

European Commercial – September 2020

Q
SPOTLIGHT
Savills Research

Impact of Covid-19 on European retail



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● Consumer behaviour ● Landlord&Tenant ● Turnover rents ● The new normal

"CHANGE IS INEVITABLE, GROWTH IS OPTIONAL"

(John C. Maxwell)

The world is slowly adapting to the new reality of living with the pandemic. Each country we monitor has its own challenges and a different timeline with reopening and managing infection rates. However, the impact of the health crisis on consumer behaviour (p. 2-5), the way retail places are changing (p.11-13) and the challenges this presents to retailers and landlords (p.6-10) are surprisingly consistent. What we are witnessing is the accelerated evolution of a number of key trends that were already reshaping retail. In this report we discuss the changes, the challenges and the opportunities. It is broken down in four sections that can also be read separately. Although we need to allow the dust to settle, some irreversible changes will lead to a "new normal". Companies in the retail sector must grasp the opportunity to shape it.

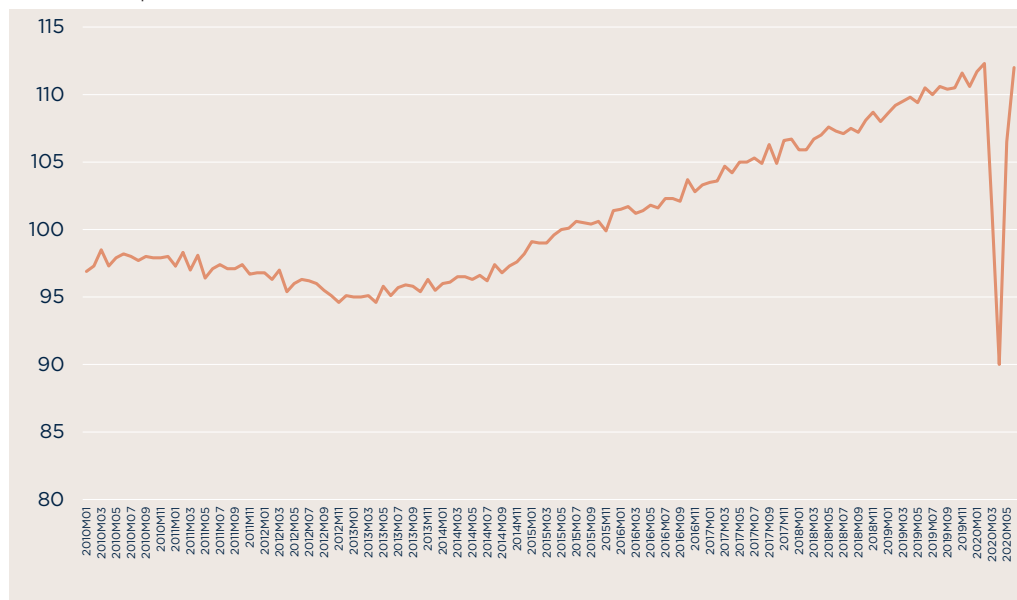


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European Union Retail trade index: "V" shaped recovery in retail sales observed post lockdown



Source: Eurostat

Consumer behaviour

The lockdown measures taken to prevent the spread of Covid-19 have had a profound impact on consumer behaviour

Consumer Confidence

Euro-zone GDP dropped by a post-war record of 12.1% q/q in Q2, reducing the economy to the size it was at fifteen years ago. The scale of the contraction varied between countries. GDP fell by 10.1% qoq in Germany and as much as 18.5% in Spain – a difference that is primarily explained by the duration and strictness of the national lockdowns. Output began to recover in May and June. The pace of the rebound will undoubtedly slow as the economy gets closer to a "normal" level. But July's final PMIs suggest that activity continued to pick up throughout the Euro-zone at the start of Q3, even if the recovery appears to have been slower in the likes of Italy and Spain, which are being held back by their struggling tourism sectors (Capital Economics).

Some of the high frequency data show that activity has got back to its pre-crisis level. Visits to leisure and retail locations are nearly back to normal in the larger economies. Despite the "V" shaped recovery in retail sales, Capital Economics expects Euro-zone consumption to recover more gradually and remain below pre-crisis levels for the rest of the year. The 0.7% increase in retail sales in July left it just above its pre-crisis level. This recovery was boosted by strong online sales. Food sale increased by 1.1%, Electrical goods and furniture by 5.6%, while Fashion was still -23.7% down yoy.

But the recovery in consumer confidence slowed in July. Consumers indicated that they are reluctant to spend on major purchases and plan to save more both currently and over the next 12 months (Capital Economics). As

a result, total consumer spending is likely to remain weak for a long time yet. Amongst the countries with consumer confidence gains in July were **Poland** (5.1 pts), **UK** (4.4 pts) and **Ireland** (3.2 pts). Some of the more pessimistic consumers were found in **Greece** (-7.0 pts), **Belgium** (-2.7), **Portugal** (-2.1) and **Italy** (-1.8).

Positive sentiment may not be long-lived as government support programs are gradually coming to an end and consumers feel uncertain about their future employment. Euro-zone employment fell sharply in Q2, as many firms have reduced their staff number by not renewing fixed-term contracts, but the drop would have been much bigger in the absence of short-time work schemes. Unemployment rate rose to 7.8% in June from 7.2% in Q1.

Spain's unemployment rate

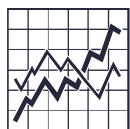
“Positive sentiment may not be long-lived as government support programs are gradually coming to an end and consumers feel uncertainty about their future employment.”

0.7%

The 0.7% annual increase in EU retail sales in July left it just above its pre-crisis level



The 6% increase in EU retail sales in June left it just above its pre-crisis level



EU unemployment rate rose to 7.8% in June from 7.2% in Q1



Food and grocery sales were up after the lockdown across all markets, 11% in the UK, 15.2% in Spain, 10% in the Netherlands (yoy)



Online sales in the UK, Germany, France, Spain, Italy and the Netherlands will be close to €325bn, a rise of 31%



The share of online sales is expected to triple in the largest markets this year compared to 2012

increased to 15.3% in the second quarter of 2020, the highest since the first quarter of 2018, but below market expectations of 16.7% given the pick-up in hiring in the tourism sector. As a percentage of employment in mid-March, furloughed workers peaked at 23.7% in late April, and still accounted for 17% at end-June.

In the **Netherlands**, unemployment has risen to 404,000 people (4.3% of the total workforce), compared to 273,000 people in March (2.9%). In **Portugal**, the provisional estimate of the unemployment rate in June was 7.0%, reflecting an increase of 21.1% (61,300) of the unemployed population in relation to the previous month. Significant rises in the number of unemployed in June compared to the previous month were also noted in **Czech Republic** (10%), **Sweden** (9%), **Italy** (7%) and **Denmark** (7%). In the **UK** a reported ¾ million jobs have been lost since March, but the ONS acknowledge that with furlough schemes in place the picture is difficult to track, with other analysis indicating that the unemployment rate remains essentially unchanged since before the outbreak began.

Footfall

Footfall has been slowly recovering over the weeks since reopening of the retail and leisure sector. ShopperTrak retail traffic data shows that in August retail footfall had recovered substantially in Europe, but was still markedly lower than last year: around -25% in **France**, -30% in **Germany** and **Italy** and -40% in the **UK**, **Spain** and the **Benelux**. However, it is important to note that some of the differences in recovery are related to different reopening schedules.

