MARKET IN MINUTES
Savills Research

European Retail Investment

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European retail is becoming cheaper

The share of retail investment is narrowing

• European commercial and residential investment volumes reached c. €107.1bn in H1 2021, marking a -7% drop compared to 2020 and a -6% decrease on the past five-year average. Retail investment fell by -39% yoy to €11.2bn and the share of retail dropped to 15% of the total real estate investment, compared to a five-year average of 19%. Over recent years retail investment as a proportion of total volume has trended downwards.

• The majority of retail investments took place in Germany (29%) and the UK (27%), followed by the Nordics (Norway 13%, Denmark 7%, Sweden 3%, Finland 3%). Against the general trend activity was up in Norway (177% yoy), Denmark (83%) and the UK (47%).

• The acquisition of five strong performing shopping centres this year by Aurora Eiendom AS in Norway shows that some investors still have confidence in dominant shopping centres with high turnover rates, which are adapting to the evolving needs of the local consumer. Retail space per capita in Norway is in line with the European average but more than two thirds of the retail space is in shopping centres. Therefore this retail format will remain important for consumers even with the rise of e-commerce share from 10.9% in 2019 to 14.6% in 2021 (Forrester projections).

• In the UK there was a rise in opportunistic interest in the sector in the last quarter, supported by significant yield correction. In a world where high yields are increasingly hard to find (whether in real-estate or outside), good UK shopping centres where there is a credible story around tenant demand and consumer need are starting to look cheap. Prime achievable yields in Q2 were at 6.75%.

Convenience sector had a strong second quarter

• In Denmark, the largest transaction in H1 21 was the sale and leaseback of a Danish supermarket portfolio of 38 urban properties with a total volume of c. €140m to Savills Investment Management. The assets are let to the food discounter REMA 1000 Denmark on a 15-year fixed-term. The subsidiary of the Norwegian food trading group Reitan Handel has a market share in the Danish food retail market of 15.5%.

• Assets related to the food sector, such as discounters, supermarket anchored retail schemes and to a lesser extent hypermarkets have been attracting multiple bids and yields are moving in. The stability and length of income streams makes this segment desirable especially for investors with long-term liabilities. The sector was traditionally capturing 5-6% of total retail investment, but this year soared to 23%.

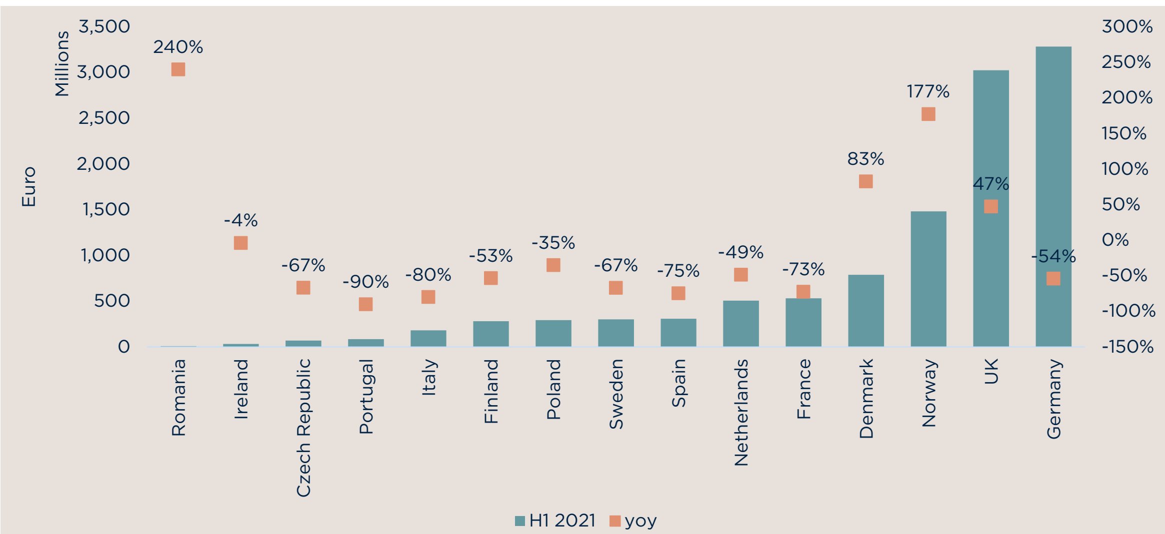
• The second quarter of this year was quite strong for the retail warehousing segment. According to RCA, Retail park and Big box transactions were up 58.7% yoy, totalling almost €2bn for the whole of H1 21 and capturing 17% of the retail turnover. It is still -20.5% down compared to the first half of 2020.

