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UNLOCKING THE TOWN CENTRE DEVELOPMENT PIPELINE

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PAUL ELLIS

DTZ



THE AUTHOR:

Paul heads DTZ's Development, Planning and Economics teams in the UK. These combined teams have a market leading, full service offer to both public and private sector clients, with over 100 specialists advising on approximately 450 projects.

A member of DTZ's Global Management Committee, his particular interest and expertise is in town/city centre development consultancy work and large scale regeneration projects. Paul also advises strategic private sector clients on development. He is also heavily involved in other areas of consultancy work, particularly related to the production of town and city centre studies, strategies and action plans; portfolio analysis for public sector clients; procurinf funding for projects; and providing expert witness advice at public inquiries on developments.

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UNLOCKING THE TOWN CENTRE DEVELOPMENT PIPELINE

INTRODUCTION

I am conscious that the town centre has not been an ACES topic of conversation for at least two years and yet, inevitably, the town centre remains hugely important, both to politicians, and by definition, to all of us that live, work and play in them. This paper includes an indirect input from Jeremy Collins, Head of Development at John Lewis and also President, this year, of The British Council of Shopping Centres.

I intend to cover the following topics

- The scale of the current challenge
- How local authorities might react
- The retailers view



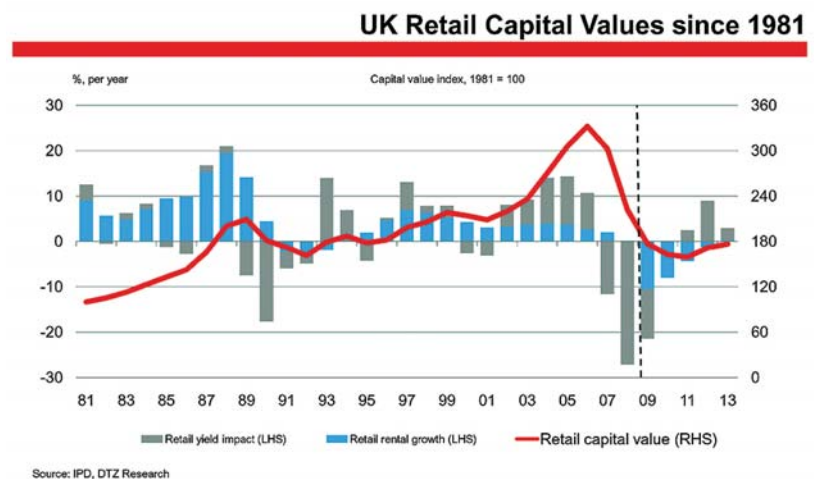
There are a lot of policy initiatives around at the moment and many of them have relevance to town centres. A key theme that emerges is that the public sector needs to be more proactive.

2008

This was an immense year, the best in terms of new scheme openings comprising 14 new schemes totalling 8 million square feet. This was the biggest area opened since 1976 – the year of the drought. The key schemes

that opened were Bristol, Westfield, West London, Belfast, Leicester, Liverpool and some small town centre schemes, all of which DTZ had the privilege to be involved with.

But trouble was lurking. As we all now know this record year has been followed by a virtual collapse in town centre development. A variety of proposed schemes have been put on hold, various developers have gone bankrupt and others are extremely fragile and probably will go as well. Some schemes have even been halted on site. And whilst the credit crunch has been the catalyst for much of this collapse, it has not, in our opinion, been the only reason.