In most countries activity normalised faster in open air and convenience retail formats, such as retail parks and neighbourhood high street locations. Especially regarding retail parks, outdoor parking, large and open spaces, which allow for social distancing, and focus of retail mix on convenience goods have offered more confidence to customers with regards to safety and comfort.

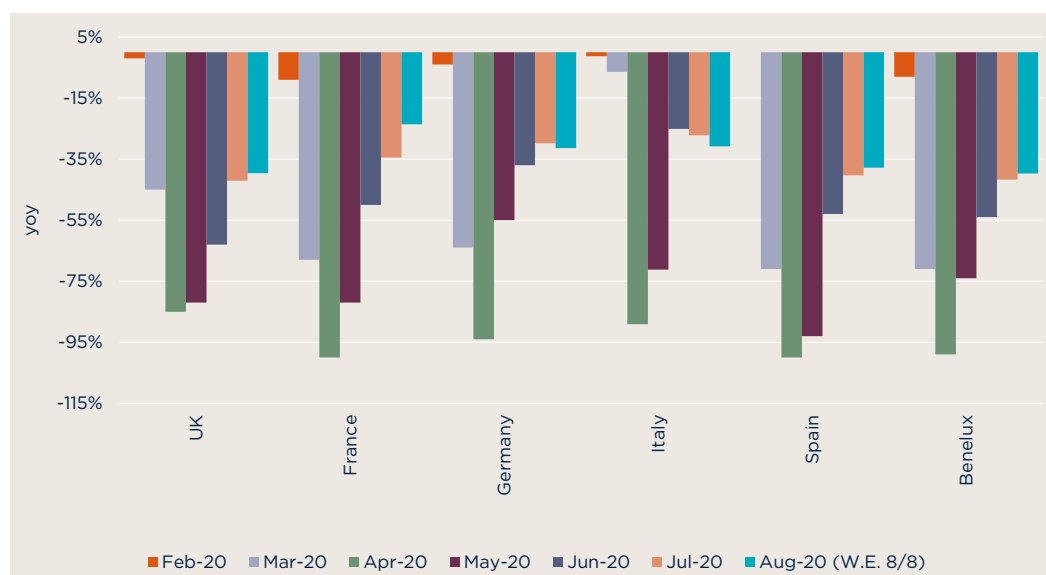
In the **UK**, retail park footfall has recovered to -20% yoy, compared to the national average of -40% yoy. Savills has observed the retail park format to also be showing greater resilience in **Spain** and is expected to gain prominence in the next few years, through improved

professional asset management. Additionally, the factory outlet format could also play an important role, especially in releasing the surplus stock accumulated during the closing period, and certain brands could have pop-up spaces to release their products.

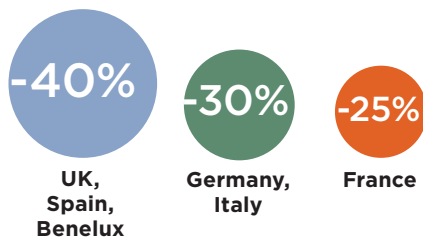
In **Germany**, the number of visitors to specialist retail parks in particular has almost completely recovered. Nationwide, only 7% fewer people were on the move there in the week from 15 to 21 June than before the pandemic; three weeks earlier the difference was only 4%. The resilience of this format is beginning to impact retailer strategies. There are examples of essential good retailers, who are shifting their expansion plans from city to retail warehouse locations.

In **France** large-scale retail formats experienced a peak of footfall during the first days of the lockdown, due to stockpiling, but later, supermarket and hypermarket footfall dropped. Travel limitations, crowd-phobia and hygienic concerns have kept people away from stores and shifted to online orders, drive-through and home delivery services. The situation seems to be improving

Retail footfall: Footfall has been slowly recovering over the weeks since reopening of the retail and leisure sector.

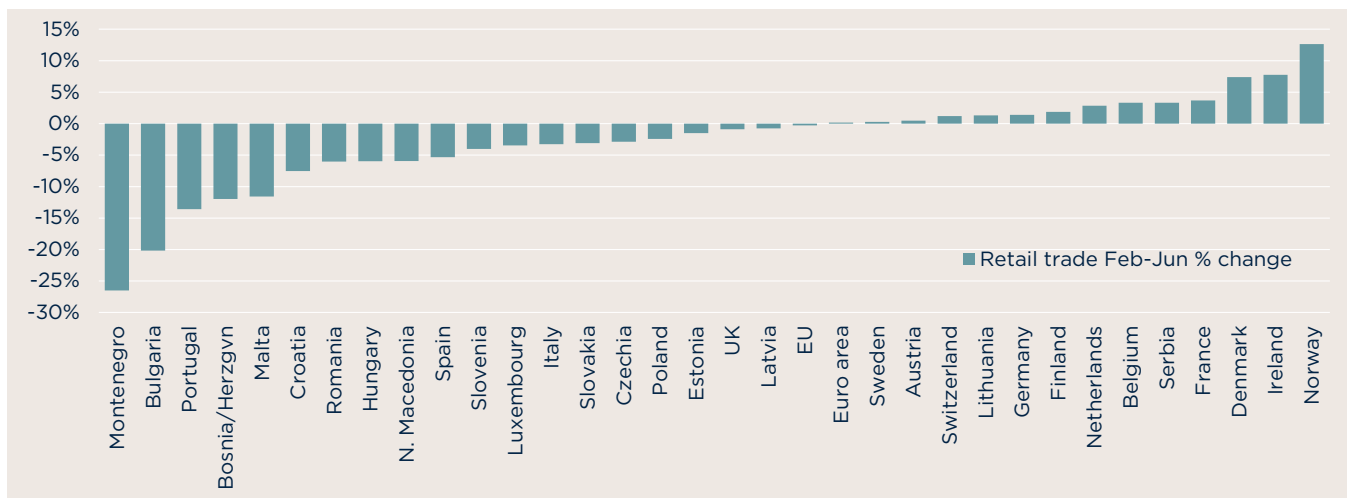


Source: ShopperTrak



Retail footfall had recovered substantially in Europe, but was still markedly lower than last year (ShopperTrak - August)

European Union Retail trade Retail spending in June was even above pre-crisis levels in some countries



Source Eurostat

since the release from the lockdown, but returning to normal still has a long way to go for large-scale retail formats.

Shopping centre formats have suffered the most during the health crisis, as social distancing regulations have not allowed the reopening of entertainment venues and consumers have been avoiding indoor retail destinations. Footfall indices in **France** confirm that, while customer flows have been on the rise in May and June, they are still far behind the pre-crisis situation (close to 80%). According to Polish Shopping Centre Council data footfall in shopping centres in **Poland** stands at over 70% of last year's levels. The figures in **German** shopping centres are continuing to rise and are approaching pre-corona levels again (-19%), albeit at a much slower pace than retail parks.

The situation on the high street is mixed. The implications have been more severe for tourist destinations such as key high streets in Paris, London, Madrid, Barcelona and Milan where the turnover is closely dependent on foreign tourist consumption. Under the current conditions both the big luxury brands and mass market brands are likely to reach their clientele through online channels, maintaining the flagship stores that have invested in over the recent years, until the situation normalises.

In high street retail locations in the **Netherlands**, footfall was 50% lower in

June 2020 compared to June 2019, and has remained on that level since May. While London city centre recovery has remained muted in **UK**, on the other hand, rural city centre footfall has recovered much faster supported by local community shopping. UK rural and commuter towns were the first to reach 75% pre-Covid mobility, following the reopening of the leisure sector. In **Germany**, city centre mobility was also just 16% below pre-lockdown levels, with smaller cities generally recovering faster.

