

TALKING HEADS: GETTING BETTER VALUE FROM A DISPERSED PORTFOLIO OF ASSETS - WHAT KINGFISHER DID

A view from Graham Orton, International Property Director, at Kingfisher



Graham Orton, provides a brief overview of the key issues the Kingfisher Group faced to leverage more value from their property portfolio and how they overcame these issues.

Q: What were the key issues Kingfisher were facing and what challenges did you need us to help address?

A: “Following a legacy of aggressive international expansion, Kingfisher being one of the first UK retailers back in 1999 to open up in China, has meant that the business could be accused of operating a loose collection of companies rather than leveraging the ‘power of the group’, to quote current CEO, Ian Cheshire. We required a clear and cohesive strategy to deliver greater value from the property portfolio.

The challenge Kingfisher faced was to provide consistent reporting on assets with different tenures from robust data across disparate operating companies with different brands, languages and currencies. It was increasingly difficult to gather this information as well as cater for different in-country requirements without huge additional effort.”

Q: What solutions were created /implemented to address your business need?

A: “Core to driving additional value from our property lies with securing greater visibility and insight into its make-up and management. The delivery of a web-based portfolio decision making system EC Harris’_On² system which was customised for Kingfisher Group, has enabled the group to globally monitor and manage their estate. At a glance, we can now review the performance of our portfolio and make key decisions to improve effective management.

Specifically, the solution delivers a tool that provides:

- An asset information database holding details and supporting documents on over 1,000 properties (such as leases, plans, etc)

Kingfisher is one of the original Retail ‘Powerhouses’ and has a stable of retail brands, including B&Q, Castorama, Brico Depot, Koctas and Screwfix, all focused on the DIY/home improvement market. Current operations extend to a store portfolio of nearly 840 stores in 8 markets, including within the UK, Ireland, France, Spain, Poland, Russia, Turkey and China. Kingfisher also sublets some of its space to other retailers.

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- Information that's tailored to each country's legislative and operating needs
- A Property Management Information dashboard with interactive mapping to drill down from a regional, country, city and store views if required (see fig.1)
- Exception based alerts to Property and Project Managers
- A customised web-based interface that reflects the operating company branding, local language and currency as well as specific user security rights."

Q: What did EC Harris do that was the difference that made the difference?

A: "Although the drive for the project was initially 'global' the solution was 'localised' as much as possible. With office locations in all of the markets where Kingfisher have operating companies, EC Harris have the professional experience and capability to engage with the various territory stakeholders to lead and drive the project forward. Working with the sponsorship of Kingfisher Group Property, relationships were established with each operating company that enabled local requirements to be gathered and effectively woven into the overall solution. Through extensive stakeholder engagement a design was developed that met both our core information needs and local variants due to local legislation and operating needs. The result was a system that delivered the core portfolio reporting data at group level but provided added value to our local operating companies.

Evidently EC Harris was able to provide the leadership and expertise to deliver the project in support of our small focused property team."

Q: What were the key benefits and the added value achieved?

A: "We have improved overall visibility in the Group and at local operating company level and are able to make better decisions as a result.

We have an overall reduction in use of standalone spreadsheets and separate systems to manage the asset portfolio which in turn has provided us with a more transparent view and better control of risks and opportunities associated to the portfolio - such as lease breaks and rent reviews.

Most recently, the system has been deployed to support our B&Q China turnaround programme, supporting how the business manages its sub leasing activities including lease details, rent payments and licenses."

