

CHANGE BRINGS OPPORTUNITY

EC HARRIS PROPERTY OUTLOOK 2012

2012 will be another year of change, but with change comes opportunity and the winners will be those that anticipate and adapt fast to create competitive advantage.



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We enter 2012 with an uncertain outlook in most markets across the World, where control, speed, asset performance and partnerships will be the key drivers for success.

For retailers the opportunities are two fold; format renewal and international expansion, both of which will accelerate this year. Format renewal is essential to maintain share of available spend in an environment where customer loyalty will be tested. International expansion is complex but necessary to drive profits and increase market share. Competition is fierce and retailers will continue to seek cost reductions and faster delivery from their investment programmes.

For corporates, the rapid need to reduce costs has fuelled a drive towards global out-source solutions. We predict that boardrooms will require further cost reductions but with a greater focus on creating an adaptive organisation; the ability to move quickly and efficiently will enable corporates to create competitive advantage. This requires closer control and we will see a shift away from pure out-sourcing to 'integrated delivery models'. Operational efficiency and the control over assets will be vital to respond to this volatile market.

Commercial, residential and mixed use developers will continue to be constrained by occupier demand and funding supply. The next year will reinforce the change we have seen over the last 18 months where developers have shifted from project solutions to strategic alliances, such as Joint Ventures (JV) with funders, development partners and consultants to deliver portfolio investment. Alongside this, in emerging markets such as Asia and the Middle East, we foresee an acceleration of national social infrastructure programmes through the emergence of PPP and JV delivery models.

For lenders and investors 2012 will complete the shift from the "reckless" to the "riskless". Risk management will be the mantra at Investment Committees and cash rich players will continue to take advantage of current market conditions. We will see investments from new entrants such as insurers and predict Middle East Sovereign Wealth Funds will become more internally focused, but Asia funds will continue to invest out with their region. One of the biggest challenges for 2012 will be 'deal pace', as the enhanced risk management, internal governance, regulation and controls will slow down decisions.

In this paper, our property sector experts consider the year ahead and what it means for you. If you would like to discuss any of the issues raised in more detail, please do get in touch.

KEITH BROOKS - Head of Property



European Property Finance

Going into 2012 there will be many new entrants in the debt market. We currently see insurers and private wealth as the biggest movers, usually at the expense of traditional lending banks and it will be important for all new entrants and banks to ensure that they find financially safe development partners.

The banks will continue to struggle and source revenue producing assets. I predict that approximately 25% of approved development schemes in Western European countries will be put on hold as banks are unable to follow through on promised commitments. Lenders and investors will need to identify the difference between "safe" and "opportunistic" markets to ensure a secure return.

Moving into the New Year, there will be a significant increase in ratio of refurbished against new build assets as owners will not be able to afford to maintain sell up and other owners will make better use of what they have got. We will no doubt witness an increase in conversions, for example, office to residential in major Western cities across Europe, such as London, Paris and Frankfurt, to help maximise the return of assets.

The weight of sustainability is too great for developers and investors to ignore. It will continue to be a unique selling point to attract tenants and help to create competitive advantage in this challenging and volatile market. I predict that most new projects will specify sustainability performance requirements tailored for the targeted tenants.

MATTHEW CUTTS - Head of Lenders & Investors



International Retailers

Given the tough consumer spending scenarios ahead - at least in the Eurozone countries - it's going to be a tough year ahead for retailers, but if you look closely the trends are there:

- 1 Make more of the stores you've got.** Consumer research suggests that cash-strapped customers are more likely to treat themselves if the store environment is easier to shop and invites them to feel special. Tired stores leak sales, and discretionary sales in particular. Many of the major players are shifting their property spend into brand renewal.
- 2 Buy don't build.** Expect to see acquisitions that will advance Asda's ambition to be number one in non-food, Sainsbury's market entry into China and Alliance Boot's global health and beauty mission. How quickly acquisitions can be integrated will be a critical success factor.
- 3 China matters more.** Increasingly, the world's leading consumer brands are identifying China as their most important market - partly due to its size and growth potential, and partly because customer perceptions created here will have global resonance for decades. Expect to see major Chinese retailers acquiring European chains that have fallen on hard times to combine Asian product and supply innovation with Western retail nous.

