.

PERFORMANCE BY SIZE AND LOCATION

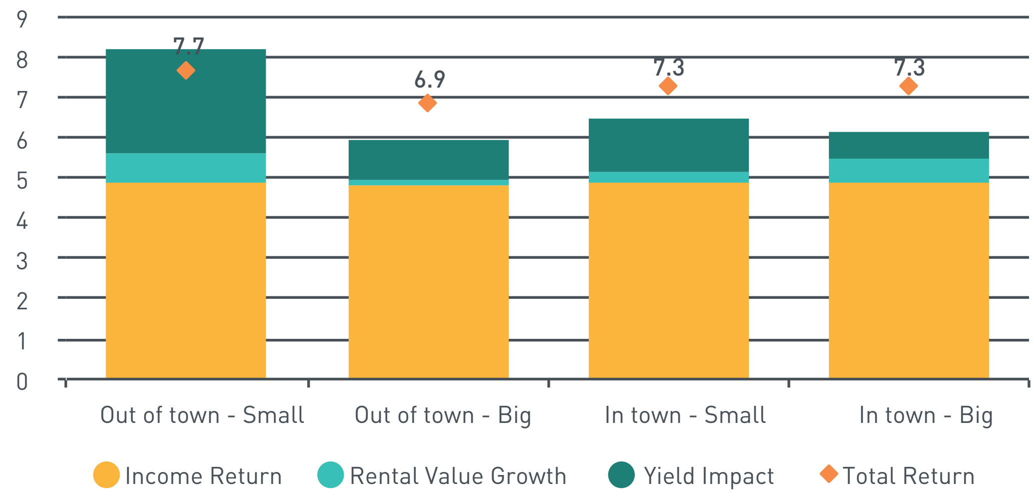
The size and location of retail investments has traditionally had a significant bearing on their performance. The growth of out-of-town retail parks and shopping centres has changed investors' perspectives given the prevalence of secure, longer leases and larger units in these schemes. However, the growth of smaller, "express" supermarkets with similar lease structures in key urban centres has changed this dynamic somewhat, narrowing the performance spread between in-town and out-of-town.

The drivers of performance in 2014 are illustrated by **Figure 13**.

In 2013, perhaps surprisingly, smaller out-of-town supermarkets outperformed with a total return of 7.7% y/y. This indicates occupiers' caution towards taking larger spaces or building extensions, as reflected in the recent rationalisation by certain occupiers of larger "hyper-market" style stores in response to weaker trading expectations.

The performance of larger, in-town units remained strong with a return of 7.3% y/y as rental growth of 0.6% y/y helped drive returns. Encouragingly, each category of supermarket recorded some rental value growth, albeit at a more modest level than in 2013, suggesting a steady, largely secure occupier base, despite the recent confidence knocks. Similarly, yield impact remained positive across the board, with the most significant boost, as with rental values, coming for smaller out-of-town supermarkets.

