European Commercial – December 2022

SPOTLIGHT
Savills Research

European Retail

Fair pricing in 2023

Costs taking centre stage over convenience

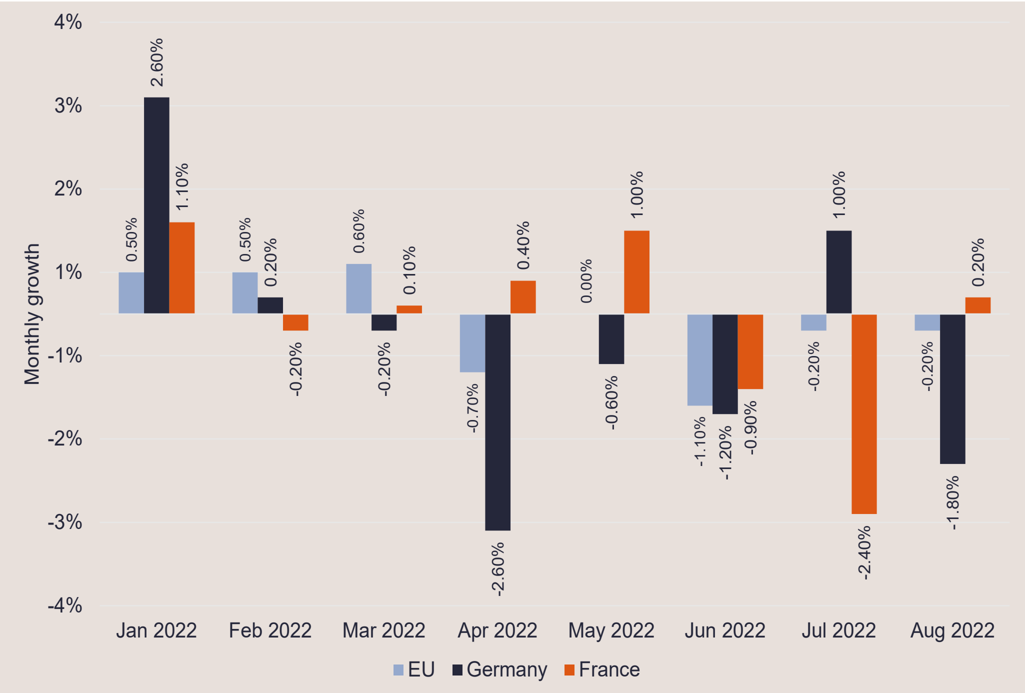
Consumer spending remained strong in the first half of 2022, maintaining pace from the post-pandemic boom. Growth continued into the third quarter of the year, though at a slower pace. Against a backdrop of high inflation, energy price pressures and tighter financing conditions, a recession is expected by year-end in many European countries. Despite this, a strong level of activity in the first half of the year has meant real GDP growth is forecast to be 3.1% in 2022, though down from 5.3% in 2021. The 2023 GDP growth is forecast to be only 0.1%. Although the 2023 GDP growth is forecast to be only 0.1%, the recession is expected to be fairly shallow given that in 2024 real GDP growth in the EU is forecast to be 2.5%.

Household disposable income growth in the EU is at -0.7% in 2022 and 2023, meaning that purchasing power will take a hit across Europe. As a result of inflation pulling down household disposable income, economic activity is expected to contract in the first quarter of 2023. Consumer spending in the EU is forecast to grow by only 0.3% in 2023, compared to 3.7% in 2022. Retail spending will also take a hit in 2023, declining by -0.56% next year. Also expected to have an effect on consumer spending is the unemployment rate, which is forecast to rise in 2023, increasing to 6.6% from 6.2% in 2022. Fewer people in the labour market can impact the total retail sales. The month-on-month change in retail sales in the European Union has been declining since April 2022, as seen in [Fig 1], with the highest decline in June at -1.1%, and we expect this to continue into 2023 based on the above statistics.

Food and grocery account for the largest share of retail expenditure across Europe, taking an average of 51% share in 2021, according to; Portugal records the highest at 57.4%. The food and grocery sector is expected to remain the dominant player in the physical space; as economies are predicted to enter into recession in the new year, the grocery sector is likely to be least affected as this type of spending will be more protected against consumer cutbacks.