Retail sales

While retail sales have been greatly affected by business closures during the lockdown, there is a significant variation in performance for different goods categories. The sectors that were affected the most were Clothing and Footwear, while smaller drops or even gains were noted in Sports, Electronics, DIY, Furniture and Homeware, as people had the opportunity to spend more time on hobbies and home improvements during the lockdown. Fashion spend was down about -30% yoy in the **UK** (July), -39.2% in **Spain** (June), while the **Netherlands** and **Portugal** suffered a -57.7% and -50% yoy drop in April respectively. Food and grocery sales were up annually across all markets, 11% in the **UK**, 15.2% in **Spain**, 10% in the **Netherlands** over the same months. This is largely attributed to lockdown resulting in all meals being taken in the home, rather than

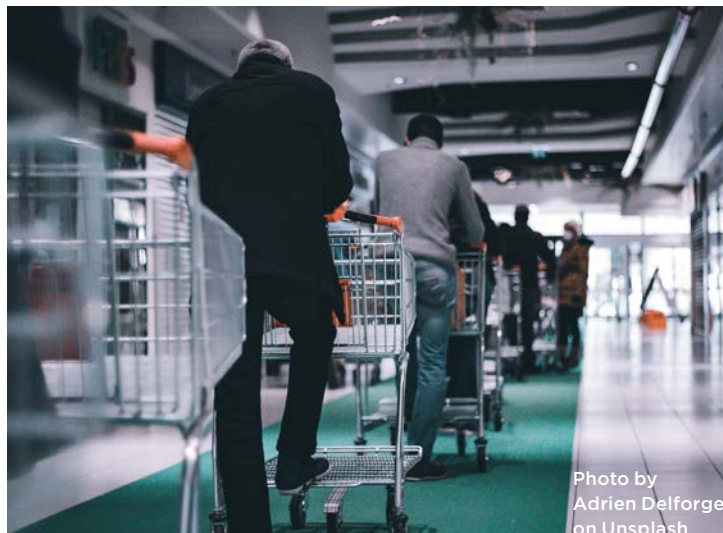
a high proportion being spent in restaurants, cafés and takeaways.

Retail sales have bounced back strongly following the gradual reopening of non-essential stores across Europe, in most countries they are at or even above pre-lockdown levels. However the situation is not homogeneous across countries or sectors. In **France**, according to INSEE, household spending is already returning to normal, with expenditure in June 4% above February levels. This could be partly attributed to the accumulation of savings during the lockdown, estimated at €75bn. Fashion expenditure has caught up since the end of the lockdown, while Food and Electronics expenditure is already above pre-crisis levels, as people still choose to spend more time at home. Conversely, spending in Hospitality and Bars & Restaurants is still lagging behind, due to a sharp drop in foreign tourist visits.

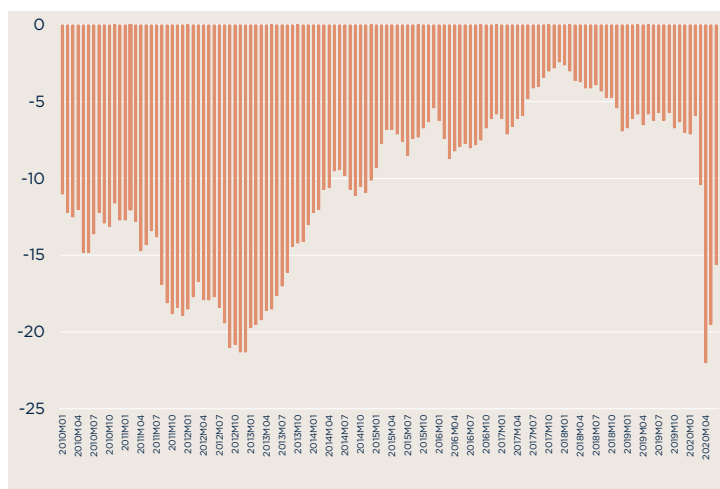
Similarly, in **Ireland** household deposits increased dramatically by €6.2bn between April and June, curtailing and spending opportunities. This pent-up demand is now being unleashed, since reopening with retail sales bouncing back strongly in June, by 3.6% pa.

In **Portugal**, despite an increase in foot traffic, this has not yet been reflected in an increase in sales. According to the Association of Retail and Catering Brands (AMRR) between the 15th and the 21st of June, in the

“In most countries activity normalised faster in open air and convenience retail formats, such as retail parks and neighbourhood high street locations.”



European Union consumer confidence: The recovery in consumer confidence slowed in July



Source Eurostat

Lisbon region, high street stores and shopping centres reported a 40.1% drop in sales, a figure that rises to 42.5% in the rest of the country, to a national average of 41.3%. In **Germany**, retail turnover was up 4.2% yoy in July, with some discrepancies amongst sectors, Fashion was still down -8%, while grocery sales were up 4.6% yoy.

In general, despite footfall being down significantly year-on-year, it appears that spending has not dropped at the same rate. Shoppers are visiting with defined missions –not only are they making fewer visits, they are shopping at fewer stores per trip, but conversion rates and basket sizes are up. There have been high levels of conversion with consumers ‘mission shopping’ rather than browsing.

Social distancing measures and other safety restrictions will remain in place in some form or another for the rest of the year, and at least the first quarter of 2021, hampering physical retail sales. While retail will recover in 2021, it is not expected to return to 2019 levels due to high unemployment, and consumer uncertainty regarding their financial futures. Retailers, especially in the fashion sector, are reacting with discounts, online promotions and many are planning the introduction of cheaper collections in order to adapt to weaker spending patterns.

E-COMMERCE TRENDS

E-commerce surged across Europe during the lockdown, as it became the safest way of shopping and the only channel for buying non-essential goods. Confined consumers used the online channel to buy groceries, pharmaceuticals, but also electronics, books, sports equipment, clothing and take-away meals. A larger share of the population has discovered the ease and the benefits of online shopping and all retailers were forced to improve their e-commerce platforms. On the other hand in less developed digital markets, the explosion of online sales has led to longer delivery times, impacting consumer trust in online retail reliability.

The digital disruption has been transforming retail well before the health crisis. Online retail penetration had increased in Europe from 7% to close to 12% between 2014 and 2019 (Forrester, 17 countries). CRR estimates that online sales in the UK, Germany, France, Spain, Italy and the Netherlands will be close to €325bn, a rise of 31% yoy pushing up their average share of total retail sales to 16.2% (skewed by the size of the UK market). However, CRR estimates that under the impact of the economic crisis and reduced consumer spending, online sales will dip in 2021 to about €312bn before the anticipated 2022 recovery and higher growth rate of e-commerce.

In the **UK** e-commerce reached 31.2% of total retail sales (ONS), compared to an average of 19.1% for the whole of 2019. Early indications suggest that the peak seen in May, is now settling to a new level. The question is where to? CRR forecasts 24.3% at the end of 2021, which fits with our own analysis. If true, then this sees a five year acceleration in the move online.

Turnover growth of online sales has fluctuated around 20% yoy in

the **Netherlands**. However, in April 2020, turnover of online sales has increased by 68% compared to April 2019. Thereafter in May 2020, online sales increased by 50% compared to May 2019, as shops reopened again. We expect the growth of online sales to increase somewhat although the degree to which it will change remains to be seen.

In **Spain**, according to Minsait, online sales in sectors such as Food, Sports, Personal care and School supplies have grown by 80% to 200% during the lockdown and are expected to expand further. We estimate that the market share of online commerce, as opposed to the physical channel, will be close to 10% in 2020, which implies an increase in sales of 27% with respect to 2019.