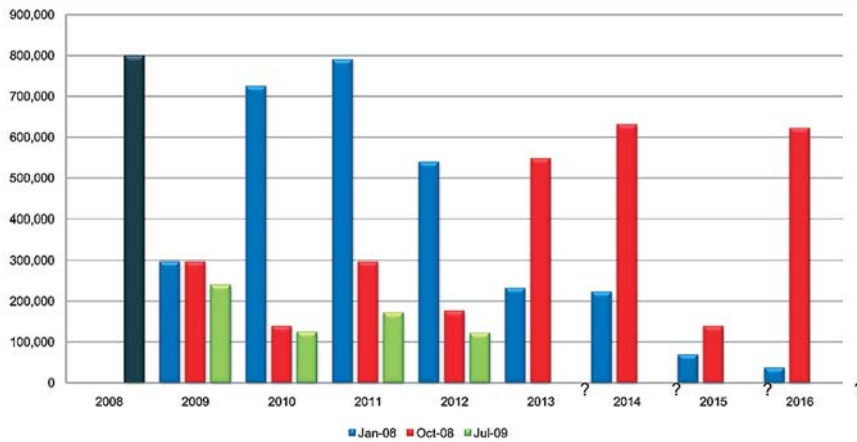


This graph shows, by red line, retail capital values since 1981 with percentage changes year on year on the left. You will note that from the mid 90s retail value has shown consistent growth up to the point of the credit crunch and is then followed by a precipitate fall. Thus 10 years of growth fuelled expansion has been followed by a 40% reduction in retail value over the last two years and this has had a huge impact on the value of schemes and their viability. The forecast is for a further small reduction in investment yield augmented also by rental reduction.

Accordingly we feel that up to 2012/13 overall retail values will stabilise and start to move forward but with at least a 50% reduction in value from peak. Overall these fundamental changes to value will impact on the viability of schemes.

The record 8,000,000 square feet of space in 2008 is shown on the left hand side in dark blue. Thereafter starts are more and more pushed back until the industry, in a large number of cases, has recognised that for the foreseeable future schemes will not be going to happen at all and many have been mothballed.

UK Retail Development Pipeline: 2008-2016



Source: IPD, DTZ Research

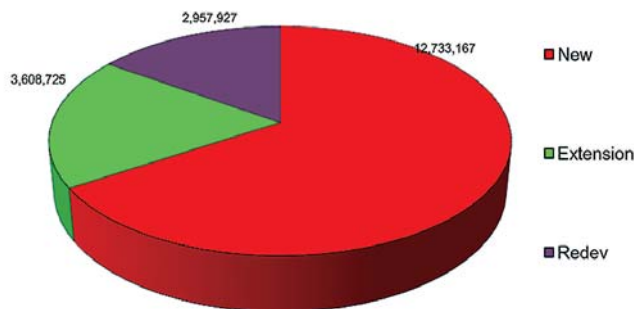
Most development in the pipeline, about two-thirds, is new development with the remaining third shared almost equally being extensions and the redevelopment of existing centres. In the future these percentages will change fundamentally as the strategies of developers and investors focus more and more on existing centres rather than new centres.

stances.

Back to basics

Developers have to get back to basics, but only in part, the industry will also have to learn new tricks. Over the last 10 to 15 years the industry has developed ever more complex and costly schemes on the assumption that a

Pipeline Development – by type



This is pictorial representation of the John Lewis pipeline. Other than two schemes, all of the projects there are to be confirmed in terms of programme opening. Very few schemes are committing unless they have to commit, for example as at Stratford.


This is the Olympics site. Work is in progress on site and DTZ is currently involved in the leasing of the development. It is leasing well but clearly there are unique and unusual circum-

stances. I think that now the development industry recognises it needs to be much more sensible, for want of a better phrase, in how it looks at both the value and the cost equations, i.e. VALUE – COSTS = PROFIT.




Some Positives




Despite all the current problems there are some positives such as lower land assembly costs and lower build costs. There is some inconclusive discussion about planning consent extensions but as a lot of stalled schemes need new planning so this is not really viewed by the industry as a positive. There has been recently a small rise in investment, the first rise for 18 months, but that has been very low based. Also there has been a modest opening up of the market to competition. For a long time the debate in the industry has been



Restoring Growth



an example of market impact on pipeline

Committed Schemes



that very few town and city schemes have been open to competition as, because by nature they necessitate long-term negotiations and many are committed to existing developers.

Options for developers

There are some options for developers. Clearly they have the ability to rework existing schemes and a number are doing that. Some can position themselves for market recovery and if local authorities are contemplating schemes they can do the same. At the same time developers still involved in a town centre scheme are trying to think in the same way as well as trying to spend as little money as they can at present. But one of the things we are emphasising to developers is that eventually a developer needs to know when to walk away from a scheme.