• Footfall levels for retail parks have proven resilient against a backdrop of subdued footfall for retail as a whole, compared to pre-Covid 19 levels. Taking the UK as an example footfall levels have recovered to broadly in line with pre-Covid footfall levels for retail parks which demonstrates the relative strength of these assets to the structural market changes and to the evolving consumer behaviours.

• If we combine supermarket and retail warehousing investment, which broadly represent the convenience sector, we will observe that they accounted for the second year in a row, for 40% of the activity, compared to 22% seven years ago.

• The defensive characteristics of the convenience sector have been driving investor confidence. This is also reflected in the narrowing of the yield gap between shopping centres and retail warehouses over the past years. In Q2 21 prime retail warehousing yields have converged further

European retail investment by country Germany and the UK accounted for 56%



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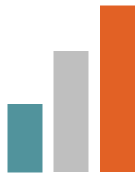
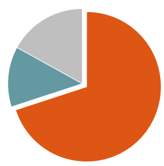


€11.2bn
Was the total retail investment in H1 21, down -39% yoy



40%
For the second year in a row the share of investment in convenience retail.

18 bps
The yield gap between the average European retail warehousing yield and shopping centre yield has narrowed from a 5 year average of 75 bps.

5.3%
The average European shopping centre yield in Q2 21, was the highest since 2014

> "We believe that retail yields will move out further. In the long-term we do not expect their recovery to be as strong as in the previous cycle"

with prime shopping centre yields. With the average prime European retail warehousing yield at 5.48%, the yield gap in Q2 was at 18bps vs. a five year average of 75 bps. Average prime supermarket yields in Q2 21 were at 5.41% and edging downwards.

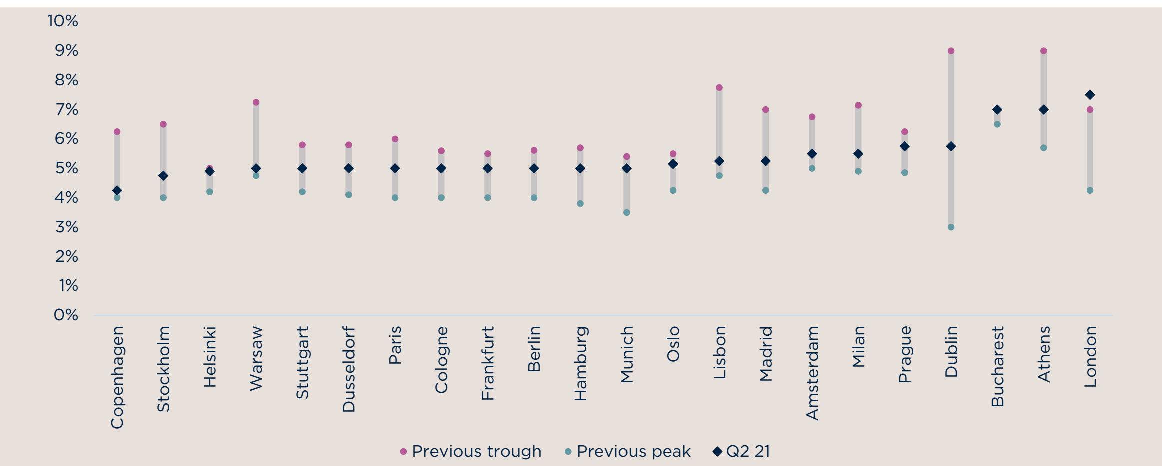
Is retail becoming cheap?