In **Portugal** SIBS announced that the average value of online purchases increased by approximately 18% over confinement period. A study carried out by Group M in April, notes that e-commerce growth in food retail was between 40% and 60%. In 2019 the share of online retail sales was at 9.8%.

In **Sweden** retail sales increased by 44% yoy in April, with the highest rises noted in the categories of Health and Beauty (48%), Fashion (40%), Books (34%), Electronics (21%) and Food (21%). In **Germany** e-commerce increased by 9.2% in the first half of the year, while in **France** its share has crossed the threshold of 10%.

While footfall has begun to slowly recover and people are gradually returning to physical stores, the latest figures in the **UK** show little abatement in the inexorable rise of online grocery shopping. Online sales for the period soared 92%, with one in five UK households having utilised the channel in some form to buy groceries. Online is now worth 13% of the total grocery market, up from just 7.4% in March when lockdown began.

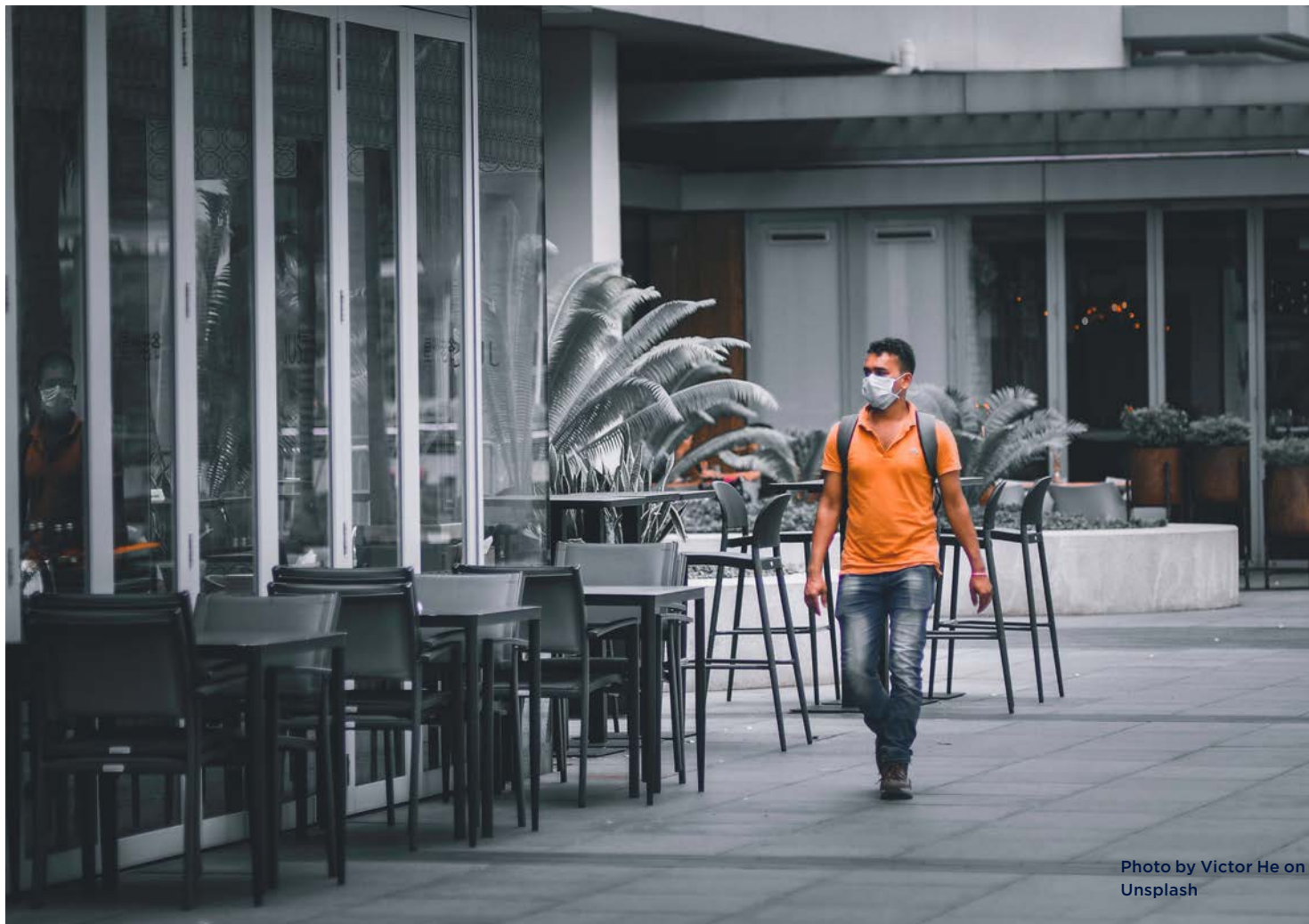


Photo by Victor He on Unsplash

Landlord & Tenant

Turnover losses and the impact on retailers to pay rent have triggered lease negotiations between landlords and tenants across Europe

Rent collection and rental negotiations

The impact of lockdown measures have been significant to retail and leisure operators across Europe, but the pain has equally been felt by landlords, who have had rent payments held back and are now seeing a significant number of tenants seeking to renegotiate their leases. While retailer trade will eventually recover as consumers return to shops and restaurants, albeit with a larger proportion of trade moving online, the consequences to landlord income and the subsequent reduced values of their assets is likely to be felt in the long term.

Retail rent collection levels were amongst the lowest across sectors in Europe during the lockdown period, in most cases below 50% of normal levels. Many retailers have been unable or unwilling to pay rents, while their businesses were closed. A few landlords have avoided having to make significant concessions, or risk losing the tenant altogether.

In the UK, since March 2020 there have been 849 stores subject to a CVA (Compulsory Voluntary Arrangement) and 3,085 stores have fallen into

administration, spread across 65 major UK brands and 33 holding companies. Overall 2020 results (Jan-Aug) suggest that insolvency activity was on par with 2019 so far, however it is likely that there will be more brand fascia's to face financial difficulties over the coming months.

Even following the reopening of outlets post-lockdown, retailers have been facing difficulties to meet their financial obligations requesting some form of rental relief from their landlords. On average retailers are typically seeking a 20-40% reduction in rent across their estates, or are seeking other rental adjustments such as rent free periods, monthly payment of rent, turnover based rents only and shorter lease lengths. In return in some landlords are being compensated by an extension of the lease term.

In most markets that Savills tracks, these negotiations take place between landlords and tenants on a case by case basis, in some cases there are some government support measures introduced to regulate rent collection and provide some relief, mainly to tenants.



Savills analysis shows that in June, UK retail park rent collections were at 53%, while shopping centres were at 39% of total.

FRANCE

- As early as March, some landlord federations took the initiative to suggest the monthly payment of commercial rents for the second quarter of the year (as opposed to quarterly payment) and to grant a rent-free period for the months of April and May. The government extended this initiative by organizing some mediation between landlords and tenants which resulted in the signing of a charter in June 2020.
- This charter, which is not mandatory, includes possibility for rent deferrals, including for the period following the lockdown, and rent free periods. However, these incentives may come at a compensation for the landlord, such as an extension of the lease term, an early renewal of the existing lease or the signing of a new lease. The charter excludes rental charges from the scope of the agreement.
- This charter therefore changes certain aspects related to the typical commercial lease, which anyway had always left a lot of room for negotiation between the two parties. The lease length is for example relatively flexible, knowing that it should be at least for a period of 9 years, whilst the typical shopping centre lease length is normally 10-12 years.
- The parties also freely set the rental level as well as the frequency of its review (annual or very three-year) and its method of payment. The rent indexation is calculated according to the variation of the index chosen by the parties, namely either the Construction Cost Index (ICC) or the Commercial Rent Index (ILC), each of these indices being published by INSEE.
- It is difficult to quantify the financial cost of the negotiations undertaken within the framework of the charter: each agreement depends on the specifics of the situation between the landlord and the tenant. Overall the purpose is to secure and extend leases and to avoid legal proceedings.