On a more positive note, there will be new schemes and opportunities coming forward.

Some Predictions

- Existing assets. The big five banks now are major owners of shopping centres and they, with their tenants, are focusing hard on those existing assets and we will see more of this over the short to medium term. Nationally the capacity to expand town centres has reduced to such an extent, and at the same time economic conditions

have declined so much, that the retail justification has reduced.

- Scrap yard opportunities. As we see more developers walk away from big schemes, other parties come in but from a perspective of looking at smaller schemes.

- Lower risk. A few years ago, a 100 plus unit town centre scheme might have been planned but that will probably downsize to 60 to 70 units now; a reduction of about a third in overall size and number of units.

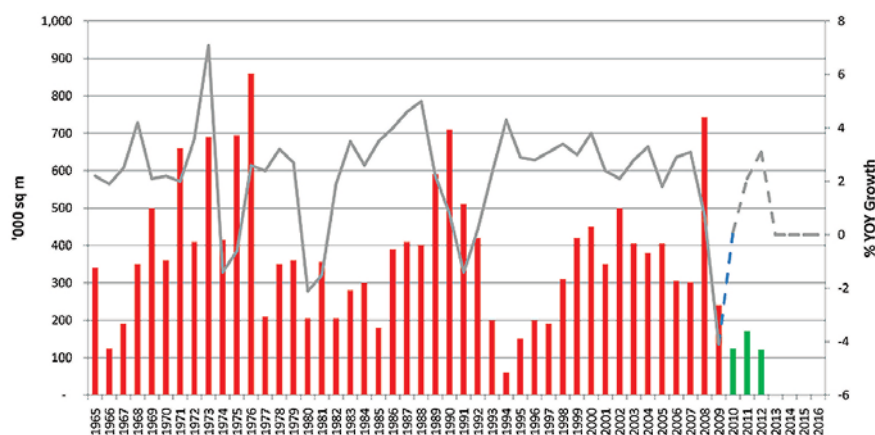
- Phasing. In addition, developers will try to phase schemes, rather than have to put several hundreds of millions of pounds into those schemes in one go. I think you will see developers looking to phase as far as they possibly can.

- Mix of uses/single use. Whilst in a number of schemes developers have been encouraged to look at retail with residential above and leisure incorporated, I think developers are now, from a position of risk, simplicity etc, trying as far as they can to reduce the uses and to make them discreet.

- Supermarket anchors. I think the industry will start to look at what it might see as an earlier and easier win through using more supermarket anchors, rather than department stores.

- Under-provided catchments will become a focus for

GDP Growth Year on Year The Retail Development Pipeline



Source: IPD, DTZ Research

developers, and they will want to be assured that most of the development building blocks are in place before they commit to a scheme.

- Strong demand. Developers will want to see evidence of strong demand and if this is not available expect developers and their investors to be extremely cautious.

This slide shows the time lag between GDP growth, the grey line, and how the development industry responds, with the red bars showing the amount of retail development year on year. You can see that there is a demonstrable lag between GDP starting to move forward and retail development catching up. This suggests the need to focus in the next 5 years on town centres plans, bearing in mind that time lag.

Public/private risk

These are two quotes from the All Party Urban Development Group.

“All towns and cities need to adopt a more proactive approach to working with the private sector, and take on more risk.”

“Towns and cities will need ... to take on a bigger share of the risk, but also a bigger share of the long term reward.”

The balance between the public and the private sector in terms of approach and risk is likely to change.

The local authority position

There are five aspects to this as follows.

1. Political context
2. Their challenge
3. How they can help
4. Their constraints
5. Key conclusions

I will deal with each aspect separately.

The political context

This is obviously very important. Whoever is in power after the next election the theme will be “going local”. Local authorities will be empowered, planning is going local and there will be a lot of discussion about TIFs, (Tax Increment Financing districts). If the Conservatives form the next Government delivery mechanisms will probably take the form of local enterprise trusts and the like. But whoever is in power I think the shift to local is clear.