FIGURE 13: DRIVERS OF TOTAL RETURN BY SIZE AND LOCATION IN 2014, % YEAR-ON-YEAR



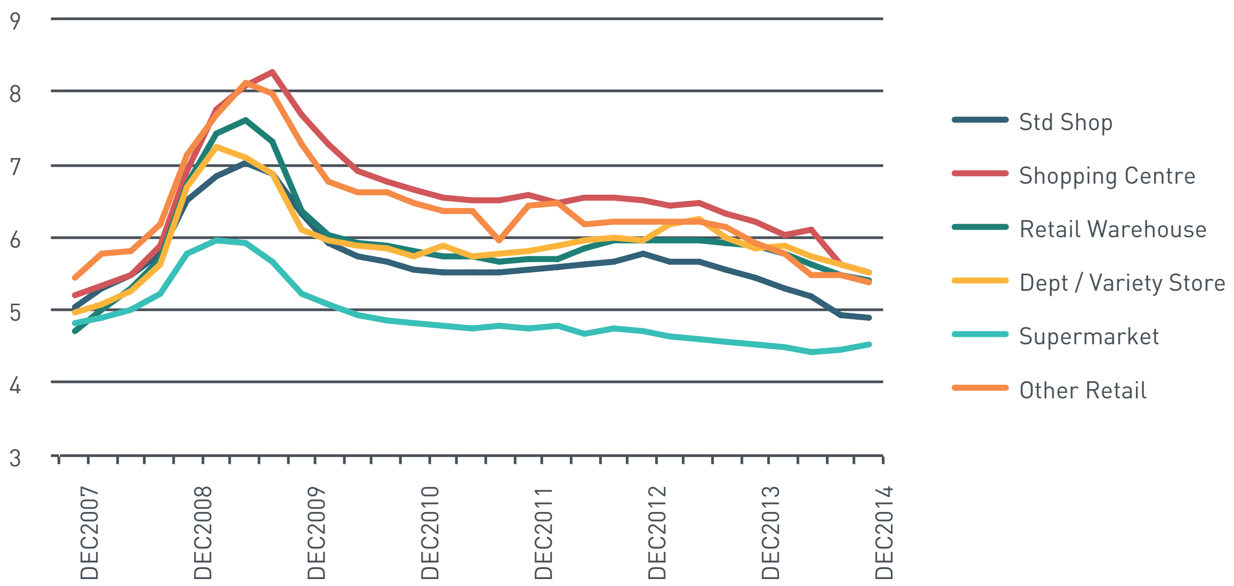
Source: MSCI

RISK AND INVESTOR PRICING TRENDS

As perceived risk receded in the retail sector through late 2013 into 2014, yields saw significant compression for the majority of property types. This was further boosted by improved investor sentiment towards retail investments as demand grew for securing assets; thus a positive yield impact was the primary driver of total return in 2014. For UK retail property as a whole, initial yields compressed by 50 bps to close out December 2014 on 5.2% - the lowest yield recorded since early-2008 when the market crash was just beginning. **Figure 14** shows initial yield trends for UK retail since the UK market peaked in late 2007.

Supermarket yields remained more solid than those for other types of retail in the aftermath of the crash, as seen in the resilience of the segment between 2009 and 2013 when the broader market was declining. 2014 reversed this trend, as concerns about occupier stability saw modest yield expansion (5 bps) in the latter half of the year; initial yields for supermarkets closed the year at 4.5%. However, this end year yield is still considerably below that for any other retail property type, with standard shops coming closest at 4.9%, while overall UK retail property yields 5.2%. Continuing low yields for supermarkets reflect their long-leasing profile and strong, low-risk income streams from covenants that are generally considered very secure.

FIGURE 14: INITIAL YIELD 2007-14, %



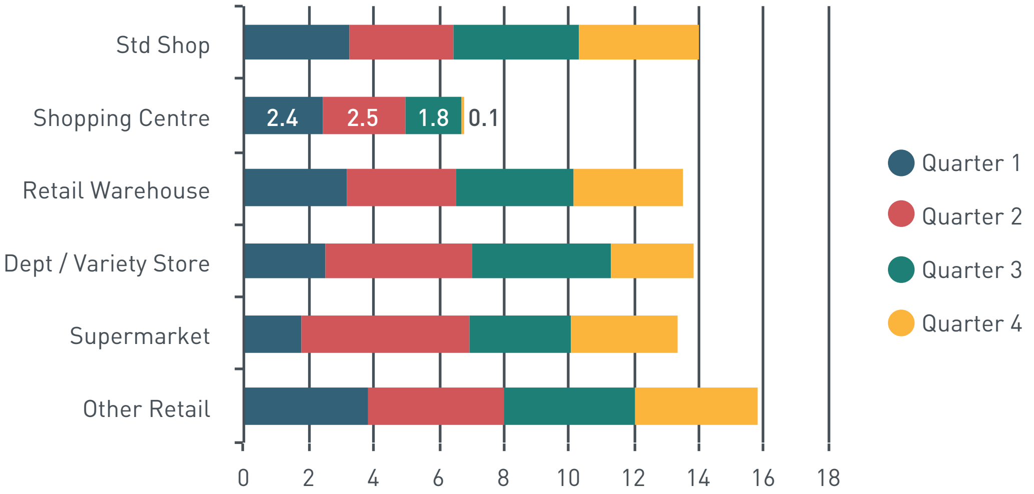
Source: MSCI

QUARTERLY UPDATE

Whereas 2013 was a year of recovery and strengthening returns for the UK retail sector as a whole and for supermarkets in particular, 2014 followed a different pattern with supermarket performance falling off significantly in the second half of the year. Total returns from supermarkets had started the year in line with broader retail (and were even outperforming shopping centres) with a return of 2.4% quarter-on-quarter in Q1.

