European Commercial – June 2020

European retail sale and leaseback

savills

Retail S&LB deals likely to pick up post COVID-19

Supermarket retailers leading the Sale & Leaseback trend

Last year approximately €2.4bn of retail properties were sold and leased back, accounting for nearly 6% of the overall retail investment volume. This was a record level since 2010, both in terms of volume and share. The activity was mainly driven by supermarket retailers. The fierce battle on food price to maintain market shares against the growing mass market grocery retailers such as Lidl and Aldi (who had been expanding their footprint across Europe), has substantially squeezed profit margins in the sector.

Since the beginning of 2020, the volume of retail sale & leaseback (S&LB) has dropped significantly, so has its share in the overall retail volume. This is unsurprising given the current pandemic context with the overall investment activity slowing down. Still, the few retail S&LB deals that were signed in Q1, nearly all concerned supermarkets (EDEKA Germany / Family Cash Spain / Coop Sweden / Match France). Yet, we believe these deals were initiated and negotiated last year.

Will retail S&LB deals continue to increase?

On the retailer side, the COVID-19 period may have proved more difficult for retailers that had to pay a rent compared to the ones that owned their retail units. Hence, some retailers may prefer to hold on to their properties. Others may see in the S&LB option, a financial opportunity to take capital out of real estate assets and put it back in the core retail business or invest in improving their omnichannel strategy to surf the e-commerce wave.

From an investor's perspective, it is an alternative opportunity to source property and to invest large amounts of capital, which in return, can provide long income streams, especially as the lease terms generally agreed are long. However, the retail landscape is currently critical with both the lockdown restrictions and the surging e-commerce adoption hitting hard the industry. Hence, investors will have to target "COVID-proof" and "ecommerce-prepared" tenants with strong covenants. Additionally, as rationalisation and consolation of retail units will continue, investors will have to focus on prime assets, dominant in their catchment.

Such tight conditions and the overall cautious investors' attitude suggest that retail S&LB activity is likely to remain subdued in 2020. Historical data shows two large waves of retail S&LB transactions. The first one in 2007, before the GFC, led by strong investors' demand, notably core investors. Retailers were easily convinced by rocket level of pricing. The second wave in 2010, led by retailers' distressed sales, predominantly acquired by opportunistic investors. On average across Europe* and across retail formats, the prime yield moved out by approx. 130bps between Q1 2007 and Q1 2010.

In Q1 2020, the prime retail yield was at 4.53% on average, 3bps above the level recorded a year ago. We anticipate prime retail yields will continue softening in 2020 and beyond. By the end of the year, we expect the prime retail yield to move out by 30-40bps on average across Europe.

Based on the above-mentioned conditions and forecasts, we do not expect retail S&LB to pick up significantly before the second half of 2021 when downward price correction will be sufficient to highlight the retail risk premium over other assets classes and attract opportunistic investors.

European retail S&LB volumes

Source Savills Research, RCA

2007

MASSIVE INVESTOR-LED RETAIL S&LB WAVE

€7.5bn
European retail S&LB volume

10%
Share of retail S&LB volume

4.7%
European prime average retail yield in the first quarter of the year

2010

RETAILERS-LED DISTRESSED S&LB WAVE

€4.1bn
European retail S&LB volume

11%
Share of retail S&LB volume

6.0%
European prime average retail yield in the first quarter of the year

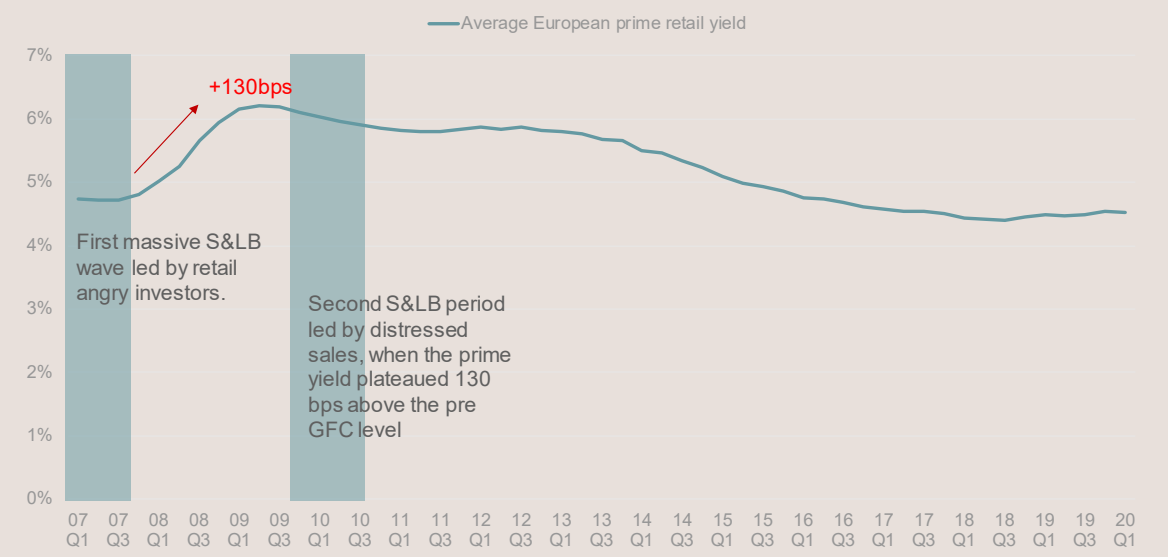
130bps

The average prime retail yield moved out by 130bps between the first and the second retail S&LB waves

30-40 bps

We expect the prime retail yield to move out by 30-40bps on average across Europe by year-end

European prime retail yield



Source Savills Research

Food vs non-food

Over the past two years, retail S&LB activity was mainly driven by supermarket retailers but the pandemic changed the situation.

Food retailers have been relatively spared by the COVID-19 and sometimes even benefited from lockdown measures as restaurants and canteens were all closed with the vast majority of the European population having to eat at home. Strong resilience of the sector may catch investors' attention. For food retailers, COVID-19 has highlighted the need to develop their omnichannel strategy by offering/expanding delivery and drive-in services, which will require investment. Hence we are likely to see more S&LB from the grocery.

We also expect to see more S&LB deals from non-food retailers with strong covenants, including notably DIY, gardening centres and home improvement, which by essence, need both a physical and an online presence.

Finally, we expect to see more retailers seeking to unlock capital from owned headquarters office buildings and more importantly from distribution centre and supply chain properties. Ths is notably the case with Next currenty looking to sell its Leicester headquarters and three major warehouses in Doncaster or with Matalan looking to sell its Liverpool HQ.

Where in Europe?

S&LB activity is not following an endless market cycle. It ends when ownership has massively changed hands from retailers to investors. Historical data shows that the previous two waves of retail S&LB deals were predominantly signed in the UK, Spain and to a less extent, in France. However, we believe there is still some scope for more S&LB in these three countries.

As the next stream will be mainly driven by distressed sales, we anticipate S&LB deals will concentrate in countries most impacted by the COVID-19. The direct impact will be squeezed retailers' revenues due to a sharp drop in domestic demand expected notably in the UK, Spain and Italy, according to Capital Economics. The ripple effect will be a surge in ecommerce adoption in countries where lockdown measures were strict and ecommerce penetration was low (Italy, Spain, Greece).

Accumulated retail S&LB volume per country

Source Savills Research, RCA

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