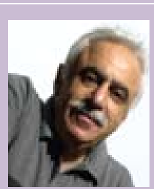
THE PANEL

PROPERTY OWNERS:
Richard Akers
Managing director, retail, Land Securities



David Pearl
Chairman and CEO, Pearl & Coutts

Beverley Churchill
Brand director, CSC

Hugh Seaborn
CEO, The Cadogan Estate

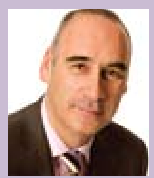
Bill Hughes
Managing director, L&G Property

Dominic Smith
Head of research – real estate, Aviva Investors

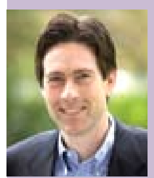
Ed Jenkins
Fund manager, Standard Life

OCCUPIERS:
Jeremy Collins
Head of retail development, John Lewis

Andrew Jones
CEO, Metric Property

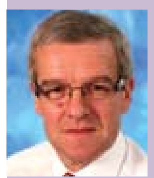


Clem Constantine
Director of international property, M&S



Scott Malkin
Chairman, Value Retail

Lindsay Page
Finance director and executive director, Ted Baker



Martin Moore
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Jo Staveley
Managing director, Cath Kidston

John Milligan
CEO, Milligan Retail

PRIVATE EQUITY:
Crispin Tweddle
Chairman, Piper Trust

THE REPORT AUTHORS **Richard Wassell** formed twentyretail in 2005 to advise occupiers, landlords and development companies in the UK and Ireland. **Geoff Nicholson** is managing director of FSP, the leading source of leasing support and strategic advice to UK property portfolios

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Can talk, must talk

Revolution through conversation: When the panel of retail experts gathered to analyse the state of the retail property industry, they all agreed that what is most needed is dialogue

More than 2,000 years ago, Euripedes said: “There is in the worst of fortune, the best of chances for a happy change.”

He wasn't of course to know of the global financial crisis early in the 21st century, but his attitude is shared by the distinguished panel of leading investors and occupiers interviewed for this report.

Their collective view is that property markets are undergoing a fundamental correction. The financial crisis has been the catalyst, not the cause. This resetting has been bubbling and brewing for at least 10 years.

In this changing environment, new and exciting opportunities are emerging.

Fundamental change

Time and again, the panel's discussions revealed that to take full advantage of these opportunities will require one fundamental change: our industry needs to become less compartmentalised. The panel feel that improved dialogue between all the stakeholders – occupiers, owners and investors – will be critical. The hope is that this report will kickstart a debate that leads to constructive and continuing dialogue. This would indeed represent a “happy change”.

“There is no reason anyone would want a computer in their home.” So said Ken Olsen, president of Digital Equipment Corp, in 1977.

Fast-forward to 2010, and technology is now woven into the fabric of all our lives. The pace of change is breathtaking: MySpace and Facebook arrived only in 2004, YouTube in 2005, Twitter in 2008.

Clicks *and* bricks, not clicks *or* bricks

Technology is reshaping the world and also retail. “The networked computer is physically transforming the city faster than the automobile did,” said American academic Joel Garreau.

However, one thing that emerged clearly from the panel talks was that nowadays the whole concept of “online” in isolation is becoming a bit of a dinosaur. Where now do bricks end and clicks begin?

Jo Staveley reminded everyone that people can research in the catalogue, try out in a shop and then buy online.

> ## DIRECT ACTION
> In the past 12 months John Lewis Direct has jumped from 35,000 to more than 90,000 items online and expects to move to around 220,000 lines in the next few years.

Multi-channel retailing has increased overall customer spend. The John Lewis experience indicates that customers who shop both online and in-store spend more than double a store-only customer annually.

“It really is about multi-channel. By the middle of the decade John Lewis Direct will be contributing probably a quarter of our sales,” explained Jeremy Collins.

Retailers will need to consider the mix of products in their stores to complement their online business.