Returns grew to 2.5% q/q in Q2 but fell back in the second half of the year with a modest 1.8% q/q recorded in Q3 and only 0.1% q/q in the last quarter. The range of quarterly total returns though 2014 is illustrated by **Figure 15**.

FIGURE 15: QUARTERLY TOTAL RETURNS DURING 2014, % QUARTER-ON-QUARTER



Source: MSCI

The strong first and second quarter supermarket performance, providing a half-year total return of 5.0% half-on-half, was driven by capital value growth of 2.6% h/h in the first six months of 2014 combined with an income return of 2.4% h/h.

In the first half capital values continued the improving trend that began late in 2013, but this contrasted with the decline in the second half of 2014 when values fell by 0.5% h/h.

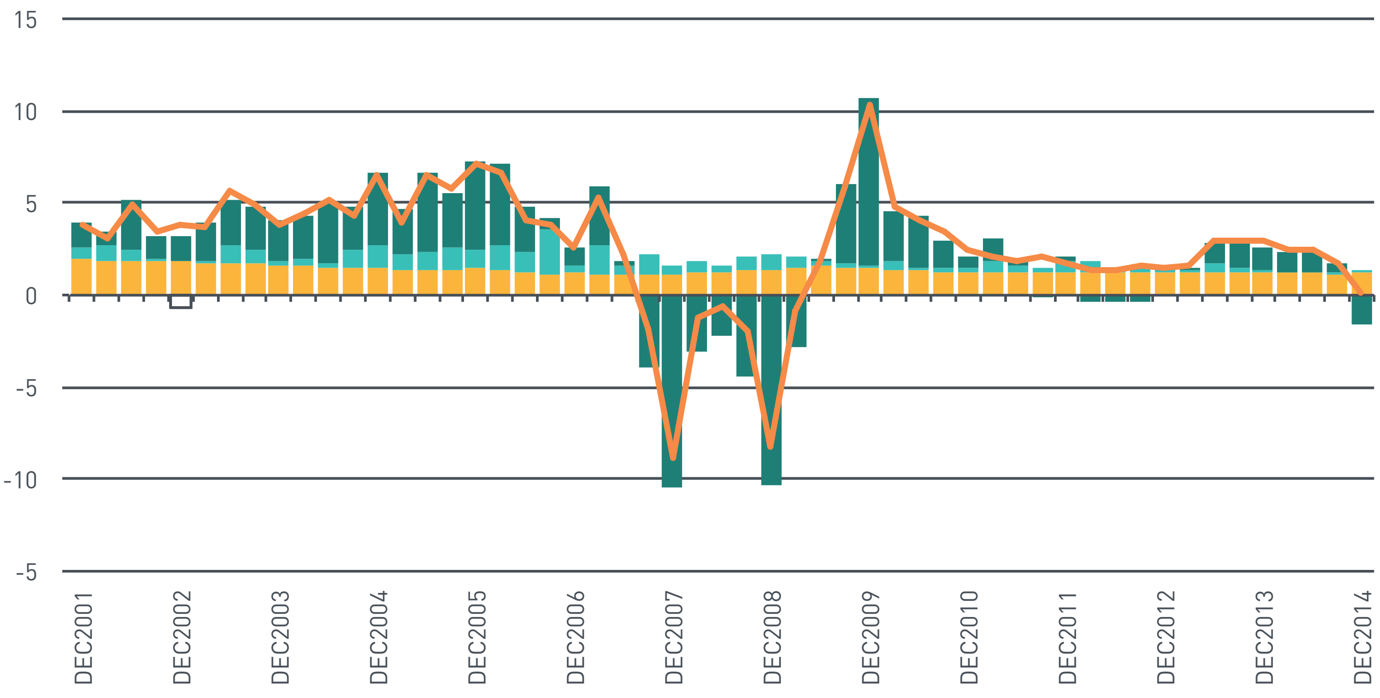
LONGER-TERM VIEW

Over the past ten years supermarkets have evolved into a distinct asset class within the retail investment sector. Supermarkets have become an integral part of our culture with their ability to adapt to evolving consumer demands, becoming bigger, better and more economical.

A review of supermarket performance trends back two property market cycles to 2001, as illustrated by **Figure 16**, highlights the defensive nature of these investments, which has been underpinned by the consistent investor preference for long and secure income streams. However, of equal importance for longer term performance has been the resilience of supermarket occupiers through market downturns, with rental growth remaining positive during periods of market decline. This has proved unique amongst retail property types, and is intimately linked with the dominance of inflation-linked (RPI or CPI) leases for supermarket tenancies.

Supermarkets' stronger lease profile and inflation-linked rent reviews have produced a cyclical performance profile with higher peaks during recovery periods and smaller troughs in downturns. Over the longer term, this has helped supermarket returns to outpace other retail property types, an advantage that was most pronounced during the recent global downturn. Despite deteriorating trading conditions for many occupiers, supermarkets remained strong, recording a more robust total return and crucially avoiding rental value declines.

FIGURE 16: DRIVERS OF TOTAL RETURN 2001-14, % QUARTER-ON-QUARTER



Source: MSCI

REFERENCE SAMPLE AND TERMS

Throughout this report, we refer to 'supermarkets', 'standard retail' and 'all retail':