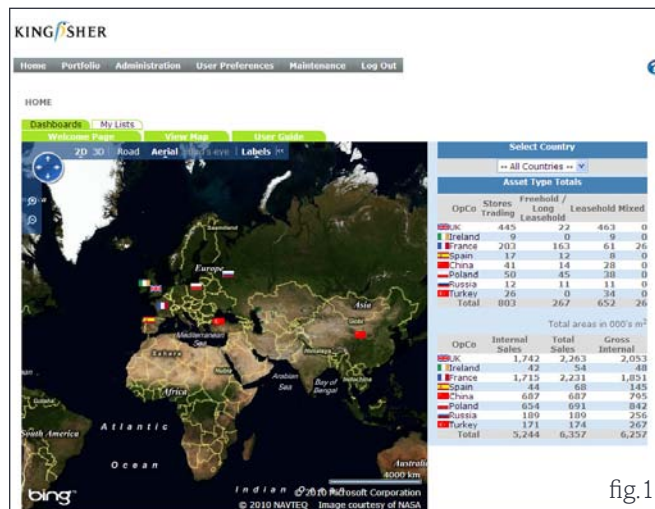


fig 1

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IS THERE LIFE AFTER RETAIL?



Apparently, approximately 1 in 8 square feet of retail space is currently empty. The rise of vacant retail space is hurting retailers who are caught up in leases but can't get out of them, and ultimately landlords are not receiving rent and have to pay business rates. Previously, efforts to combat vacancies have mainly focused on new market entrants, pop-up shops and charity shops (who are attracted by the lower rents and tantalising deals on offer from desperate landlords). Not only does this not fully address the underlying trend of reducing demand for secondary retail space but this can cause issues with existing retailers in neighbouring units.

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How can we optimise the space we already have and how can we get the best from the available assets?

EC Harris, with its partner organisations, has created a new concept for retail 'shells', applying techniques learned from other sectors.

The opportunity

A surge in birth rate and the current population bulge has resulted in an unprecedented demand for primary school places. Some local authorities already have schools with class sizes approaching 35 with up to 500 five year olds without a current school place and this is expected to increase over the coming years, requiring the construction of approximately 375 new institutions. However, due to intense pressure on public finances, this major construction programme is effectively ruled-out and new remodeling and refurbishment options are being explored.

The opportunity intensified with the emergence of 'free' schools to open in September 2011. These will be state-funded independent schools run by groups of parents or charities, outside of the local education authorities control.

Looking to retail

Given the amount of retail space currently vacant there is a clear opportunity for former shops and offices to be converted. Michael Gove, The UK Minister for Education, has already recognised that the retailing industry has a track record of improving capital efficiency by looking to retail advisors, such as Sebastian James from DSGi and Kevin Grace from Tesco.

There has been much debate around this initiative with some delighted to see some initiative work in progress around school housing and recognising the added value this could bring to nearby businesses, whilst others have reservations on how it will work and want to understand what this will mean for towns, industrial parks and communities.

At EC Harris we wish to take the debate even further and provide evidence that there are significant savings and efficiencies to be gained in adopting new and radical models over the more conventional ones. There is a clear need for a greater focus on what works; doing more with less; more remodelling and refurbishment and above all, genuinely creative design and commercial solutions.

Cut 36% from the average cost of building a new school

Our initial findings, based on existing guidance for school provision, has indicated that making use of an existing retail shell could cut 36% from the average cost of building a new school. Not having to begin construction from scratch

would speed up the programme from building a new school - shaving 30 months off the programme. This also fits with current budgetary restrictions on completely new development.

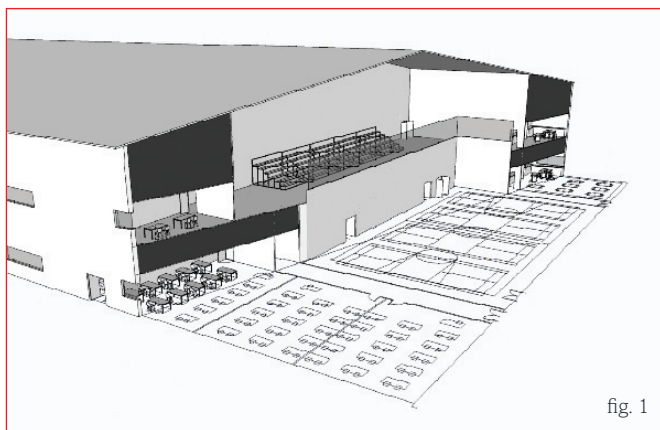
The social, economic and environmental sustainability