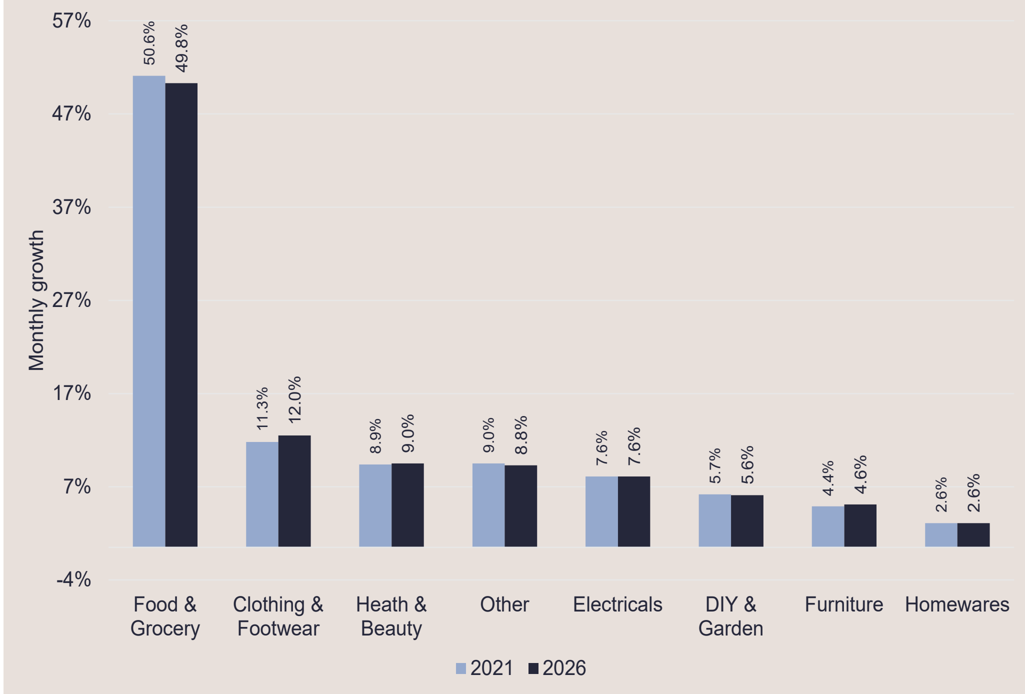
The rise of discount stores across Europe coincides with the increasing price sensitivity consumers feel in the current economic landscape. Food cost inflation in the European Union reached 17.3% in October 2022, a twenty-year record high. Consumers will certainly feel the effects of this as rising inflation will mean less money for groceries, making discounted stores more attractive and affordable.

Fig 1: EU monthly retail sales

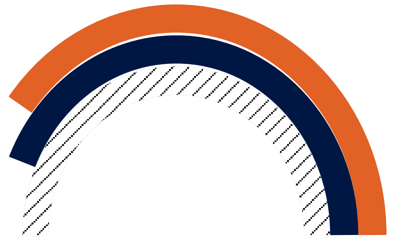


Source: Eurostat

Fig 2: Share of retail revenue by category across Europe



Source: Global Data



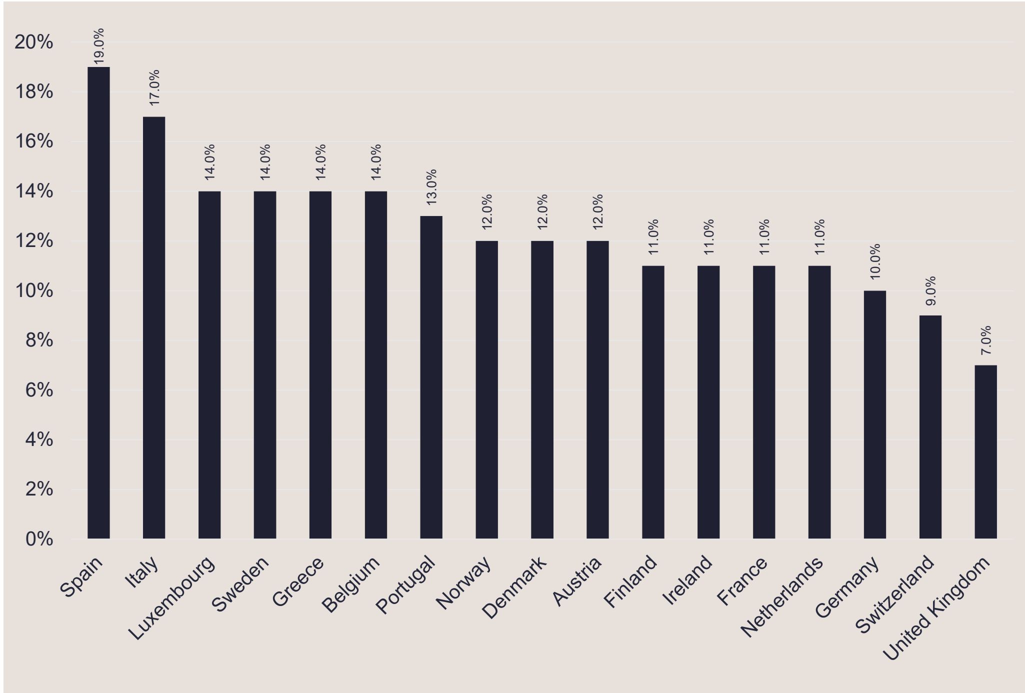
12%
European average online retail growth between 2021 and 2025