- 'Supermarkets' refer to both super- and hypermarkets which have been taken from the IPD Quarterly Universe.
- 'Standard Retail' is a bespoke dataset created for this report. It contains standard retail units such as unit shops, banks and restaurants as
  well as department and variety stores. This sample does not include any supermarkets.
- 'All Retail' is the entire retail sector taken from the IPD Quarterly Universe including:
  - standard single units
  - arcades
  - shopping centres
  - retail warehouses
  - supermarkets
  - department/variety stores

Total return is the overall level of return derived from property. This can be split into income return, which is the money investors receive from rent (net of costs), and capital growth, which is the change in the capital value of the property. Income return might be compared to the dividend on a company's share; capital growth could be compared to the change in price of the share.

The capital value of a property is affected by two factors: rental levels and yield levels, meaning that capital growth can further be split out into two drivers.

- Rental value growth is the change in the level of rent that a valuer estimates a property might achieve were it to be let on the open market at the relevant date. If a valuer thinks that open market rental values have risen from, say, £40 psf pa to £50 psf pa, rental value growth would be 25%, and capital values would also increase by this amount with all other factors remaining the same.
- Yield impact quantifies the impact on capital values of a change in yields. If yields rise, capital values fall; conversely, if yields fall, capital values rise. A positive yield impact of say 10% would indicate that yields had fallen by such an amount as to increase capital values by 10%. Likewise, a negative yield impact of say -15% would show that a rise in yields had caused capital values to fall by 15%.
- Residual is caused primarily in markets where rental values of an asset are falling, but the underlying tenant's lease structure prevents these falls from being fully realised in the final capital growth movement.

Annual figures in this report have been taken from the December 2014 IPD UK Quarterly Property Index and annualised so that the sample is consistent with our quarterly analysis.

'By size' refers to the analysis where the supermarket and retail samples have been split into two groups; those that are between 0 sq m and 5,000 sq m, and those which are more than 5,000 sq m.