The local authority *raison d'être* for retail led regeneration provides a legitimate agenda to be involved in town centres in a more proactive way. Our feeling is, if you look at the transformation agenda and its economic and social wellbeing aspects, the efficiency agenda, service delivery, joined up public sector, sustainability, promoting a cohesive and complimentary environment and an intervention agenda through local and multi-area agreements then there is a very strong context, and a set of powers and justification for local authorities to take a more proactive approach. I think there is a significant challenge for local authorities to do just this whereas for the last 30 years all involved in the development process have seen the council as the statutory body and the developer as the one in the driving seat. A big cultural change is in progress.

The local authority challenge

The scale of the market challenge is huge and I think local authorities need to fully appreciate that. It leads into policy changes, which takes time. Understanding market changes is important. There is a view that the bottom of the market has been reached and a view needs to be taken about whether the market will bounce back quickly.

An interim plan for the town centre is a political and economic necessity, but developers, in our experience on town or city centre schemes nationwide, are giving little thought to proactively work with councils on a robust interim plan. This is one of the things councils need to push their partners much more on. Resources too, be they people and or money, are also constrained. Many authorities have lost development partners and there are few creditable options in the market if you are looking for a new one and any that are still around have less money available.

Local political pressure is a challenge for councils to respond to.

Local authority views on town centre development

If the public sector are going to get more involved in taking forward town centres a proper justification is needed to put that resource in. DTZ did a piece of research for the British Council of Shopping Centres Educational Trust and for Business in the Community called “Retail led regeneration, why it matters to our communities.” We used various case studies in the study, copies of which are available, on request, from DTZ. The study showed there was a clear demonstrable social and economic case for involvement and this has helped some of our public sector clients justify putting more effort

and priority into pushing forward their town centre. Housing and jobs were shown to be very important with a strong correlation between the two. Town centres are now in a more fragile state with vacancies and retailers trading poorly and that creates another dynamic between the new scheme and the existing town centre that was probably less important a few years ago.

Partnerships between developers and local authorities are vital but equally local authorities need to have proactive partnerships as well with key retailers, key investors and others. And finally local authorities have to appreciate the reality of edge of town and out of town pressure that will become a significant additional pressure that authorities need to prepare for and respond to appropriately.

Local authority potential assistance – general

- Partnership. DTZ has been involved in extending development agreements between existing development partners, clearly these ought not to be extended without agreeing a proper basis, but, realistically, some of the terms in the development agreements will probably have to be softened.
- Scheme concept. On the whole schemes are going to have to be simpler, smaller, more phased, and with elements of discreet uses. Also schemes may be multi-sited. I think more thought will have to be given to the scheme concept.
- Obligations. The obligations between the private and private sector will have to shift and authorities will have to be more involved in how they link into other sources of public monies.
- Policy/planning. There are a lot of confirmed (*schemes/agreements) that now will not be implemented.
- CPO. We are debating with a lot of council clients what you do in that context without that CPO.
- Outputs. Scheme outputs will have to be prioritised and probably reduced.

Interestingly some local authorities have actually taken

the initiative and bought property. We act for Birmingham City Council on the Palisades and they have spent £91 million through prudential borrowing to buy out their partner. Not everyone is in the Birmingham league but we have various other council clients who are actively looking at this. Obviously when an authority is trying to get a scheme ready there is a focus on dealing with infrastructure or relocations. Can you put in some public assets to pump prime or perhaps take some out that are a drain on the scheme. Can you focus on leading the delivery of third party money? Have you got the desire to take on an element of development risk? Will this lead to a discussion around overage and claw back, if so those mechanisms will need to be much more robust. And finally because you need to understand cash flow rather than just profit there will be a need more for financial modelling rather than very simple appraisals.