ONLINE RETAIL SALES WILL GRAB FURTHER MARKET SHARES

Online retail is set to grow across all retail spend categories as online shopping becomes more accessible and barriers, such as cost and speed of delivery, are increasingly broken down. One of the biggest catalysts for the rise in online shopping was the pandemic, as a result of strict lockdown restrictions in which stay-at-home orders were issued, and shops were forced to close. Annual online retail sales are expected to grow by an average of 14% across Europe between 2021 and 2025, with Spain (19%) and Italy (17%) forecast to see the highest growth. The UK is expected to see the lowest growth, at 7% annually. However, even with the strong growth expected across Europe, this is off of a lower base and online retail will still have a smaller market share than physical retail. Physical retail in Spain will account for approximately 80% of all retail sales by 2026.

Major markets UK, Germany and France, are expected to see some of the lowest growth rates because online shopping has been a major retail channel in these economies for a longer period, with e-commerce penetration rates highest here. In comparison, total retail spending is forecast to see a much lower average annual growth rate between 2021 and 2025 at 1.2%, demonstrating the importance of online shopping to consumers and the speed at which e-commerce is growing.

Fig 3: 2021 - 2025 average annual growth rate of online retail sales



Source: Forrester

NO REAL CHANGE TO RETAILER STRATEGIES IN 2023 DESPITE THE ECONOMIC HEADWINDS

Retailer demand for prime retail locations across Europe has been relatively buoyant over the last 12 months as markets have emerged from the pandemic. From a cross-border perspective, technology & consumer brands, athleisure, F&B, leisure and luxury brands have been the most acquisitive.

Looking to 2023, retailer strategies look unlikely to change materially, with many seeing the economic headwinds as a short-term issue rather than a threat to long-term expansion aspirations. We expect to see more non-European brands make their European debut in 2023, particularly premium fashion brands from North America and Australia. What has changed, from a cross-border perspective, is how brands are approaching Pan-European expansion. Post-pandemic we have seen the rise of city-focused strategies as the shift of spend online during lockdowns highlighted new opportunity in city markets beyond the usual gateway targets. For example, markets such as Dublin, Hamburg and Oslo are featuring more frequently on retailer acquisition target lists. Likewise, Southern Europe has also moved up the agenda for a number of aspirational brands.

Similarly, prime high street locations are also being viewed more favourably, bolstered by the recent acceleration in footfall recovery and the fact that in some cases, headline rents are significantly below pre-Covid levels, essentially making these locations more profitable. On average, prime high street rents across Europe are 34% below where they were in Q4 2019, and as much as -29% in London and -22% in Lisbon. While we are of the view that occupational demand should remain relatively resilient next year, there are some potential challenges. Rising debt and energy costs, in the face of weaker consumer spending, and its read through to retailer margins could negate this optimism. In a similar vein, the high inflation environment and its impact on index-linked leases could temper confidence, particularly for those with an existing presence in Europe.