Reusing existing buildings is one of the most sustainable methods of construction, reducing the construction embedded carbon footprint and amount of demolition building waste being sent to landfill. This solution prevents retail buildings standing empty, attracting vandalism and becoming an eyesore. It helps to stimulate the local economy by providing employment and serves the community by providing local educational and community facilities. The solution therefore addresses the holistic sustainable development areas of social, economic and environmental sustainability.

Alongside this, the retail unit solution provides greater opportunity to enable significant reduction in the operational carbon footprint. This can be achieved through passive means by massing the accommodation together, having a high performing fabric and a single plant solution which can be designed for efficiency. For example, the large single roofs of existing retail units also represent a simpler solution for solar thermal and PV installations and rainwater collection.

Flexibility

Research shows that industrial retail park space is a good model for a school because of the flexibility it offers. The internal space can be divided up to suit a number of different class sizes and teaching methods. The opportunity here is to focus on and optimise the interior environment. Car parking areas could be partially fenced off for use as play areas accessed through the main doors and the remaining parking space could be retained for staff. There are opportunities to create state of the art indoor sports



halls and performing arts facilities. Internally, there would be a need to ensure that drainage and delivery services are matched to need - for example sanitation upgrades and potentially resize of drainage to take increased volumes. See fig 1 for an example fit out.

The simple construction of a retail unit 'shell' lends itself to future re-use should the school become surplus to requirements if pupil numbers fall in the future as predicted. Likewise, should the school no longer be required in the future, the shell could be retained and the interior adapted for a different use. This flexibility results in inherent long term sustainability of building and the site. This could improve the sell-on value should a local authority purchase the land rather than enter into a lease.

Alongside this, high street unit space can be used for smaller campus style sixth form college space or many empty retail 'shells' could be knocked through to create a school block of classrooms. Likewise commercial office and industrial space can use similar construction methods.

What happens next?

As built asset consultants our expertise in the retail sector and the efficient construction methods employed, combined with our in depth understanding of and experience in education gives us a unique ability to inform the way we approach school building in the future. We help clients to realise added value, reduced programme length, increased flexibility and support the drive to raise levels of educational attainment.

We are currently working with several local authorities, free schools and BSF with retailers on the first pilot sites.

Schools need:

- Space which is flexible for future need
- Adequate external space
- Good infrastructure
- Good access
- Space which can inspire.

Large retail units have:

- Large roof spans over big floor area
- Large car parking areas
- Excellent infrastructure - technology and services
- Good access
- The potential for real design innovation for what goes inside them.

To discuss these potential opportunities in more detail please contact Catherine Tobiasinsky, Head of Retail.

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THE CHANGING FACE OF EUROPEAN DISTRIBUTION



Uncertain economic times have meant that many retailers, developers and investors have stalled or cancelled their store development plans due to fragile consumer confidence, constrained funding and a need to optimise existing space. However, on-line retailing is growing at such a pace which gives the opportunity for 'borderless' trading and a quick way to expand into markets close to home. This therefore requires continued investment in appropriate fulfilment assets. These 'Cinderella assets' of the retailing world can no longer be ignored or retailers risk their ability to perform.

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Retailers often use sophisticated demand modelling tools to optimise their supply chains, with the goal being to optimise the location of logistics assets, reduce delivery times and keep transportation costs down. However, a potential flaw in many of these 'inwardly' looking models is they don't take into account the bigger picture. There are many crucial macro-trends that are redefining the European distribution market. Does your model make the most of these macro-trends that are changing the face of European retail distribution?

