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Savills World Research
Germany

Spotlight

The investment market for retail parks

October 2018

Between a long-term boom and a descending fog of risk

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Record levels as far as the eye can see

It just runs and runs and runs…what was once an advertising promise of German car manufacturers is now an apt description of the global real estate market. Following years of bull market activity, the global transaction volume since 2014 has evened out at around USD 1.4 to 1.6 trillion. Investment during the year to date suggests that this level will be significantly exceeded in 2018 (see Graph 1).

Zero interest rates have driven the property boom

If such a prolonged boom is rather extraordinary, the conditions that have facilitated this bull market are also exceptional. In the prevailing zero interest rate environment, liquidity costs money not only in the form of lost yield but also via penalty interest from the banks. Moreover, (real) yields on many bonds considered secure are in negative territory. While there may now be a foreseeable end to the ultra-accommodative monetary policy following the first interest rate hikes from the US central bank, it remains to be seen when and whether interest rates will return to their levels prior to the financial crisis (see Graph 2).

A new era for real estate

Against this background, it remains impossible to look beyond real estate as an asset class. Indeed, many institutional investors have increased their allocations to real estate and also intend to do so going forward. This is producing massive inflows of capital into the real estate markets. Pressure to invest is high and this is reflected in the German property market. By investing in German real estate, investors are ultimately participating in the productive capital of one of the world's strongest economies, which also offers a highly stable political environment and a reliable legal framework. A glance at the UK, the USA and other regions around the world underlines the value of such a combination. Even the longest government formation period in German history cannot deter investors.

As a result, Germany in particular is enjoying a seemingly endless real estate boom. More than EUR 50bn has been invested in German commercial property in each of the last three years, which is unprecedented. The transaction volume is also expected to exceed EUR 50bn this year and there is currently no indication of the momentum declining (see Graph 3).

Rising prices across the board

The immense demand has manifested itself in significant yield compression across all sectors. The prime yield on offices across the top seven cities has hardened by an average of 210 basis points since 2009, while logistics property has even witnessed yield compression of 240 basis points (see Graph 4). Prime yields on retail property also show a significant downward trend, albeit less pronounced, with yields on high-street properties hardening by "only" 160 basis points.

Retail property has lost market share

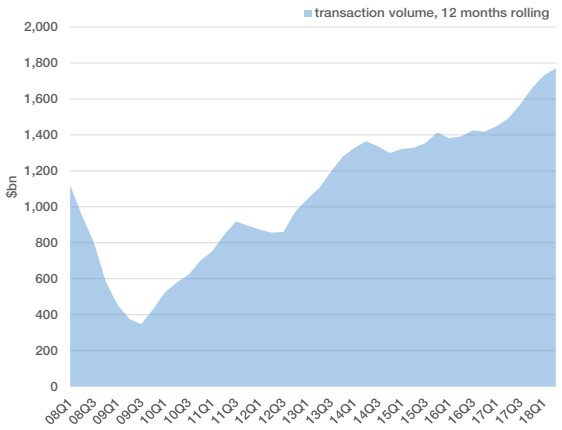
Retail property has also deviated somewhat from the overall trend in commercial property in terms of transaction volume. While the transaction volume for retail property has been relatively high since 2015, in line with the commercial investment market as a whole, many of the largest transactions during this time can be described as "consolidation purchases". The acquisition of Galeria Kaufhof by HBC and the acquisition of Corio by Klépierre were the two largest transactions during this period. Furthermore, the transaction volume for retail property as a proportion of overall investment in commercial property has been in decline since 2011. While retail property accounted for almost half of the investment volume in 2011, this had halved to just below 25% by 2017 (see Graph 5).

Growing investment in retail parks

The performance of individual retail formats has varied widely. Shopping centres have been among investors' favourite types of property, accounting for record investment of EUR 3.4bn in 2010 and EUR 4.5bn in 2011 as well as market share of up to 47% of the overall transaction volume for retail property in the years following the