COLIN TURNER - Head of Retail



European Residential Development

Global uncertainty driving the London market

Looking forward London stands to benefit from global uncertainty due to the continuous flow of equity driven into the luxury residential market, the currency advantages and the restrictive Asian domestic residential investment markets. Alongside all of this, London has and will no doubt continue to be seen as a "safe haven" for investment. However not withstanding this positive sentiment, there may be a risk of overseas investor 'fatigue', especially for more mainstream outer London new build residential developments. Such developments are causing some confusion to investors that are new to this market as the boundaries between 'prime' and 'mainstream' are becoming blurred. The desirability and the off plan sales will no doubt be more susceptible to over supply, as the wider London residential market benefits from the international interest that prime central London is seeing. However these types of developments are much more limited.

More demand

Overseas purchasers in London will become much more discerning in response to any increase in the supply of residential product being offered which may have a stabilising effect on the mainstream London residential market. Nonetheless, super prime and luxury London residential in prime locations will continue to be under supplied and will see steady price growth.

At a crossroads for the UK mainstream market

The wider regional UK residential market remains at a crossroads. The first time buyer accessibility to the market is at an all time low. The UK government is being forced to use the banking sector as an instrument of government policy and this will only be successful if all banks (including non tax payer owned ones) are willing to increase lending in overall terms. The much vaunted advent of a large scale private rented investment and development sector may start to materialise in 2012. Investors may realise that there could be a forced long term structural shift in the UK away from home ownership and towards renting, due to the lack of access to the housing ladder.

The Eurozone crisis is a continued threat

The Eurozone crisis continues to threaten the economic heart of many European countries. With more regulated lending and mortgage markets, few Western European countries have had a housing market crash as the size seen in the UK. However, with domestic residential demand ultimately driven by income, employment and economic confidence, the nature of the uncertainty facing these countries could precipitate long term inactivity in residential markets. Government sponsored social housing programmes will be squeezed as national debt burdens are reduced. This will create socio economic tensions, further exacerbated by demographic and migration trends in many European countries indicating increasing numbers of households being formed going forward.

MARK FARMER - Head of Residential



Commercial London Office Development

Investment remains strong for prime assets

Investment remains very strong for London's prime assets and competition is extensive. Insurers, Private Equity, Institutional Funds and Sovereign Wealth Funds are all fighting to secure prize and 'trophy' assets to bank within their portfolios. This is set to continue throughout 2012 and beyond.

Refurbishment remains a strong option, with a lower risk profile, reduced capital costs and earlier to market opportunity. We expect to see the extent of refurbishment projects increase over the next 2-3 years as significant new development will continue to be driven by tenant demand.

Outside London, the market will continue to struggle. Pockets of development are projected, particularly around Birmingham and Business Parks. This is set to continue into 2012-13, as projects inherit the same 'certainty' restrictions and requirements as identified above.

European Retail Investment

Pockets of opportunity

It's going to be another tough year ahead but the market will provide pockets of opportunity for those across Europe. Food store development will continue at a pace, but mainstream retail development looks set for a relatively quiet period.

We expect to see continued investment in to retail assets across Europe, where there is the opportunity to generate greater value and income. Therefore we predict greater demand for active asset management, skills and capabilities. We see this trend being replicated across Asia and the US. Shopping centre owners will need to respond to the changing demands of their tenants and their customers.

RICHARD TAYLOR - Head of Commercial Development



Global Corporate

Creating an adaptive organisation

The key driver for corporate property executives is to reduce operating costs, improve margin and to free up capital to allow for investment in new and more profitable markets. The boardroom agenda will become more agile and responsive, improving speed to market and allowing their business to execute plans efficiently and effectively, to grow and sustain revenues.

Weighed down by an excess of property assets, the successful corporate will be those that manage their assets strategically, put in place clear asset plans that will improve utilisation and productivity and create a workplace that retains the best talent, drives innovation and competitive advantage. Asset plans should look to reduce fixed asset costs by developing flexible workplace solutions, optimising the use of the building and accelerating on a managed divestment of property assets. Operation costs can be reduced by implementing whole life cycle costing and sustainability approaches to lower costs and reduce carbon footprint.

The need to deliver overall reduction of operational costs from simple outsource models are largely not sustainable and we will see many property service models evolving. These models should deliver clear asset plans that integrate the very best practice and expertise, reduce overall operation costs and enable corporates to become agile and proactive. When these types of models are implemented successfully they should provide a sustainable solution to the asset planning challenge of developing asset strategies to support corporate business plans.

JON MOORE - Head of Property, Asia

For further information, please contact:

KEITH BROOKS - Head of property

e keith.brooks@echarris.com

w echarris.com/property