- Since the beginning of 2021, prime shopping centre (SC) yields have been correcting across Europe. The current average prime shopping centre yield stands at 5.29%, the highest it has been since 2014. During the past peak in 2007, the average prime shopping centre yield in Europe was at 4.84% and post GFC it reached 6.58% (Q3 2009). Shopping centre yields peaked again in 2018 at 4.45%, and ever since they have been rising.
- Currently the markets that have experienced the strongest price corrections (current prime SC yield has moved out by 25% or more compared to its last peak) are the most liquid ones such as the UK, Germany, France and Ireland. We expect that the markets that may experience stronger corrections in the coming quarters may be the ones with higher total physical retail supply per inhabitant, such as the Benelux markets.
- However, pricing will also be asset specific. While average prime shopping centre yields increased by 21bps (4% yoy) from 5.12% in Q2 20 to 5.29% in Q2 21, secondary shopping centre yields increased by 59 bps (9% yoy) to 7.27% across our survey area.

Outlook

- For a decade consumer journeys have become increasingly polarised, which has been driving changes in the market. We believe the best performing schemes are those which respond effectively to the hierarchy of needs of their consumer catchment. Investors need to understand the customer journey and the reasons for visiting different types of retail formats in order to evaluate whether an asset is resilient against the changing market dynamics, including rising e-commerce penetration rates across Europe.
- Increases in online penetration rates cast a shadow over the future of physical retail assets, but the fundamental question for stakeholders in the market will be what the longer-term, stable outlook will be for consumer spending as a whole, and the proportion of online spending within this. The impact of this varies across geographies, given the heterogeneity of locations and differences in consumer behaviours.
- Retail owners of retail premises face the pressure to adapt to consumer's expectations for an omni-channel experience. In some cases, units and assets may lose their lettability for retail uses indefinitely, with the option to welcome complementary uses, which can contribute to customer experience and enhance the sense of place-making (See Re:Imagining Retail #2). The location of some void retail assets may also become attractive for alternative uses, such as services, medical, storage, dark stores, co-working, fulfilment centres and others.
- Economic activity has been recovering in recent months, picking up the pace throughout the second quarter. In May 2021, the volume of retail trade rose by 4.6% yoy in the EU. As non-essential retail activities reopened across the EU, and following the observed swift recovery in mobility and sentiment, retail trade recovery is expected to continue. Also in June, the Commission's flash estimate of consumer confidence saw a further improvement, increasing to its highest reading since October 2018.
- We expect that in the coming quarters there may be a rise of opportunistic interest in the retail segments that show significant repricing. Given the market context, understanding and selecting the 'right' retail stock is fundamental.
- It is not certain if the current yield cycle will mimic the post GFC one, as at that time the price correction was driven by a drop in consumption and the economic downturn. Currently the factors that drive prices down are structural, which may allow some assets to adapt to new consumer habits, while others may need to change use altogether.
- We believe that retail yields will experience further softening. Strong recovery in consumer spending may support some optimism for retailer performance and covenants in some locations and resilient assets. This may lead to further polarisation between prime and secondary pricing. In the long term we do not expect the recovery of retail yields to be as strong as in the previous cycle.

Prime shopping centre yields are on average c.25% above their past peak



Source Savills Research

Savills team

Please contact us for further information

Eri Mitsostergiou
European Research
+30 (0) 694 650 0104
emitso@savills.com

Oliver Fraser-Looen
European Head
Investment Advisory
+44 7807 999582
OFLooen@savills.com