GRAPH 1

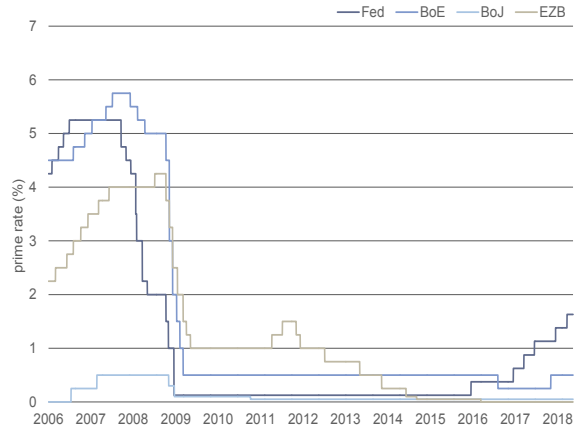
Global real estate transaction volume



Source: RCA, Savills

GRAPH 2

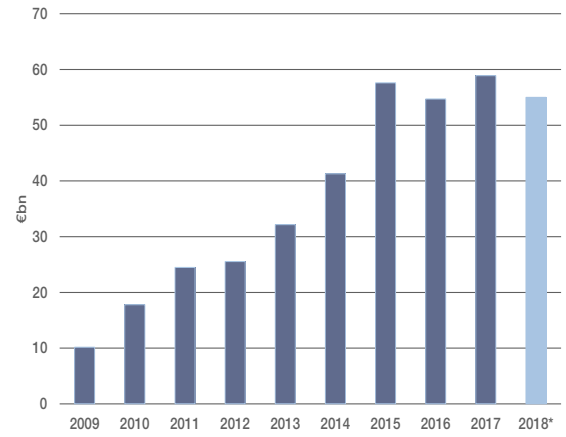
Prime rates of selected central bank



Source: Central banks, Savills

GRAPH 3

Commercial property transaction volume



Source: Savills /*projection

financial crisis. However, they have subsequently lost favour and were responsible for less than 20% of the transaction volume for retail property last year (see Graph 6). Retail parks, meanwhile, have shown an inverse trend with transaction volumes rising continuously since 2009. Investment in retail parks last year totalled almost EUR 2.9bn, representing a new record and simultaneously overtaking shopping centres for the first time. Retail parks have also enjoyed a significantly stronger start to 2018 than other retail property.

Concentrations of retail warehouses, supermarkets and similar formats have shown comparably strong growth to that of retail parks. Investor demand for these properties has also risen continuously in recent years, culminating in (provisional) record levels in 2017 both with regard to the number of properties transacted and transaction volumes. Another reflection of investors' appetite for this type of retail property is the large number of high-value portfolio transactions. Between January 2017 and August 2018 alone, there were five transactions with volumes in excess of EUR 200m. Acquisitions such as those of the Quest and Leopard Portfolios by Patrizia made a substantial contribution to the record level of investment. Other large transactions included the disposal of a retail park portfolio by IKEA to Pradera and the acquisition of the Bordeaux Portfolio by Redos (see Table 1).

Yields on retail parks and shopping centres are converging

The rise of retail warehouse formats has also been reflected in yield trends. Prime yields on retail parks have hardened by 250 basis points since 2009 to 4.2% last year. Yield compression on shopping centres during the same period has totalled just 170 basis points. Consequently, the risk premium for retail parks compared with shopping centres has fallen by 80 basis points in recent years (see Graph 7). The convergence in yields has principally occurred over the last two to three years and can be regarded as a clear indication of a change in the perception of risk on the part of investors.

Changed investor preferences correspond with developments in retail

This shift in the preferences of investors in recent years corresponds with developments in the retail sector. While the sector continues to grow as a whole, this growth is significantly slower than that of overall consumer spending. In other words, people are evidently preferring to use their increase in income to take more frequent holidays or to eat out rather than to buy the latest flat-screen television for their apartment every year. In addition, growth in retail sales is largely attributable to online retail while in-store sales are largely stagnating. In fact, the latter even declined in many retail segments last year (see Graph 8).

Fog of risk for shopping centres is becoming thicker

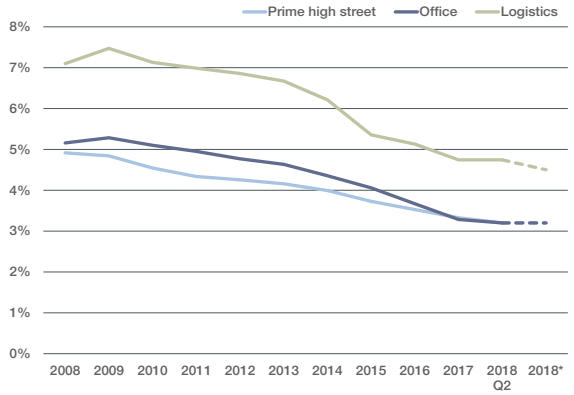
The decline in in-store sales is particularly affecting those segments that play a large role in the typical product mix of a shopping centre. At the same time, the online growth rate in these segments remains around 10% per year, meaning that shopping centres are surrounded by an increasingly thick fog of risk into which fewer and fewer investors are willing to venture, particularly if they lack expertise in shopping centres.