South East in this report consists of the following regions:

- Central London
- Inner London
- Outer London
- South East
- Eastern

Rest of the UK in this report consists of the following regions:

- South West
- East Midlands
- West Midlands
- Yorkshire and Humberside
- North West
- North East
- Scotland
- Wales
- Northern Ireland


Flour
Decorations
EVERYDAY VALUE
Hot Food
Desserts
Vegetables
Meat
Fish

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ABOUT IPD | AN MSCI BRAND

IPD is a leading provider of real estate performance and risk analysis, providing critical business intelligence to real estate owners, managers, brokers, lenders and occupiers worldwide. Our unique database holds searchable information on 79,000 properties, valued at approximately USD 1.7 trillion, which are located in 33 countries, with a long performance history (25+ years) and which are mostly appraised quarterly.

IPD is well known for its sophisticated research capability and provides fundamental analysis that can be applied across all types of real estate: direct property, listed and unlisted vehicles, joint ventures, separate accounts and debt. IPD's clients are global industry leaders and we have a symbiotic relationship with them. This includes nine of the top ten global fund managers* and nine of the largest ten European REITs**.

IPD does not participate in real estate investment markets and does not offer consultancy advice on investment decisions.

* INREV/ANREV Fund Manager Survey 2012
** MSCI 2013

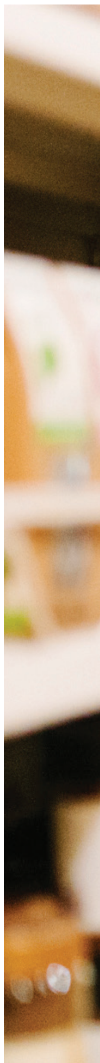
ABOUT COLLIERS INTERNATIONAL

Colliers International is the leader in global real estate services. Through a culture of service excellence, and a shared sense of initiative, we integrate the resources of real estate specialists worldwide to accelerate the success of our clients.

The large foodstore and supermarket sector remains a key focus of the UK business. It is a specialist sector of the property market and the supermarket operators' requirements have continued to evolve to meet the demands of a changing economic and technological environment.

A thorough understanding of the factors affecting supermarket value is critical in achieving the best terms on investment sales, acquisitions, new lettings, re-gearing leases and at rent review.

Colliers International has one of the largest and most experienced teams in the sector, and has established a market-leading specialism through dealing with all types of supermarket transactions throughout the UK.



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Appendix 2

Commercial Development Appraisal

Use Class:	Supermarket

DEVELOPMENT VALUE			
Rental Income	**Area sq m**	**£ per sq m**	**£ per annum**
Rent - (GIA)	1,700	162	£275,400
Total Rental Income	1,700		£275,400
Rent free/voids (years)	1	0.9478673	£261,043
Total revenue, capitialised		5.50%	£4,746,230
(incl all costs)			
Gross Development Value			**£4,746,230**
Less Purchaser's Costs	**5.75%**	**£272,908**	**£4,473,322**

Surplus to fund CIL - sensitivity

Rent/sqm	£152.00	£162.00	£172.00
Yield			
5.00%	£278,501	£536,488	£794,147
5.25%	£81,133	£325,817	£570,467
5.50%	-£98,520	£134,338	£367,168
5.75%	-£262,493	-£40,451	£181,590

Surplus after CIL Charge £10,958

CIL Charge as % of GDV 2.15%

DEVELOPMENT COSTS			
	Area	**£ per sq m**	**Total**
Demolition Costs	850	£64	£54,400
Building Costs		£1,178	£2,002,600
Area	1,700		
Contingency		5%	£100,130
External Works		5%	£100,130
Professional Fees		12%	£246,840
Planning Costs		10%	£200,260
Community Infrastructure Levy		60	£102,000
Total			**£2,806,360**
Disposal Costs			
		%	**Total**
Letting Agent's Fee (% of Rent)		10%	£27,540
Letting Legal fees (% of rent)		5%	£13,770
Agent's Sale Fees (on capital value)		1%	£47,462
Legal Sale Fees (% of capital value)		0.75%	£35,597
Total			**£124,369**
Interest on Finance			
	Months	**%**	**Total**
Total Development duration	36		
Loan arrangement fee		1%	£28,063.60
Finance Costs ('S' curve)		7.0%	£410,302
Total			**£438,366**
Profit			
		%	**Total**
Developer's Profit on Total Development Cost		20%	£673,819
Total Development Costs			**£4,042,914**