Retail investment the most resilient in 2022

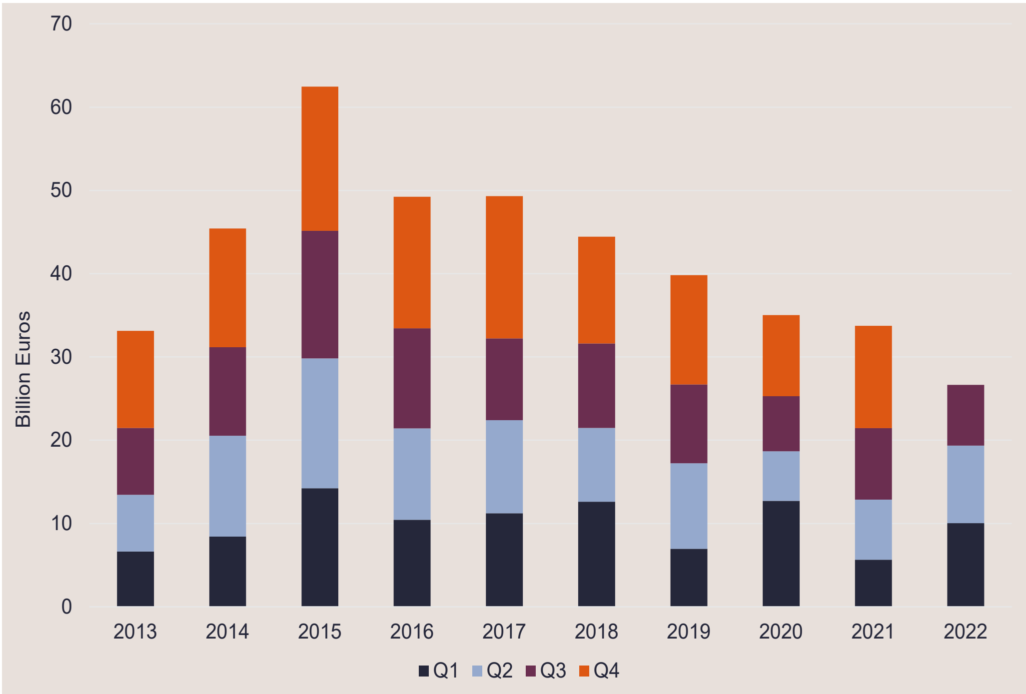
In Q3 2022, retail investments reached €7.3bn, 15% lower than in Q3 2021. Whilst in the negative territory, this result is more robust than the decline recorded during the same period for multifamily (-70%), office (-27%), and industrial investments (-17%). Cumulated with strong retail investment activity recorded during the first half of the year, this brings the total volume since the beginning of the year to €26.9bn. This is 25% above the same period last year - on the back of an exceptionally mediocre 2021 investment turnover. Yet, so far this year, retail investment has been the most resilient of all sectors.

Apart from Norway (-46 YoY), the UK (-26% YoY), the Czech Republic (-15% YoY) and Sweden (-9.5% YoY), Q1-Q3 retail volumes increased in all other countries, most notably in Romania (+2421% YoY), in Spain (484% YoY), in Finland (177% YoY) and Portugal (170% YoY). All in all, the core markets, UK, Germany and France, captured slightly more than half of the activity (55%), against 62% last year. At the same time, the share of Spain's retail investment increased to 13% this year from only 3% last year.

Shopping centres clearly regained their attractiveness, accounting for 27% of all retail volume cumulated since the beginning of the year, compared to 14% the full year in 2021. Whilst significant investment growth was recorded in Spain (+789% YoY), Germany, the UK, and France accounted for 67% of the Q1-Q3 2022 shopping centre volume. The re-purposing of shopping centres remains a key theme in retail whereby tenant mix is diversified to incorporate health centres, convenience shopping and services, making shopping centres more attractive destinations.

The share of grocery stores, including supermarkets and hypermarkets, remained relatively unchanged still accounting for approximately a third of all retail investment, whilst the volume dedicated to discounters has already doubled compared to the full year last year. At the end of the spectrum, the share of high street and retail warehouses has decreased to 15% and 19% respectively, from 22% and 27% last year.

Fig 4: Retail investment volume



Source: Savills,

Major softening yield correction in Q3

Prior to the pandemic, retail yields had been experiencing upward pressure, particularly shopping centre yields in some markets, making them the most competitive across the real estate sectors. Unsurprisingly the pandemic accelerated this trend, but the rebound in retail sales post-lockdown, and the high yields, reactivated investor interest, as shown more recently in transaction volumes. As a result, prime yields started to come in, most notably for convenience-led segments such as retail warehouses and supermarkets.

More recently, the rapid increase in debt costs as central banks raised interest rates in order to curb inflation, alongside weakening sentiment around the economic outlook, has generated upward pressure on yields over the past three months. Not only for retail assets but across a range of real estate sectors.

In Q3 2022, prime shopping centre yields reached a new high of 5.52% on average across Europe. This is 20 bps above the previous quarter and 105 bps above its last peak of prices in Q1 2018 (4.47%). Warsaw and Brussels moved out 50 bps QoQ, Berlin, Frankfurt and Munich moved out 30 bps, London, Madrid, Copenhagen and Stockholm moved out 30 bps, and Oslo moved out by 5 bps whilst quarterly yields remained stable in other locations.

Retail warehouse yields move out circa 30 bps to an average of 5.27%. London moved out 75 bps, Madrid, Brussels and Milan moved out 50 bps, Berlin, Frankfurt and Munich moved out by 35 bps, and Copenhagen and Lisbon moved out by 25 bps, while yields remained steady in other locations.