Retail parks are benefiting from strong sales growth in fast-moving consumer goods

One retail segment, however, continues to enjoy strong growth in terms of in-store sales: fast-moving consumer goods, i.e. products for short-term needs such as food and drug store products. Sales in this segment increased by 2.6% in 2017 compared with the previous year and the growth in absolute figures is even more impressive. In-store sales rose by around EUR 5bn while online growth added a further approx. EUR 0.5bn. This gives the segment a veritably unique position in German retail since no other area of the retail market can even come close to such an increase in sales. In that respect, it is little surprise that retail parks and similar formats focused on food retail have

GRAPH 4

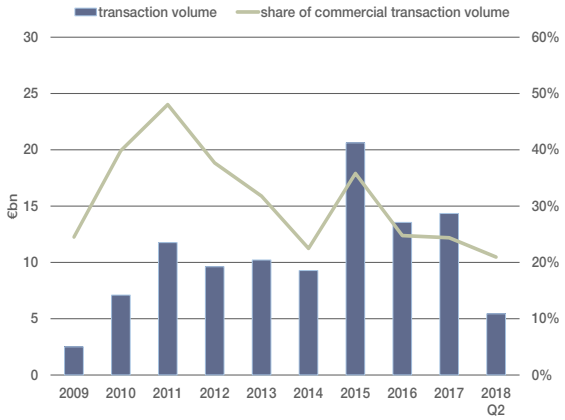
Prime yields



Source: Savills

GRAPH 5

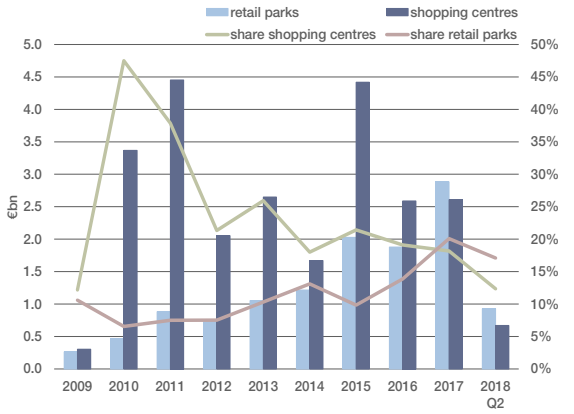
Retail transaction volume



Source: Savills

GRAPH 6

Transaction volume of shopping centres and retail parks



Source: Savills

TABLE 1

Selected retail transactions 2017/18*

Name	Usage	Area (sq m)	Volume (€m) ↓	Buyer
Quest-Portfolio	Supermarket	235,596	undisclosed	PATRIZIA
Ikea-Portfolio	Retail park	197,597	undisclosed	Pradera
Bordeaux-Portfolio	Retail park	257,825	ca. 240	Redos
Gravity-Portfolio	Supermarket+DIY	undisclosed	ca. 230	Castlelake
Leopard-Portfolio	Supermarket	138,749	ca. 205	PATRIZIA

Source: Savills / * including April

grown in popularity with investors.

Food retail is turning to larger space concepts

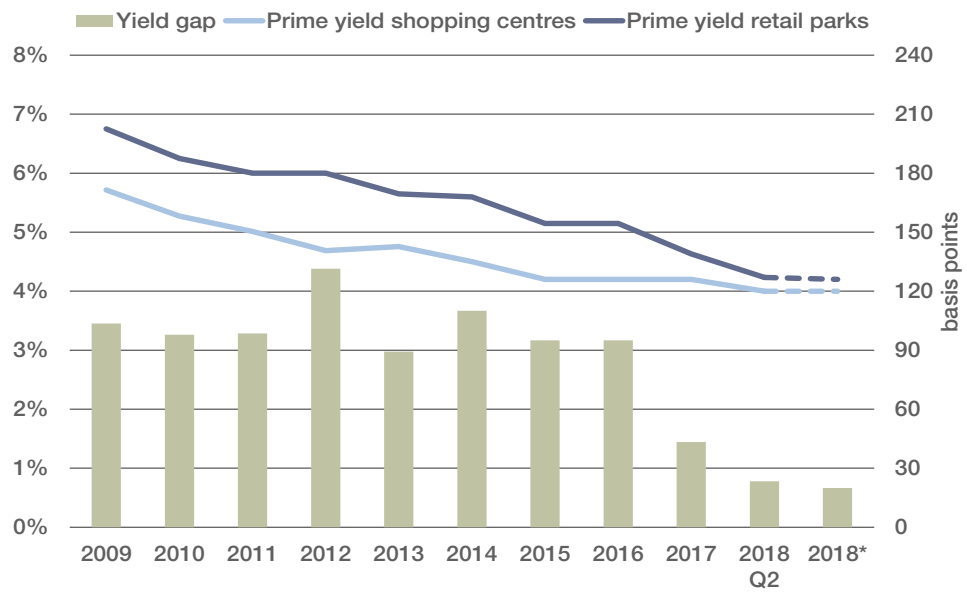
That food and drug store retailers appear more successful than retailers from other segments when it comes to using trading-up strategies to achieve higher prices and sales volumes, and hence rising receipt totals, is benefiting retail parks and also making these more attractive to real estate investors. It is surely also favourable that space concepts in food retail are now becoming larger and spacious market hall concepts are on the rise. Retail parks could take advantage of this and fill space vacated by textile or electrical retailers, for example, with larger food retail concepts. Unlike in food retail, the trend in other retail segments is towards store concepts that can manage with less space. This could particularly help smaller retail parks in urban areas to position themselves (even more strongly than to date) as local supply centres.