Prevalent consumer and retail trends

1. On-line - consumer spending habits are constantly changing aided by technology, culture and accessibility. Spend via e-retailing in the UK alone is expected to increase by 48% over the next five years, signalling a permanent shift in requirements for retail fulfilment formats and space. Customers no longer want to wait weeks for goods to be shipped from faraway locations. Changes need to be made to ensure retailers are staying ahead of the competition.

2. Near-sourcing - the recent 'volcanic ash incident' in Europe drew focus to where products are being sourced from, but the trend for sourcing products closer to the market in which they will be consumed has been increasingly prevalent. Major near-sourcing centres in Europe are currently in Turkey, Czech Republic, Poland, Romania, Baltics and Morocco. These destinations are attractive to supply Western Europe as they are low-cost, have skilled labour forces, and a less stringent regulatory environment. These locations enable retailers to monitor the quality of goods and reduce delivery times.

3. Changing footprint - retail growth in European 'hot-spots' is set to continue with retailers attracted to compelling long-term growth opportunities and fleeing from saturated home markets. Many retailers are already taking advantage of excellent international growth prospects. However it is the Central and Eastern European (CEE) markets that are most promising - TK Maxx launched 28 stores in Germany and Poland in the past three years and M&S opened 16 stores across the region last year.

So what does this do to the current supply model?

Retailers clearly need to maintain the efficiencies of their supply chains and consider positioning of distribution networks based on effective local multi-nodal transportation for future network growth. An existing 'home market' distribution centre can support the initial launch of stores

in a new market, but after a critical mass of new stores has been reached (typically 10 stores of a large high street fashion format) we find it is time to set up a dedicated distribution centre to significantly cut down lead times and costs. This also extends to the strategic positioning of smaller fulfilment centres around major cities to further reduce journey time and costs to support multi-channel retailing.

Infrastructure improvements

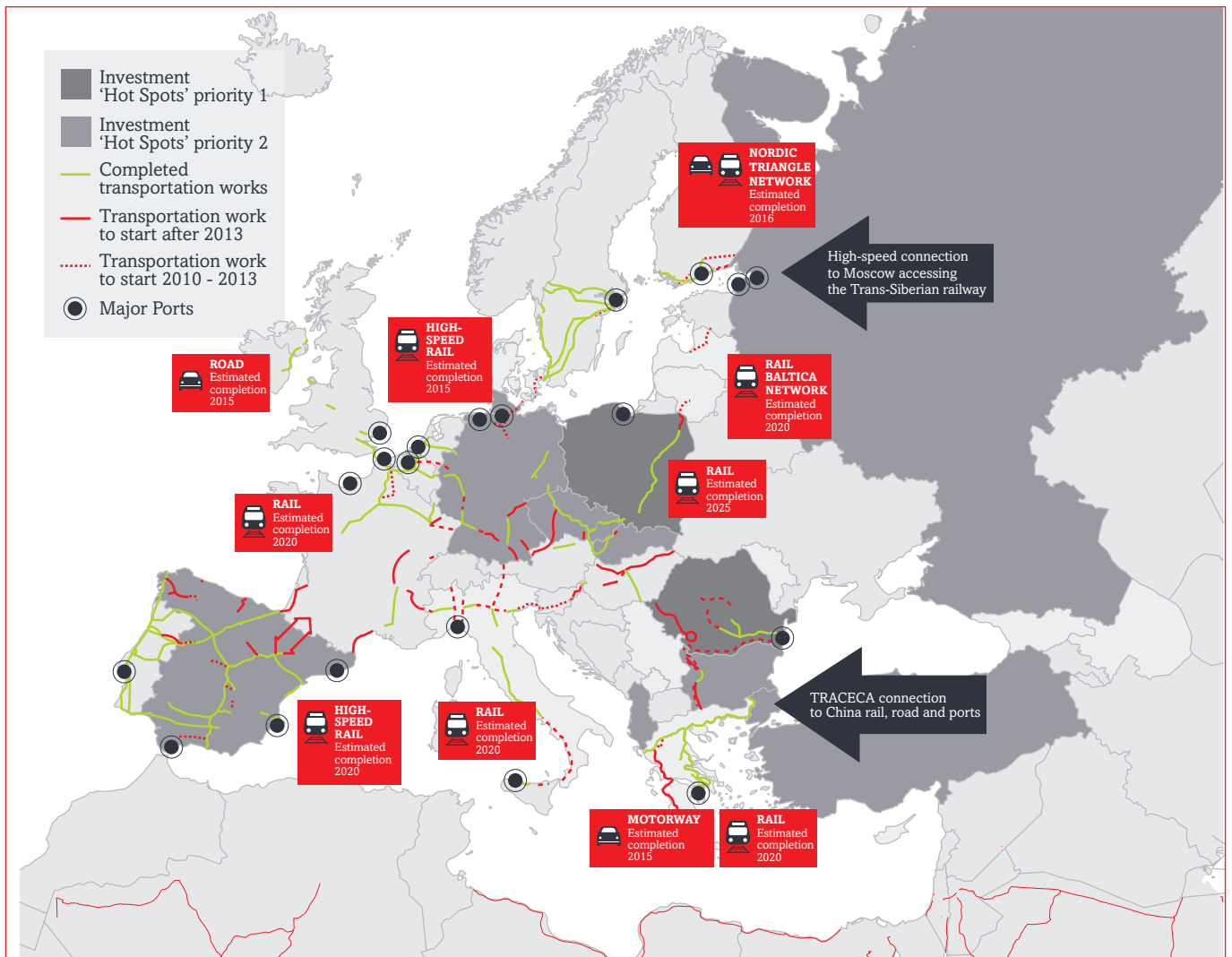
Even if you consider the still dominant Far-East supply model, as accession into EU dissolves trade boundaries, we are increasingly seeing goods arrive into Europe from the bottom up via the Balkans rather than top down through Northern Europe.