High street yields moved out an average of 18 bps during Q3 to 3.78%. %. Quarterly yield decompression was noted in Stockholm (50 bps), Frankfurt and Munich (40 bps), Berlin and Dusseldorf (30 bps), Brussels, Copenhagen and Prague (25 bps), Milan (15 bps), and Madrid and Cologne (10 bps). We anticipate further yield softening for the next six months, particularly for high street and retail warehouse assets.

Fig 5: Breakdown of retail volume per format

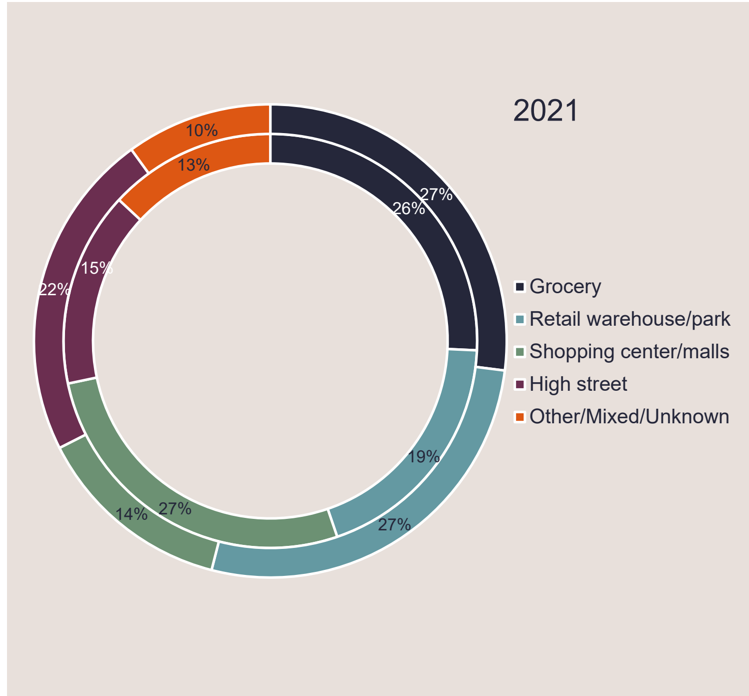
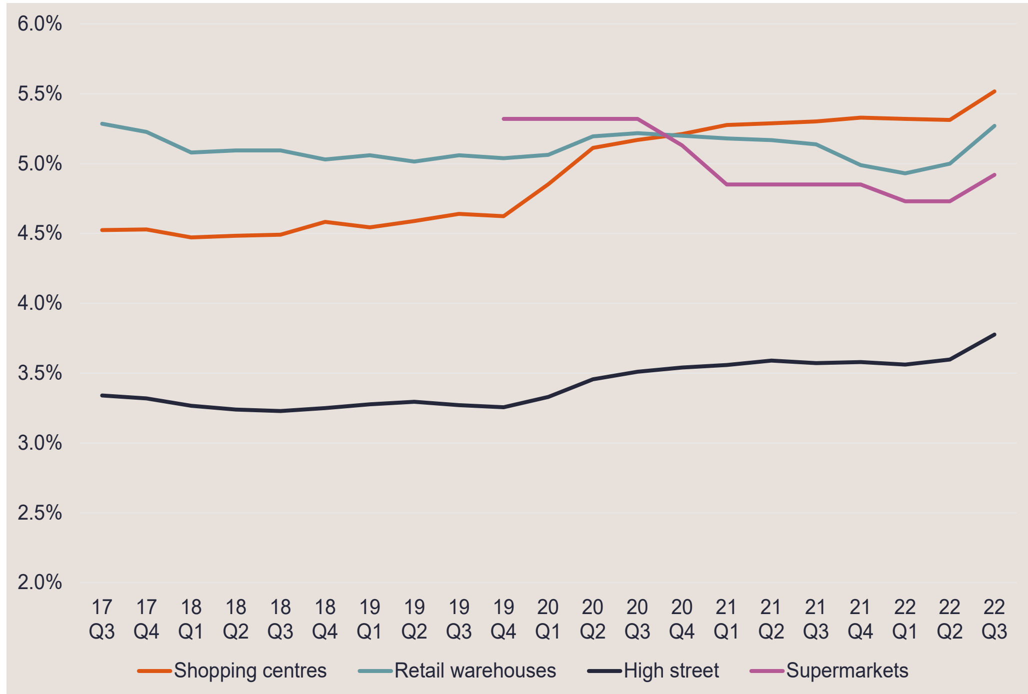


Fig 6: Average European prime retail yields

Source: Savills



Source: Savills

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