Retail parks are tailor-made to connect the online and offline worlds

Retail parks are tailor-made to connect the online and offline worlds However, even food retail or the fast-moving consumer goods segment are not panaceas for balancing out declining sales in other segments. Fast-moving consumer goods themselves have long been subject to a shift in sales from offline to online, which is only less obvious than in other segments since overall sales are (still?) growing strongly. It is quite possible, however, that online food retail is only just gaining momentum and that the breakthrough is on the horizon. Yet retail parks are tailor-made to connect the online and offline worlds. They benefit from good transport links, provide ample free parking and offer sufficient space to accommodate pick-up stations for collecting goods ordered online. The highly successful 'drive-in' concepts implemented in France can serve as a blueprint here.

GRAPH 7

Retail prime yields



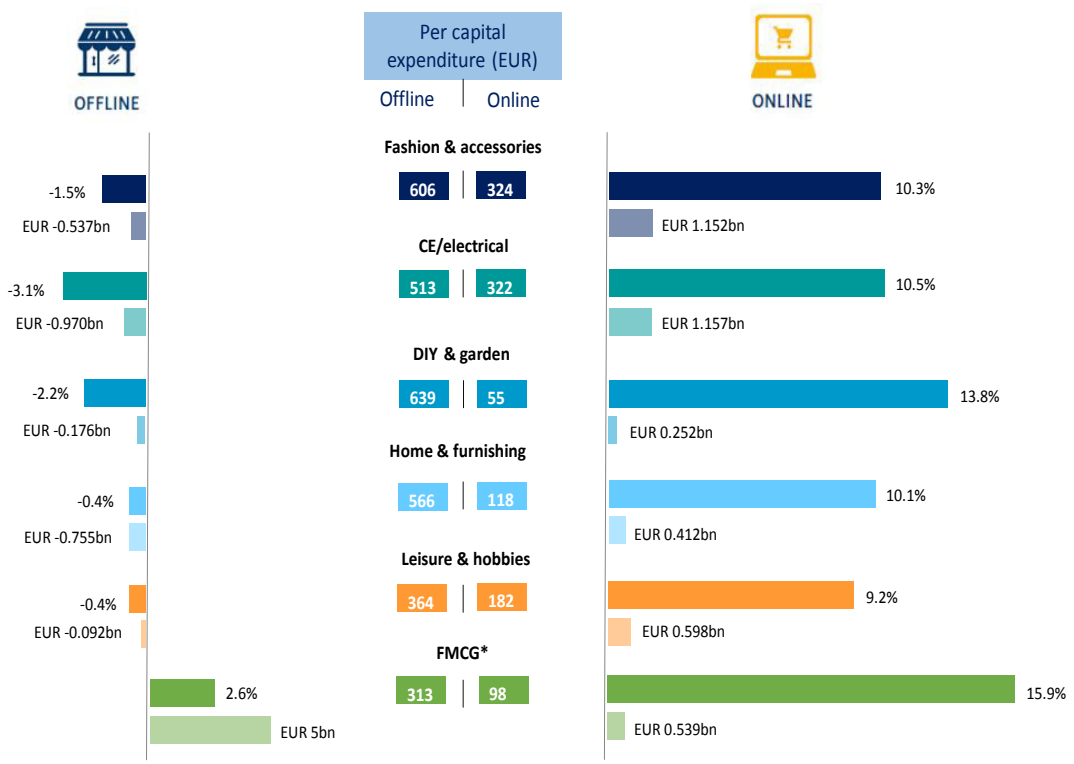
Source: Savills / *forecast

Additional travel times must be offset by synergies

The growing significance of online retail, whether in food retail or the other segments, also influences the value of retail locations. While consumers were previously forced to travel some distance to go shopping (leaving aside mail-order catalogues), this is no longer necessary today since goods ordered online travel to the customer. This is generally likely to increase the time sensitivity of the customer and, consequently, to devalue those locations to which the customer has to