ITALY

- Lockdown measures, which forced the closure of shops in malls for about 2 months, motivated the request from the Tenants to the Landlords for discounts on rents and exemptions from the payment of common charges. Landlords' response was not homogeneous although there was a common request to continue to pay common charges in order to guarantee the shopping centres' operations.
- The widespread Landlords' course of action has been to grant a rent discount for the lockdown period and to allow for deferrals in payments, switching to a monthly basis, or postponing payments to the end of the month – at least until the end of Q3 2020.
- Regarding anchor tenants, discount requests have been greater and negotiations are still ongoing. Big players have asked for the transition to a rent structure exclusively on a turnover basis, for the 2020-2021 period, to then return to the "usual" structure (MGR plus turnover rent).
- Contributions available at the Governmental level for the retail sector have been in the form of tax credits for rental fees, usable in compensation or transferable to third parties. The beneficiaries had to have revenues not exceeding €5m in 2019 and to have recorded a reduction in monthly turnover (March, April or May 2020) of at least 50% compared to the same months of the previous year. The credit is equal to 60% of the monthly rent for property lease agreements and 30% of the rent in the case of business lease agreements, providing that the rents were paid.
- Businesses that did not reopen after the lockdown are limited in number and mainly regard the catering and services sectors. This is due to the need to reorganize spaces on the basis of the restrictive measures imposed.

POLAND

- The Polish government enforced the closure of shops in retail schemes of above 2,000 sq m and shopping centres, with the exception of super/hypermarkets and drugstores between mid-March and May 4th. Leisure activities, fitness centres/gyms and food courts, which are operating only for "take-away", re-opened on June 6th.
- In the so called "anti-crisis shield" act (an act aiming to limit the effect of coronavirus on Polish economy) during the ban on trading, a tenant who could not trade due to the COVID-19 ban was not obliged to pay rent and other lease payments, and the landlord was not obliged to allow the tenant to use the premises. Also, other lease rights and obligations expired. The tenant had to submit to the landlord an unconditional and binding statement to the effect that they wish to extend the lease contract under the existing terms and conditions for the duration of the ban plus six months. The statement was to be submitted within three months of the date of the ban being lifted, thus majority of lease agreements were renegotiated.
- It is still too early to predict the effect of the on future lease agreements, but stricter clauses of protection against future crisis situations, which safeguard both parties, are expected to be included.



Photo by Kutun Ural
on Unsplash

GERMANY

- In April, the GCSP published a code of conduct with recommendations for landlords and tenants as a response to the COVID19 crisis and the resulting problems due to the lockdown. These rules of conduct are not legally binding, but represent a voluntary commitment on the part of landlords and tenants.
- Suspensions of payments were largely requested by fashion stores, leisure and bars/restaurants since these industries suffered the heaviest loss in turnover. It is hard to generalize, as landlords' response to tenants' requests was not homogenous. For example, while one of the largest shopping centre owners is very solution-oriented and approaches the tenants, another has a rather hard position and is only oriented towards the legal requirements.
- There are some owners who act similarly tough and even draw the bank guarantee and ask the tenant to refill it - this is legally possible. Other owners are more flexible and offer e.g. 2 months' rent free against a 2 year lease extension. In addition, there is also the division model that landlord and tenant share the loss of rent due to the lockdown.
- Rent reductions in general are difficult to achieve without extending the lease terms and, in the case of contracts with longer terms, only make strategic sense for large institutional investors / multiple owners.
- With new lettings we are observing an introduction of pandemic clauses in the contract. Also, rent reductions of owners up to 30% even in prime locations are being seen. Additionally, shorter lease terms are being observed, especially by big anchor tenants. However, this trend was already apparent before the crisis.

IRELAND

- Shopping centres were closed for approximately 3 months, with non-essential retailers on high streets and retail parks closed for 3 weeks less than this. Rent collection rates for Q2 and Q3 were approximately 40% for shopping centres, with retail parks at approximately 75%.
- Landlords and Tenants are engaged in discussions on Covid-rebates, the majority of which have yet to be finalised. Laws on rent reviews in Ireland state that the rent can go up or down, so the market operates on a two-tier system of legacy upward-only and newer up-down reviews.
- This influences the approach by both Landlords and Tenants in re-gears and provides an added dimension to negotiations. In addition, there are relatively low levels of sales-reporting by tenants with this likely to increase going forward.
- Turnover rent deals are very rare in the market. There are getting more airtime currently, but in reality only a very small proportion of deals will eventually include them. They may be used as short-term measures to navigate any 'post-Covid' trading nervousness.

NETHERLANDS

- Suspensions of payments have been accommodated to help tenants with payment issues. The degree to which suspensions have been provided differs from location and industry and was done on a case by case basis. A remission of payments is mostly seen in leisure and bars/restaurants since they weren't allowed to be open in the height of the Covid-19 crisis. Suspensions of payments were largely requested by fashion stores, since that industry suffers the heaviest loss in turnover.
- 'Situation related rent', which would cover for the loss of turnover due to catastrophic events, has been suggested by a singular tenant. Turnover rents have been suggested as well. It is however, too early to say if those lease types will become more common, since both tenants as owners are primarily focussed on temporary suspensions of rent payments.

SPAIN

- Based on shopping centres managed by Savills Aguirre Newman, from March to June 67% of total invoicing rent has been collected.
- Shopping centre and retail outlet landlords have adopted various measures with which they propose to "share" the negative effects of the standstill in consumption, by means of different formulas. In broad terms, the majority of property owners in Spain have negotiated a 100% discount on rents in April and May, and have negotiated an average discount of 30 to 40% during the month of June, July and August, in order to avoid vacancies. The exceptional cases are the French owners that are giving discounts of up to a maximum of 2 or 3 months.
- Tenants are asking to include contractual clauses that address measures to deal with a new pandemic, but in general, landlords are not accepting.



Photo by John Cameron on Unsplash



Shopping centre rent collection were at 39% in the UK, 67% in Spain and 40% in June. Retail park rent collection rates were 52% in the UK and 75% in Ireland in the same period.



Photo by John Cameron on Unsplash

- 💡 Retailers are facing difficulties to meet their financial obligations requesting some form of rental relief from their landlords. In return some landlords are being compensated by an extension of the lease term.💡

PORTUGAL

- As a protectionist measure, the Portuguese government determined that rents due, even during the period of lockdown, could be settled in 12 payments, after a three-month moratorium.
- More recently, the government decreed the suspension of the fixed rent component in turnover rents, until 31 March, 2021. This measure, which has generated strong disagreement among landlords and investors, decrees that tenants will only pay the turnover rent, calculated on the volume of sales. It also includes the payment of all contractually agreed expenses, referring to common expenses and service charges. For large tenants, the weight of the fixed rent may mean 50% to 70% of the total rent value, whereas for small tenants the turnover rent has a more significant weight.
- According to the APCC, 99% of the associated shopping centres are in operation. Until June 12, 87% of its landlords agreed to grant support in a total amount of €305m throughout 2020, in the form of discounts and rent arrears that allow the payment of these monthly payments to be deferred for 2021 and 2022.
- It will still be premature to be able to predict what effect this crisis will have on future lease agreements. Traditionally, the standard lease structure has a flexible character, depending directly on the relationship established between owner and tenant, and the size and importance of the brand for the retail scheme.
- For anchor stores, established contracts may have a duration of between 10 and 15 years and for smaller stores, the duration of the contract may be six years, with a break clause at the third year. At this point, greater flexibility and openness for renegotiating contractual conditions, seems to be of mutual interest to both owners and tenants.