LAND VALUE		
	%	**Total**
Land Surplus		£430,408
Stamp Duty	4%	£17,216
Agent's Fees	1.25%	£5,380
Legal Fees	0.50%	£2,152
Total		£24,748
Interest on land finance	7.00%	£28,396
Total		**£53,145**
RESIDUAL LAND VALUE		**£377,264**

Existing Site Value				
	%			
Assumes existing space is % of new	50%	850		
Rent per sqm		£63		
Rental income per annum		£53,550		
Rent free/voids (years)		3	0.7938	£42,508
Total revenue, capitalised			8.00%	£531,350
(incl all costs)				
Refurbishment costs (per sqm)		£215	£182,750	
Fees		7%	£12,793	
Total			**£195,543**	
Purchaser's Costs		5.75%	£30,553	
Total Costs			**£226,095**	
Existing Site Value				**£305,255**

Site Value incl Landowner Premium	20%	£61,051	£366,306
Surplus available to fund CIL			**£10,958**

Appendix 3

Commercial Development Appraisal

Use Class:	Supermarket

DEVELOPMENT VALUE			
Rental Income	**Area sq m**	**£ per sq m**	**£ per annum**
Rent - (GIA)	1,700	162	£275,400
Total Rental Income	1,700		£275,400
Rent free/voids (years)	1	0.9501188	£261,663
Total revenue, capitialised		5.25%	£4,984,052
(incl all costs)			
Gross Development Value			**£4,984,052**
Less Purchaser's Costs	**5.75%**	**£286,583**	**£4,697,469**

DEVELOPMENT COSTS			
	Area	**£ per sq m**	**Total**
Demolition Costs	850	£64	£54,400
Building Costs		£1,178	£2,002,600
Area	1,700		
Contingency		5%	£100,130
External Works		5%	£100,130
Professional Fees		12%	£246,840
Planning Costs		10%	£200,260
Community Infrastructure Levy		60	£102,000
Total			**£2,806,360**
Disposal Costs			
		%	**Total**
Letting Agent's Fee (% of Rent)		10%	£27,540
Letting Legal fees (% of rent)		5%	£13,770
Agent's Sale Fees (on capital value)		1%	£49,841
Legal Sale Fees (% of capital value)		0.75%	£37,380
Total			**£128,531**
Interest on Finance			
	Months	**%**	**Total**
Total Development duration	36		
Loan arrangement fee		1%	£28,063.60
Finance Costs ('S' curve)		7.0%	£410,885
Total			**£438,948**
Profit			
		%	**Total**
Developer's Profit on Total Development Cost		20%	£674,768
Total Development Costs			**£4,048,607**

LAND VALUE		
	%	**Total**
Land Surplus		£648,862
Stamp Duty	4%	£25,954
Agent's Fees	1.25%	£8,111
Legal Fees	0.50%	£3,244
Total		£37,310
Interest on land finance	7.00%	£42,809
Total		**£80,118**
RESIDUAL LAND VALUE		**£568,744**

Existing Site Value				
	%			
Assumes existing space is % of new	50%	850		
Rent per sqm		£63		
Rental income per annum		£53,550		
Rent free/voids (years)		3	0.7938	£42,508
Total revenue, capitalised			8.00%	£531,350
(incl all costs)				
Refurbishment costs (per sqm)		£215	£182,750	
Fees		7%	£12,793	
Total			**£195,543**	
Purchaser's Costs		5.75%	£30,553	
Total Costs			**£226,095**	
Existing Site Value				**£305,255**

Site Value incl Landowner Premium	20%	£61,051	£366,306
Surplus available to fund CIL			**£202,438**

Surplus to fund CIL - sensitivity

Rent/sqm	£152.00	£162.00	£172.00
Yield			
5.00%	£278,501	£536,488	£794,147
5.25%	£81,133	£325,817	£570,467
5.50%	-£98,520	£134,338	£367,168
5.75%	-£262,493	-£40,451	£181,590

Surplus after CIL Charge	£202,438
CIL Charge as % of GDV	2.05%