GRAPH 8

Online & offline rates of change by segment in 2017 compared by percentage and EUR bn



Source: HDE / *FMCG: food incl. Tobacco products plus drug store products; offline growth excluding tobacco products: 2.6%, sales figures are net (excluding VAT)

make a (further) journey. In this regard, retail parks situated on busy commuter routes are equally well positioned as those located in the direct vicinity of the homes of as many consumers as possible. All other retail parks must save their customers so much time by combining appropriate offers that this offsets the (additional) travel time.

Growing consumer spending is an opportunity for re-positioning

The various trends in fast-moving consumer goods and the rest of the retail sector, as well as the shift in sales from offline to online retail, are not the only developments for retail parks to capitalise on. The above-average growth in consumer spending mentioned earlier is also important for positioning considerations and creates opportunities. This can allow for the creation of synergies that generate footfall on retail parks, such as the expansion of restaurant offerings, the integration of a medical centre or the incorporation of fitness or wellness facilities. In doing so, larger retail parks in particular could position themselves in the direction of experience retail. This strategic orientation could be supported via branding appropriate to the target group and centre management that organises and delivers appropriate events.

In a world of limitless possibilities, the customer needs direction

While some retail parks have the opportunity to position themselves in the experience segment, this is not suitable for other retail parks, owing to their size for example, and may not even make sense at all. Ultimately, there are also customers who simply want their shopping to be quick and convenient every time. These consumers neither require a sophisticated restaurant offering nor experiences or events. A clear positioning in the convenience segment can also be a strategic orientation, particularly for small retail parks. The key point to remember is that the question of convenience versus experience cannot be answered wholesale but only on a case-by-case basis. What can be said with certainty is that the undifferentiable middle is likely to struggle the most going forward. Consumers can buy practically everything today and at any time. And this 'everything' is larger than ever. Faced with such variety, many people feel the need for simplicity, clarity and structure. Locations that offer customers such qualities will be readily visited while those that fail to provide consumers with any clearly identifiable positioning will be avoided. This includes retail parks.

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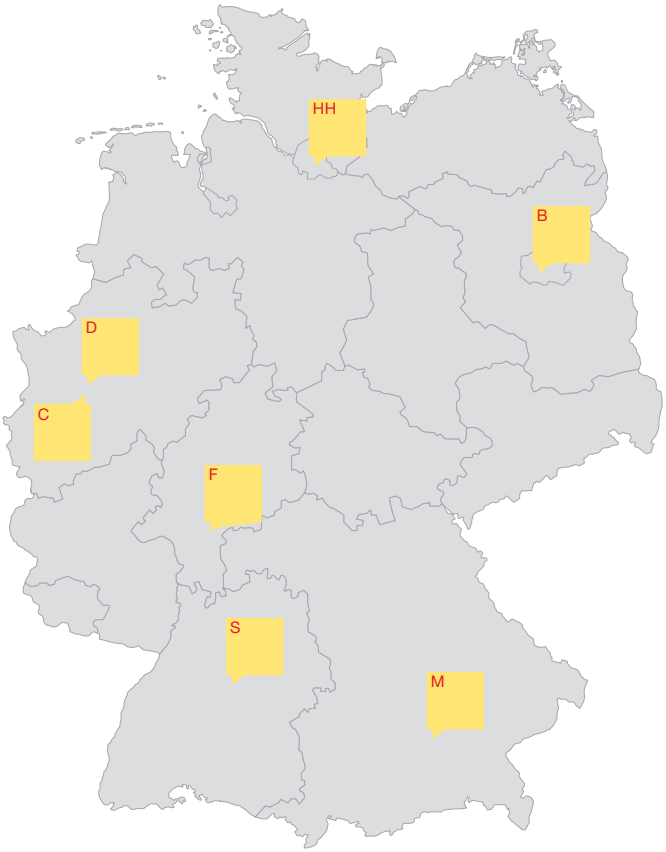

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