The scope for the development of ever more efficient supply chains has been significantly improved by the investment in the European high-speed transport network (TEN-T) which has created an international road, rail and port network

for freight and passenger customers. The investment by the European Commission and national governments is improving accessibility across Europe and provides transport connections to Asia via adjoining transport initiatives of the near-Asia Caucasus (TRACECA) and the improving Russian rail system.

These investments provide retailers with the opportunity to reduce delivery times significantly, for example transporting goods via road from Constanta, Romania to Western Europe now takes days not weeks, with rail cutting this time down further. It currently takes 4 - 7 weeks to receive goods from Asia and with rising transportation costs and consumer expectation, accessibility and speed is key. Countries are starting to extract the value from the TEN-T network by creating the secondary transport networks and logistics centres around economic 'hot spots' as highlighted in the map below.

Investment 'hot spots'



Considering which markets are most promising given their strategic geographical location, relatively strong forecasted economic growth, high brand awareness, and sizeable populations, and spending power overlaid with significant investment in transport networks, Germany remains a hot-spot. However it is CEE where real opportunity exists (identified as priority 1 on the map.)

Poland, Romania and the Czech Republic have forecasted strong economic growth for the next five years - IMF data indicates Poland's GDP is set to grow by almost 20% from 2009 - 2014, with Romania and the Czech Republic to experience growth of more than 10%, which is higher than those in the west. The greatest amount of investment on transport infrastructure will be realised by Poland and the Czech Republic whilst Romania and Poland also possess two major ports - Constanta and Gdansk with direct access to Asia.

Retailers, investors and developers will have increasingly viable investment options in countries and markets once regarded as unimportant, inaccessible or too high risk. These emerging gateways in Europe are creating clear opportunities for demand and supply but are retailers, developers and investors taking full advantage? Focusing only on where your existing demand and supply is centred means you risk losing out on gaining significant competitive advantage for the future.