SWEDEN

- There has been a continuity in rent collection over the past months. Some tenants have been offered monthly payments instead of quarterly. The state subsidies (up to 50% of the base rent) have been used by a lot of property owners. The subsidy was available for Q2 and extended to Q3 as well.

UK

- In the UK £1.5bn of March rent payment remain unpaid in UK commercial property. Savills analysis shows that retail park rent collections were at 53% and 52% in June and March respectively, while shopping centres went from 45% in March to 39% in June.
- Landlords have been traditionally relying on fixed rents and upward only rent reviews and they have been reluctant to commit to turnover leases. Turnover rents have been discussed in the industry for a number of years, since the industry has been experiencing challenges from the rise of ecommerce. Now the topic has come under the spotlight again.
- Landlords are now having to be more open to restructuring their leases and a significant proportion of the lease discussions Savills are involved in includes negotiations around turnover based rents. However, the new agreements we have been seeing put in place over the last four months are not necessarily intended as a permanent fixture by landlords, but more of a way of navigating the current challenges in the sector; our recent survey shows that 74% of landlords anticipate current arrangements to only be in place for up to 24 months. The trend towards shorter lease lengths is also expected to accelerate. Lease lengths have reduced significantly in recent years, with a threefold increase in leases less than 2yrs between 2018 and 2020. A further doubling of leases less than two years is expected by 2022, likely to account for 30% of deals signed in that period. In 2016 leases of 6-10 years accounted for around 55% of deals signed. This has since more than halved for new deals and is expected to reduce further in the next two years, when 90% of new leases are anticipated to be shorter than five years.
- It is worth highlighting that the vast majority of leases in the UK will remain untouched by the end of the crisis and current projections suggest that at the end of 2020 turnover leases will still account for fewer than 10% of leases and almost half will remain unchanged. Lease negotiations are usually where there is a lease event coming up, but the incidence of retailers coming cap in hand to landlords to renegotiate rents to a more affordable basis is increasing.
- As a consequence of low rent collection levels, 86% of landlords expect shopping centre rents to fall. Landlords anticipate rents to fall by an average of 22% on high street, 30% in shopping centres, 13% on retail parks and 34% on leisure schemes, following the Covid19 pandemic.



Photo by Erik Mclean
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LEASE LENGTHS UK

Lease lengths in the UK have reduced significantly in recent years, with a threefold increase in leases less than two years between 2018 and 2020. A further doubling of leases less than two years is expected by 2022, likely to account for 30% of deals signed in that period. In 2016 leases of 6-10 years accounted for around 55% of deals signed. This has since more than halved for new deals and is expected to reduce further in the next two years, when 90% of new leases are anticipated to be shorter than five years.

Without a lease expiry event on the horizon there is little impetus for landlords to consider re-gears or alternative leases, so much of the noise we are seeing at present is a trickle of deals being agreed in the context of the wider market, with most leases that have no events coming up will remain on traditional rents for the time being

It is worth highlighting that the vast majority of leases will remain untouched by the end of the crisis and current projections suggest that at the end of 2020 turnover leases will still account for fewer than 10% of leases and almost half will remain unchanged. Lease negotiations are usually where there is lease event coming up, but the incidence of retailers coming cap in hand to landlords to renegotiate rents to a more affordable basis is increasing.

“Even in markets where turnover rents are prevalent, the affordability matrices may be permanently altered and leases in need of adaptation.”

Turnover rents, an imperfect model?

Turnover rents are common in some European markets and non-existent in others. In landlord and tenant negotiations, turnover based rents have become part of the discussion, especially in the UK

Although accounting for a significant proportion of rents in parts of mainland Europe, **turnover rents** are by no means a straightforward alternative to UK upward only market based rent reviews, with few deals being identical and the terms agreed very retailer, sub-sector or location specific. Analysis of Savills rent negotiations in the UK shows that turnover rents requested by retailers range from 1%-15%, with an average of 7%. However, the detail is far more complex. Almost all deals are in some way unique, either from the turnover %, or baseline with ratchet top-up, or inclusion of service charges, or for lease term. Furthermore, the agreements need to consider the percentage of turnover to be classified as rent, the length of the lease and other costs such as service charge. Turnover rents may be separate from service charges, or be higher and include service charge provision. The advantage of the latter is that the retailer then has a clear view on their affordability. However, for a landlord where service charges are fixed, this can put further pressure on income from rents collected.

It could be argued that a **margin based rent** makes more sense as margins vary so significantly across the sector and could therefore be a fairer approach for each type of retailer, regardless of the products they sell. Two retailers with the same turnover can have very different levels of profitability depending on what they sell and their price point. The problem is transparency. Many retailers are

now prepared to share their turnover with landlords, but not their full P&L. And yet, if they did, landlords could make more informed decisions about their assets and could invest accordingly to help secure the long term future of the schemes. In many European markets retailers already share **effort ratios** with landlords, where all property costs as a proportion of turnover are considered. This provides a degree of transparency on rental affordability and insolvencies rarely come as a surprise. The system clearly benefits both parties, but can see weaker retailers being removed for the better vitality of those that remain. Landlords need to think about who they want in their schemes and offer a fair rent accordingly, which might even mean a different tenant line up. This is essentially the model that works in the outlet market already.

Another added complication of turnover based rents is how a sale is attributed to a store. Some brands have a significant **proportion of online sales**, but use the stores for showrooming, click & collect, or returns. While a lot of work has been done on the ‘true value of the store’ in a multichannel world, no-one has yet worked out the true value that a specific store in a specific location has in an e-commerce transaction. For F&B/leisure measuring the performance of a specific property is much more straightforward and hence we already see quite a few tenants within this space on turnover based arrangements. In countries where

turnover rents are prevalent, transparency of multichannel sales remains limited; a problem that will only increase in line with the proportion of retail sales that are online.

A secure income will always be a preference for a landlord and therefore many will consider fixed-rate leases over a long term to remain the preferred option choice. Of course in the current environment this does not mean landlords will get what they want. However, we may also start to see more landlords opting for a **hybrid model** with a base rent plus a turnover top up. This can be preferable for a retailer compared with a fixed-rate lease, and also still provides the landlord with some level of income security.

The biggest challenge for the property sector of turnover based leases is with asset **valuation**. Firstly, valuation based on turnover leases typically reviews the previous three years sales evidence and asset values become closely aligned to the volatility of market economics and consumer confidence, rather than based on landlord guaranteed income over the long term. Secondly, in many markets where there is little history of turnover based leases there is no comparable evidence. Thirdly, property value becomes heavily weighted to the turnover of a specific store rather than the benefit that store has in the retailer’s supply chain.



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Outlook - The new normal?

The health crisis has brought forward a number of key trends that were already reshaping retail

Each country we monitor has its own challenges and a different timeline with reopening and managing infection rates. However, the impact this is having on the retail sector, the way retail places are changing and the challenges this presents to landlords are surprisingly consistent. We need to retain confidence that the current situation is not a permanent fixture; things are not fundamentally changed for good, but that the next normal will not be quite the same as before.