In the past 12 months John Lewis Direct has made a huge jump, from 35,000 to more than 90,000 items online, and it expects to move to around 220,000 lines during the next few years.

Enormous changes are taking place in the traditional production cycle for fashion brands, which will only accelerate over the next 10 years. It is already possible to order directly from some fashion shows.

With so much technology now at people's fingertips, the watchwords for retailers are immediacy, real-time and transparency.

News of a positive, or disappointing, in-store experience for one person is quickly spread among a group on social sites. This can lead to a widespread surge – or boycott – unimaginable 10 years ago.

The arrival of price comparison apps means that shoppers can have near-perfect knowledge, thus reducing the scope for price variations on branded merchandise.

Social media sites are used by more than 28m people in the UK. Nevertheless, human beings remain innately social animals. We all need real human contact. ▶

> ## WHAT IS KEEPING THE PANEL AWAKE AT NIGHT?
> **Business behaviour is determined by what is given attention. So, what are the issues preoccupying our panel?**
> **As Ed Jenkins said, “We forget at our peril that shoppers today are subject to a host of new influences and live in a world significantly different from that of their parents.”**

Online sales currently account for less than 10% of retail turnover – much more of course in categories like books, music and electrical goods.

The functional benefits of online shopping, convenience and accessibility, are clear. However there are emotional benefits too~ parcels received can feel more like a present than a purchase.

How big will online get? The panel expects the overall market share of online to increase to between 20% and 30% over the next 10 years.

This gives rise to issues which our panel are tackling now;

Retailers are aware that the current multiple delivery system is inefficient and in a resource constrained environment, unsustainable.

In a slow growth economy, online sales growth must lead to pressure on turnover generated from shops.

The "open all hours" access to online will place more pressure on shops. "Nobody recognises boundaries, so there aren't any boundaries" says Crispin Tweddle. Only 10 years ago, many John Lewis stores were shut 2 days a week. John Lewis's Jeremy Collins commented: "Longer opening hours have been critical to providing high standards of customer service, but this has created significant operational challenges and attendant costs."

£5bn
monthly spend by internet shoppers in the UK

110%
increase in spending on the Liberty website last Christmas

20-30%
increase, the experts believe, in market share online in the next 10 years

"An extension of social networking within a physical space" Beverley Churchill

Teenagers using Facebook, Twitter, Foursquare and Buzz morning, noon and night still like to meet up with their friends. So one of the challenges for owners of shopping centres over the next 10 years is how to give these customers reasons to visit.

Centres are being designed and built that provide space for the community to create, curate and edit for their own needs.

Retailers are using social media to attract and retain customers.

The new media revolution is not just for young people.

YouGov reports that women aged over 55 are the most likely group to consider an iPad purchase.

Money, money, money...

The panel is by no means convinced that we have seen the worst of the financial crisis. Quantitative easing and continued governmental expenditure have so far softened its impact. Ironically, the property industry, being more reliant on transactions than most, may have been among the earliest to taste recession.

Across UK society in general the overall effects are far less marked than in the US, but the anticipated cuts in UK government expenditure may precipitate a change.

Oversupply has been caused by the addition of new retail space, weak retail sales and growth of online sales. So the outlook for overall rental growth – which at the macro level is directly related to growth of sales densities – is limited.

The implications of subdued consumer demand, in the panel's view include the following:

● What may be true at the macro level is not necessarily valid for individual locations. The best 100 locations have gradually taken an increasing market share over recent years. Sales densities in these locations have grown, resulting in continued competition for space. Investor interest in prime and super-prime locations will keep yields low.

● In secondary locations there will be opportunities for active management. The outlook for other locations is more challenging, and in many cases alternative uses will need to be found.

● Of the £200bn or so of property assets held by banks, perhaps £40bn-£60bn will not be fit for purpose. Vast swathes of relatively undermanaged, depreciating real estate will have a significant influence on the market.

● Banks do not usually have the resources or the setup for the intensive management required of real estate.

● The absence of banks as a source of capital has created a huge gap. The limited possibilities for new development have put a much greater emphasis on working existing assets more intensively.