Contact



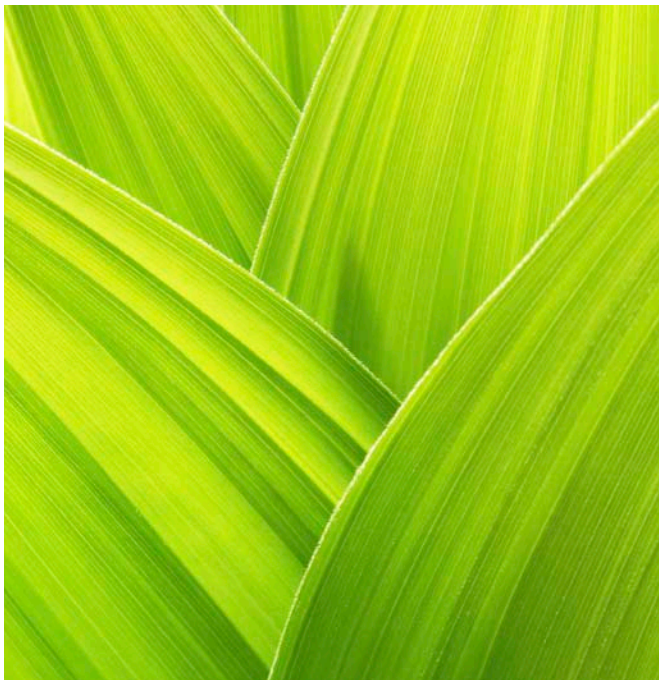
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CRC - WHEN AN INCENTIVE BECOMES A TAX...WHAT'S IN STORE



In the Spending Review a fundamental change was made to the way in which the Carbon Reduction Commitment (CRC) will operate. What was designed as a revenue-neutral incentive to cut carbon emissions has become a Green 'stealth tax' which will result in all affected retailers paying 8-9% of their energy costs to Government. Organisations should quickly implement practical carbon reduction measures to reduce their future liability.

Buried deep inside the Spending Review was one short but very significant paragraph for organisations and their carbon reduction plans.

“The CRC Energy Efficiency scheme will be simplified to reduce the burden on businesses, with the first allowance sales for 2011-12 emissions now taking place in 2012 rather than 2011. Revenues from allowance sales totalling £1 billion a year by 2014-15 will be used to support the public finances, including spending on the environment, rather than recycled to participants. Further decisions on allowance sales are a matter for the Budget process.” This means that participants in the scheme will no longer receive any money back from the Government - changing the CRC from an incentive to a tax overnight.

When it was first designed, CRC was meant to be largely revenue-neutral for participants and the Treasury. Under the previous model, retailers that were impacted would pay out at a certain level but receive money back six months later, depending on their carbon reduction performance (ranked in league tables). Effectively this meant the maximum a retailer could lose in the first year was £1.20/tonne and by year five was £6.00/tonne.

Many would have gained a similar amount and the vast majority would have experienced little overall gain or loss. Now all organisations in the scheme - likely to be between 3000 and 5000 - will have to pay £12/tonne on all their carbon, regardless of how well they perform in the league table.

It is likely to impact organisations of medium-sized energy use (those spending over £500,000 on electricity in a year) but will not affect big polluters which fall under The European Union Emissions Trading Scheme (EUETS) nor small organisations with limited energy use.

What is the financial impact?

The CRC has become a carbon tax and will add on 8-9% to all gas and electricity costs from April 2012. Retailers should look to budget for this cost now, in addition to the forecasted increase in utility costs, as it will be unavoidable.

Overall the Treasury expect to raise £715 million in 2011-12 rising to £1.02 billion by 2014-2015. Given the number of participants within the scheme this means that on average an additional £200,000 per retailer per year will have to be paid to the Treasury. However, the variance of cost will be significant, with many larger retailers unexpectedly paying much more than this.