What we are witnessing is the accelerated evolution of a number of key trends that were already reshaping retail. These trends have been gradually reducing our need for retail and the advent of Covid-19 may well have moved us forward five years in the advancement of these trends.

Retailer portfolios

In this moment it is difficult to predict the future for retailers, but the recovery of the sector will depend to a great extent on the financial soundness of the companies, on the effectiveness of public subsidies and, the capacity and speed of businesses to adapt to the new normality and the willingness of consumers to return.

Reduction of employees, adoption of the sale & leaseback format to face the need for capital, redefinition of store networks, commitment to digital spaces and last mile logistics, are some of the formulas that entrepreneurs will adopt to face this new situation.

Factors such as increased home working have altered shopping patterns and created new challenges to retail brands' supply chain process. While many brands had to swiftly adjust their entire business model and adopt new delivery models, many of these changes were already overdue. Accessing customers in suburbs and rural cities will have an impact not only on their logistics network but also on the choice of the size and geographic distribution of their physical stores.

Changes in consumer behaviour will determine the future of retail strategies. Economic uncertainty and health concerns are the two most important factors that will influence their shopping patterns and habits. Flight to value, focus on essential and meaningful shopping and the rise of e-commerce have emerged as the most common ones across Europe.

E-commerce

During the crisis, online channels are likely to step forward 3-5 years, depending on the territory and the category. Fear of contagion, concerns about hygiene standards in stores and convenience are some of the factors that will continue to underpin the appeal of e-tailing. With queues outside supermarkets and the need to wear masks, online shopping will continue to be a compelling proposition and likely to be habit forming the longer the situation persists, particularly as the situation moves towards Winter. Additionally, the increasing familiarity of older generations with online shopping will undoubtedly result to a higher contribution of this demographic group to e-commerce.

In the more digitally developed markets online retail sales are predicted this year and next to cross the 10% threshold (France, Sweden, Netherlands) and in the less mature ones to closely reach it (Spain, Poland, Belgium). In the established markets of the UK and Germany online sales are expected to capture close to a quarter and to one fifth of total retail trade respectively, with the rest of the activity still conducted in physical stores.

Expectations for consumer behaviour post Covid-19 relative to pre-crisis: Consumers will most likely shop less for non-essential goods in physical stores



Source Savills Research based on McKinsey & Company Consumer Pulse Survey data



However, we caution against predicting the future of e-commerce based on the spikes in trading experienced during lockdown when there was no alternative. E-commerce continues to serve some categories better than others and even online grocery, which in the UK temporarily increased penetration by 300%, was still only accounting from a marginal base. This is a huge leap of course, but we need to retain perspective on where the majority of retail trips are made.

When consumers across a number of European markets were asked (McKinsey & Company Consumer Pulse Survey) how they expect their habits to change when the coronavirus situation has subsided compared to pre-crisis, the overall net intention of consumers was to maintain the same shopping habits: there was no overall change observed in the intention to shop online for non-grocery products, while a net 8% of consumers intend to shop less online and 6% to shop more in physical stores for groceries.

However, there was a clear message that consumers will shop less for non-essential goods in

physical stores: a net average of 17% will decrease their visits to the mall and 5% will shop less in physical stores for non-grocery products. We believe that this attitude is likely to last as long as the economic crisis dampens confidence and spending putting pressure on retailers and landlords of shopping malls. The variations of answers per country are broadly correlated to the degree of transmission of the virus and the stringency of measures applied.

Convenience and value

Retailers that were planning to jettison their regional and local stores in favour of prime city centres are now reconsidering their strategies. Indeed, many convenience food outlets and medium-sized supermarkets in the urban areas have been relatively resilient over the lockdown period. Even if once this is over people are only working from home an extra two or three days a week, that's still an increase in local demand and decrease in city centres and business hubs. We therefore expect to see the resurgence of interest in neighbourhoods and towns with sizeable and growing

residential stock.

This follows a trend that Savills Research has been reporting for some years now, on the importance of community and convenience retailing. We have previously forecast local retailing to be more resilient to the impact from e-commerce than prime retail destinations and in the aftermath of the pandemic people will favour local community focussed retail compared to destination schemes, for the immediate future. Consumers seeking tried, tested and trusted compared to seeking new and experiential visits.

Another trend that has already been evolving since the previous economic crisis, is consumer focus on value. With rising concerns about the future of the economy people will be spending more on essential goods and they will be looking for value for money. This trend had fuelled the expansion of value retailers over the past few years, a trend that will intensify again. We expect their efforts to concentrate on town locations that attract community shopping and well accessible out-of-town locations and schemes.



In the more developed markets online sales are expected to capture between 20% and 25% of total retail sales, with the rest of the activity still conducted in physical stores

LEASING MODELS & VALUATION

Downward pressure on rents either via re-basing or through alternative approaches to leasing models will dictate much of the debate between landlord and tenants. Retailer affordability is not expected to recover to 2019 levels and was already under pressure – a consistent message we get from across the Savills' network. Even in markets where turnover rents are prevalent, the affordability matrices may be permanently altered and leases in need of adaptation.

Whether the market embraces these discussions or diverts to them reluctantly, there are serious consequences for the way we value retail assets and indeed, a bigger question is whether many of them will remain solely retail assets at all.

“Many convenience food outlets and medium-sized supermarkets in the urban areas have been relatively resilient over the lockdown period.”

- ☞ Convenience retail formats and retail parks have proven the most resilient, with footfall recovering at twice the rate of destination and shopping centre retail. ☞



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The future of the store

There is a significant change in consumer behaviour, and the impact on physical stores will be substantial, especially if, as expected, several stores will not re-open (8% estimated in the UK). However, we need to be clear that nevertheless, a significant proportion of retail transactions remain in-store.

The collaboration between landlords and tenants will be of paramount importance over the coming months, until a vaccine or a treatment brings the health crisis to an end. Even then, the recovery will be gradual and certain habits will remain with us, meaning that the current models of leasing space may become inefficient and irrelevant. Owners and occupiers are becoming partners who both share the gains and pains of the market conditions in order to ensure the long term viability of both. Lease terms flexibility, turnover rents, shorter leasing periods, collaboration in omnichannel strategies are some of the issues to be considered.