● Private landlords are increasingly entering into joint ventures with their tenants and are focusing on income. The view of David Pearl on shorter, more flexible leases was: "It might lower the value of your investment, but my real interest is in rental income because that's what pays the wages."

"Historically we used to think that high proportions of public sector employment meant the asset would be immune to the pressures of a recession. This time round, it is quite the reverse" Andrew Jones

● A distinction between London and the rest of the country is emerging in vacancy rates and retailer performance. The gap seems likely to widen further.

● The growth of overall UK sales density (total retail sales divided by total retail space) averaged about 3% a year in the late 1990s.

● This contrasts with the period between 2000 and 2005, when annual growth in UK sales density averaged about 1.5%. More recently, from 2005 to 2010, there has been no overall growth in sales density.

● The panel members all agreed that the UK is entering a period of, at best, subdued consumer demand.

New York, London, Paris, Munich...

The world is getting smaller. The globalisation of the retail supply chain has been very high profile. It has led to 15 years of clothing price deflation and scandals about factory working conditions.

Less recognised is the impact of retailer globalisation. Lindsay Page of Ted Baker said: "There will be more pressure to be international because you won't be getting growth out of your home market. If anything, people will be consuming less. So if you're going to get more growth, you will have to go into new markets." In the past two years, Ted Baker has opened no shops in the UK, but is opening 10 shops this year "from Santa Monica to Sydney".

The developing markets, particularly China and also India (often overlooked), are going to exert enormous influence on brand identity, authenticity, supply and distribution. Retailers are excited by the opportunities to expand their business in emerging markets where they can secure sites at lower cost.

In Europe there are just 35 cities that have populations of more than 1m. There will be more than 200 in China by 2020.

Tesco has become one of the largest developers in Europe, with a £35bn portfolio. Over the next five years, the company plans to open more retail space in China than it now has trading in the UK.

"In India there are 20m people joining the workforce every year, with around 9m mobile phones being sold every month," said Clem Constantine.

The continued validity of talking about a UK property return is questionable. The two influences on return – yield and rent – will be more dominated by global factors. It was overseas investment that last year drove the rebound in prices. If rent is derived from tenants whose income comes mostly from outside the UK, is that a UK return? It may be denominated in pounds, but that is as far as it goes.

If retailers and investors are trading globally, there will be exciting opportunities for more landlords to extend the reach of their relationships and experience to operate in territories outside the UK.

International expansion is always risky. However, the panel discussed the fact that the growth of online sales provides a relatively cheap way to test the water before opening physical stores.

Inditex is now extending the trial launch of Zara online into Austria, Belgium, Ireland, Luxembourg, the Netherlands, South Korea and Canada.

WORLD-WIDE VIEW

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THE DANGERS OF THE MIDDLE GROUND

More than 30 years ago, Suzy Menkes, then fashion correspondent for *The Times*, predicted the demise of the middle market. She was right. Premium brands and value retailers have gained market share at the expense of the middle market.

The tougher market makes a more focused offer necessary in a low-, or non-growth, environment. This will exacerbate the polarisation of the market between more cost-effective operations and those focused on providing high quality.

Retailers need to mean something valuable to their customers. This is the essence of being a brand and is independent of price position or exclusivity.

Historically, many retailers have provided customer service on their own terms. The transition over the next 10 years will be an increasing recognition of the importance of being convenient, relevant and engaging on terms set by customers.

The discussion is now about the use of space for services that might add value to the product. The question is not just how to serve customers, but what services to offer them. So perhaps the beauty department is not just about selling perfume, lipsticks and nail varnish; it may also provide a complete beauty service. Selfridges' new Shoe Galleries (which are bigger than the Turbine Hall at Tate Modern) form the largest shoe department in the world, with over 5,000 pairs on display across 150 labels.

If the internet enforces price matching, competition will become more about the quality of the product itself and the overall purchasing experience. The perception of quality and durability will become far more important over the next 10 years.

This leaner, meaner world will create more clearly defined winners and losers.