Broader Horizons

Local Authority

- LABVs
- Prudential borrowing
- Competitions
- Partnership structures

HCA / RDA etc

Central Government

- TIF's
- PPP's

European Union

- JEREMIE
- JESSICA
- Procurement

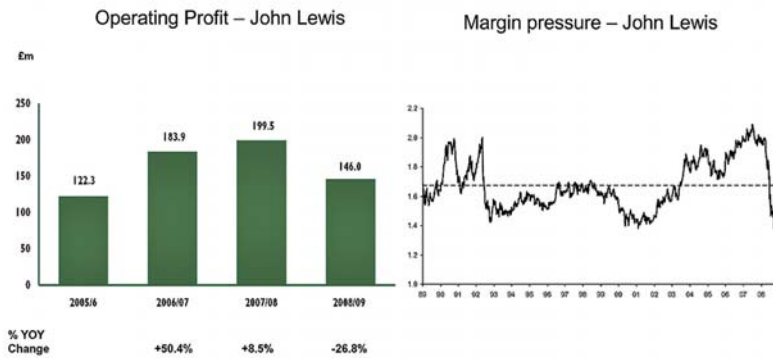
Local authority constraints

Constraints include politics, procurement, best consideration, best value, procedures and processes, and budgetary. These all are issues that can be dealt with and are not in any way killers to schemes progressing.

Local authorities are all different

We think all authorities are different and how they respond depends absolutely on the individual authority. Differences include politics, leadership, regeneration curve, property assets, the local market, in-house resources and structure, capital programme, regeneration objectives and response to the credit crunch. We have many potential ways to help and believe that a generic response is therefore not appropriate.

Retailers – key issues



Source: Reuters/John Lewis

Even the John Lewis operating profit has reduced significantly but more concerningly the right hand graph shows that margin pressure has fallen off a cliff for John Lewis and it is way below the average of the last 20 years. Interestingly, Next announced their results in September and on the surface they were quite positive, but like-for-like figures were “positive” in the sense that they only reduced by 1.2% over the first half of the year when a downturn of 7% had been forecast, so it is a relative point. At Debenhams sales for the same period reduced by 3.8% so retailers are still under significant pressure. The key issues for retailers are a need for a much more substantive involvement and engagement with developers, investors and local authorities, where they own assets, in relation to service charge, rates and rental and all property costs. There will be a huge amount of discussion on that within the industry over the next 12/18 months.

The retail scene

John Lewis, as successful retailers, have recognised the reality of that time lag between GDP growth and retail activity, as mentioned earlier, and are starting to introduce some new formats now, for example, “John Lewis At Home” which is just about to open in Poole. There are other success stories on the High Street too. Sales growth at HMV has increased due to the demise of Zavvi and Woolworths; HMV is acquiring new stores and improving existing ones. JD Sports total revenue is up by 13.3% in the year to April with like-for-like sales up 3.9%; JD is opening new stores. Other retailers are expanding. Apple continues to expand, Hollister recently opened their first three stores in and around London and Gilly Hicks is about to launch a UK initiative.

Also some well-known international brands are coming to the UK, particularly into the larger centres. They see it

as a massive opportunity. New Yorker are planning their first UK store, Deichmann are securing large stores of 4,000 sq. ft. and are the only footwear brand currently expanding, Forever 2, the US equivalent of Topshop are looking for stores of up to 50,000 sq. ft. DTZ has a large retail leasing team and believe that many international retailers now see the UK as opportunity time because rents are coming down to such a great extent. Restaurants and the leisure market are also doing well.

And finally

How should ACES respond to what is happening in the Town Centre market at the moment.

- Take the initiative internally within your Council. From the property industry’s perspective, local authorities

Restaurants

Fast Casual

- The casual dining market still experiencing growth.
- Eating out is ingrained
- Independent chains such as Carluccios, Giraffe, Pizza Express, Yo! Sushi, GBK and Wagamama continue to do well.

Casual Dining

have a different role to play and a more proactive role to play than they have to date.

- Recognise that there has been fundamental market change, and that Government and the industry have placed changed expectations on local authorities.
- But it is opportunity time as well as responsibility time for local authorities and hence ACES members.
- And finally engage in the Town Centre Development policy debate. I am pleased to tell you that the ACES President is joining me in meeting with Jeremy Collins, Head of Development at John Lewis and also President, this year, of The British Council of Shopping Centres (BCSC, a key industry organisation for town centre development) in the very near future to try to forge more of a link between ACES and BCSE.

Paul Ellis

Director and UK Head of Development,
Planning and Economics, DTZ