Evolving retail spaces

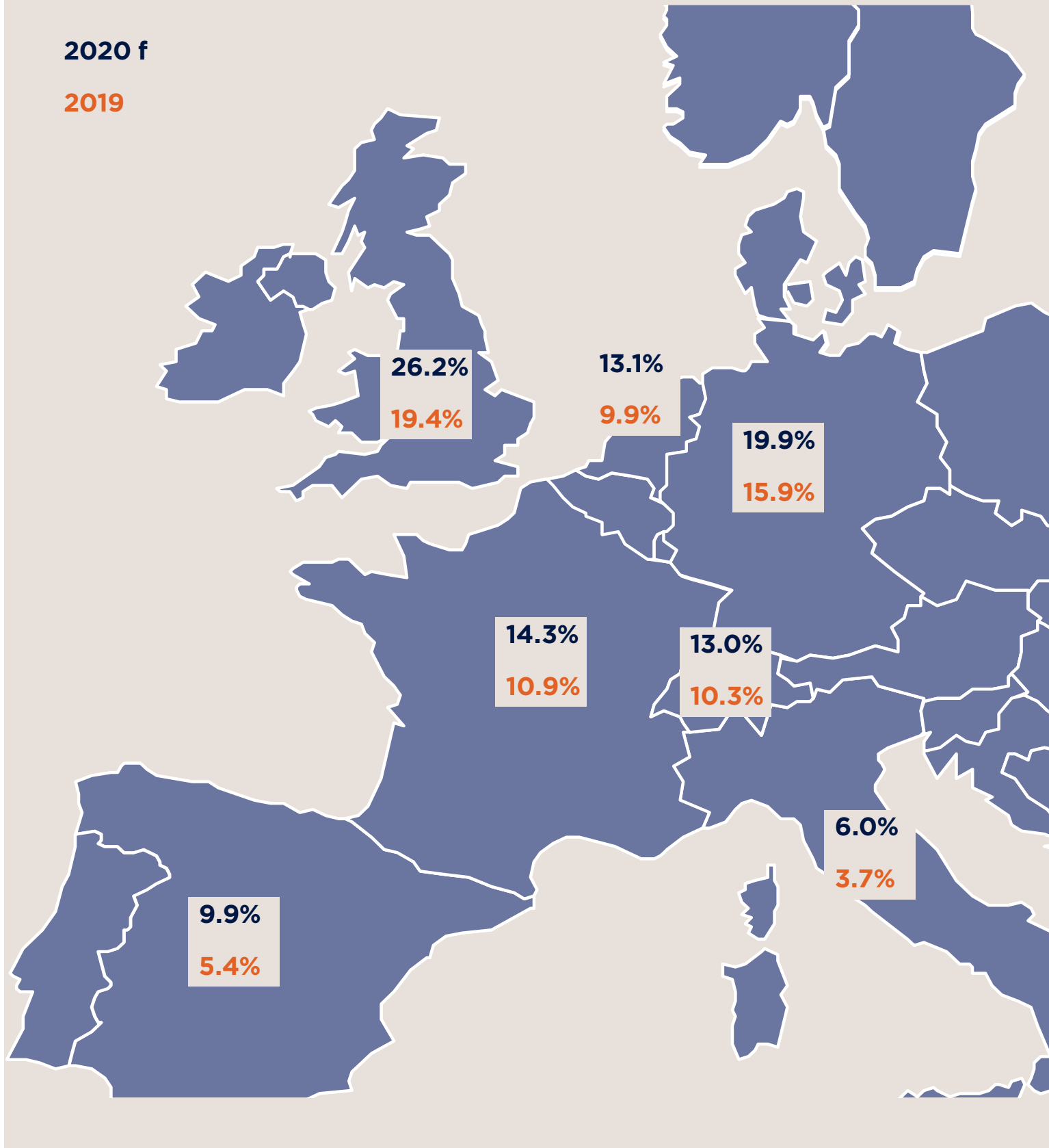
With the need for retail space in decline an urgent review is required by all landlords, asset managers and town centre planners in rethinking retail space. Failing to act will result in many places losing relevance and further increases in voids. Adapting retail space to alternative uses is still seen by many as a last resort, but is far from a hopeless resignation towards the death of retail places. On the contrary, it is a fundamental consideration that will see dynamic retail survive and mixed use retail spaces thrive.

There remains demand for new retail concepts that fit with evolved consumer preferences and additional space where demand has shifted to, but this can only happen if the industry is prepared to move away from single use assets. The retail spaces that survive will be genuine mixed use spaces that benefit all uses by creating footfall through linked trips, operating different day parts, have greater social value, are more vibrant and in tune with the needs of the catchment. Evolving places will prove the most sustainable and the most resilient.

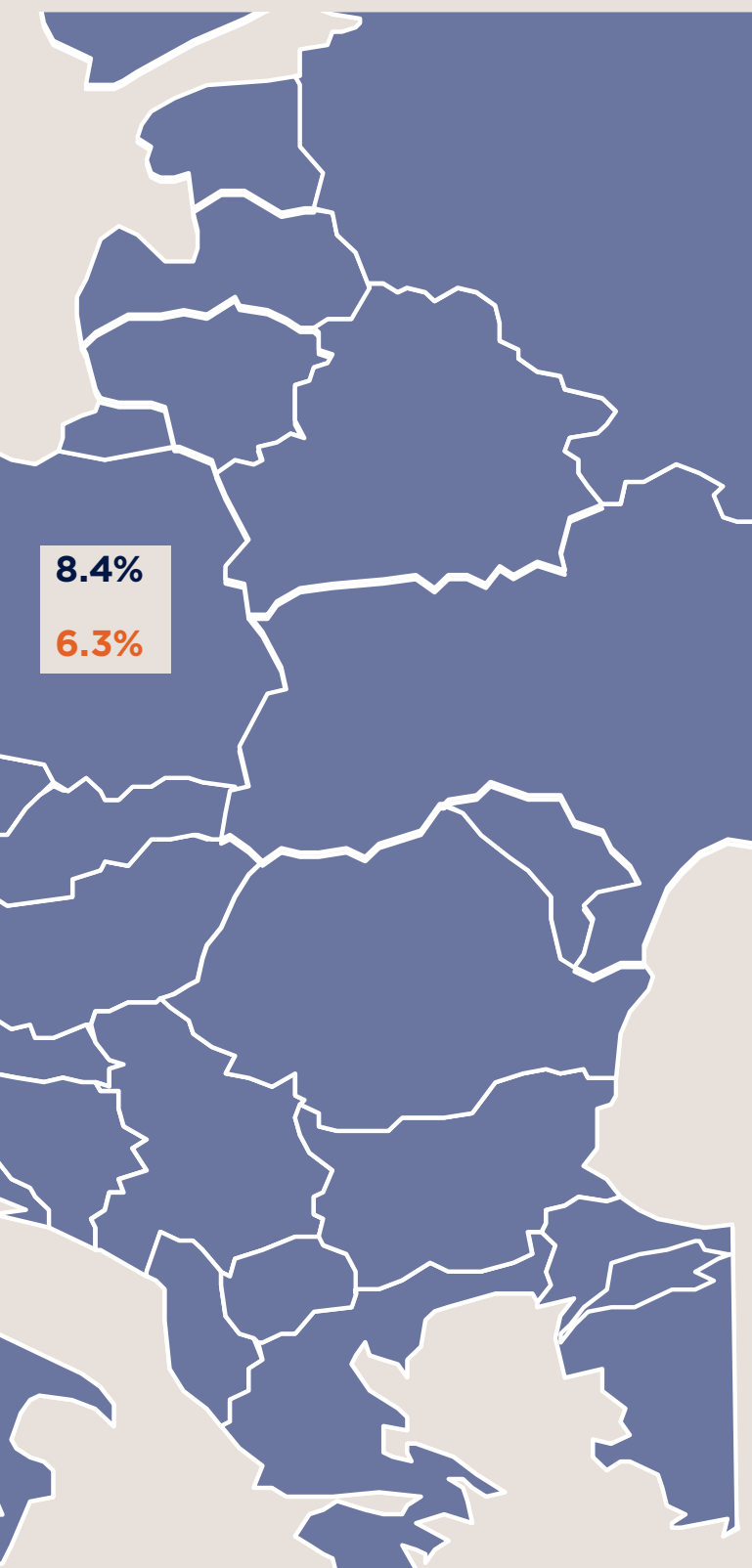
16.2%

The average share of online retail sales for UK, Germany, France, Spain, Italy and the Netherlands is projected by CRR to reach this level in 2020

Online share of retail trade: In the more digitally developed markets online retail sales are predicted to cross the 10



% threshold in 2020



Source CRR, GfK, VSV, Credit Suisse, Savills



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Savills Commercial Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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