For example, for a leading high street retailer that we have worked with, the CRC liability will cost approximately £260,000 per year and the larger tier one retailers will have to find millions of pounds per year.

What you need to do...

Previous advice has been around taking the relevant quick wins to improve your position on the league table. The main elements of this were to install automatic meters and gain the Carbon Trust Standard. However, the league table no longer applies and will become a reputational driver only (if it is still produced).

The Carbon Trust Standard now has little value under the new model but Automatic Metering Reading will still be greatly help with administrating the scheme and provide an excellent tool for carbon reduction. Retailers should continue with plans in this area although should review the value of installing them in small energy-use buildings.

The key action retailers should now take is a focused drive on carbon reduction to reduce the amount of tonnes of carbon they emit and therefore the amount they will have to pay. To gain the full benefit of carbon reduction in reducing CRC the steps should be taken prior to April 2011, but reductions at anytime will help. The CRC will have the effect of improving the payback periods on any investment made in 'greening' built-assets.

Five steps to reduce your liability

We find that most retailers can save 20-30% of carbon through a series of carefully designed reduction measures which payback in under 5 years. There are also a handful of measures which payback in less than two years and increasingly there are funding methods available to finance these improvements, so capital expenditure is not needed. To establish the best strategy to reduce their liability, retailers should follow these five steps:

1. Establish whether you are eligible for the scheme
2. Undertake an estate audit to assess current emissions and what your future liability under CRC would be (if no action was taken)
3. Identify if any preparations have already been made for CRC in its previous form
4. Develop (or re-develop) your strategy to minimise its impact
5. Implement the strategy, starting with practical carbon reduction measures.

To find out more information on CRC, its potential impact and how to reduce your liability, contact: Matt Fulford, Head of Sustainability.

Client success:

We have recently completed a study with Mothercare to reduce their carbon emissions by 20% under three years through a series of supported improvement recommendations;

We delivered a sustainability policy to ensure that the business could have a defensible and deliverable strategy, covering new acquisitions, store development works and existing estate improvements. We demonstrated that the savings from delivering the accompanying roadmap were equivalent to the profit generated from opening three new Mothercare stores.

Mothercare comprises of over 1100 stores worldwide and has over 400 stores in UK in both High Street and Out of Town locations. The business has an approximate turnover of £725 million per annum and a profit of £30 million. A typical standalone store of Mothercare is between 3000-6000sq ft in size.

What were the specific added value items from our study?

- A 1.73% reduction in carbon from baseline. We found that a 1% carbon saving = £52,000 financial saving per annum
- Demonstrated that a certain format type was the biggest emitter and least carbon efficient - supporting business preference
- Converting all to a different format type would deliver a further 9.5% carbon reduction in a standard sized Mothercare store
- A 10% reduction in water usage over 4 years delivering savings of over £55,000 per year
- A 15% reduction in energy, delivering £780,000 of savings per year.

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BECOMING MORE EFFICIENT AT INTERNATIONAL EXPANSION

Taking your brand into new markets, you're attracted by the growth potential but how best to manage the costs of setting up abroad? With so many new things to grapple with - the right customer proposition, locations, recruiting and training staff, cultural differences, regulation etc - how do you tap into the best knowledge? What is the price you should be paying to construct or fit out new stores?

The questions we get asked most often include:

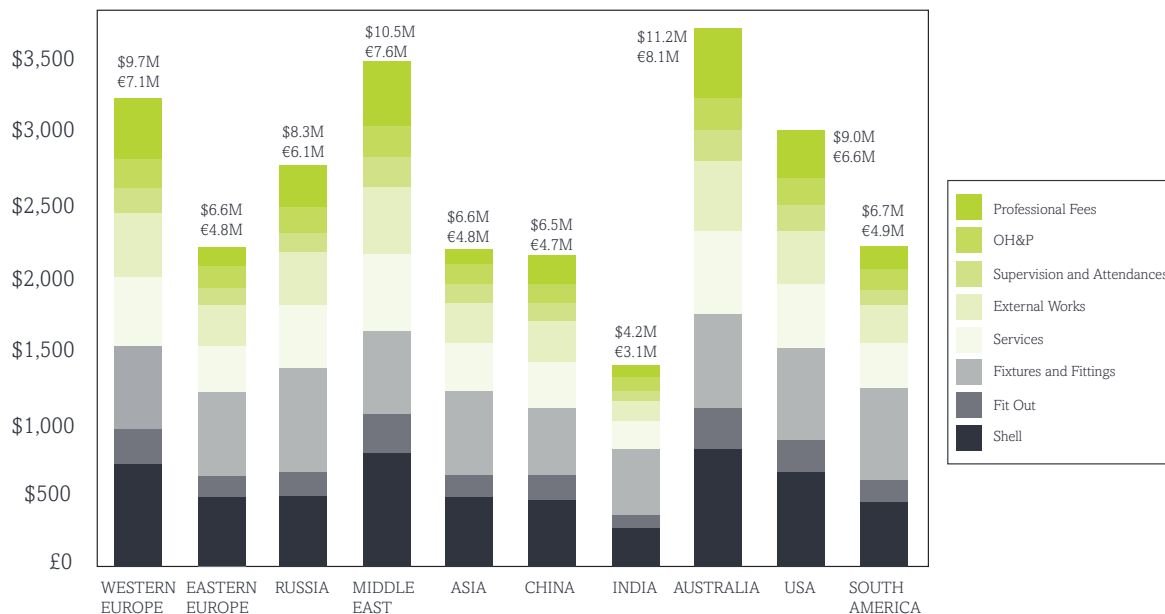
- How do I best take my brand into a new market being sure that I do not compromise my offer?
- How do I protect the customer journey but still be flexible to local market customs?
- How do I protect workers with reasonable fire, health and safety standards that don't cost abnormally high amounts of time and capital?
- How do I bring group initiatives into new markets such as sustainability?

- What supply chains are required globally, regionally and in a local market to drive value?
- How should we manage performance of regional and local market teams?

EC Harris works with a number of leading retailers to solve these problems by compiling the tools to support international delivery, combined with international experience, in new and emerging retail markets. This includes the detailed specification review and advice on appropriateness of the supply chain approach to the market and tools to define a consistent approach to commercial management. Using our network of regional offices supported by our Retail Centre, EC Harris is implementing global specifications mindful of the regional differences and the associated tools to support procurement.

How do your costs currently compare to our data? Do you think you can achieve market average or do better?

The graph shows the market average for fit out costs in different markets for a standard 3,000m² Net sales area, 5,200 m² Gross area. *



*Notes on the graph:

The figures are expressed US\$ per m² of net sales area, excluding Goods and Service Taxes (VAT) and internal business costs such as management and logistics. The Fit Out element includes Finishes, Internal Doors and Internal Walls & Partitions, Services includes Mechanical and Electrical Categories, Sanitary Fittings, Plumbing and Sprinklers but excludes services upgrades and infrastructure improvements.

The Regional Descriptions are as follows:

- Western Europe: UK, Germany, France, Spain, Portugal, Italy, Austria, Belgium, Denmark, Ireland, The Netherlands and Sweden
- Eastern Europe: Bosnia and Herzegovina, Czech Republic, Croatia, Bulgaria, Hungary, Latvia, Macedonia, Poland, Romania, Slovakia, Turkey and Ukraine
- Middle East: Saudi Arabia, Qatar, Oman, Bahrain and The United Arab Emirates
- Asia: Thailand, Vietnam, Pakistan, Taiwan, Sri Lanka, South Korea, Malaysia, Indonesia, Hong Kong and Japan
- South America: Brazil, Mexico, Argentina and Chile.

To find out how EC Harris can work with you to maximise your international delivery into retail markets please contact Chris Read.

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