European Commercial – December 2020

SPOTLIGHT
Savills Research

Retail investment
Focus on Food

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● Retail investment ● Food sector ● Sale and leaseback ● Outlook

CHALLENGES AND OPPORTUNITIES IN RETAIL

The outlook of the retail sector was already fragile before the pandemic, mainly challenged by the rising importance of e-commerce on consumer habits. Structural changes have been brought forward as confined consumers have used online platforms to satisfy their essential needs. During the first lockdown food sales peaked, following the closures of bars, cafes and restaurants across countries. Sales of sports equipment, furniture and electronics also showed resilience.

Retail investment in the first three quarters of the year, held up well, despite the circumstances, underpinned by investor demand for food and convenience retail.

We are in the middle of a crisis and although some trends become more clear, it is still uncertain what will be the final impact on consumer behaviour and eventually on retail itself.

The announcements of effective vaccines signal the "light at the end of the tunnel". In the meantime retailers and investors adapt their strategies to the new normal.

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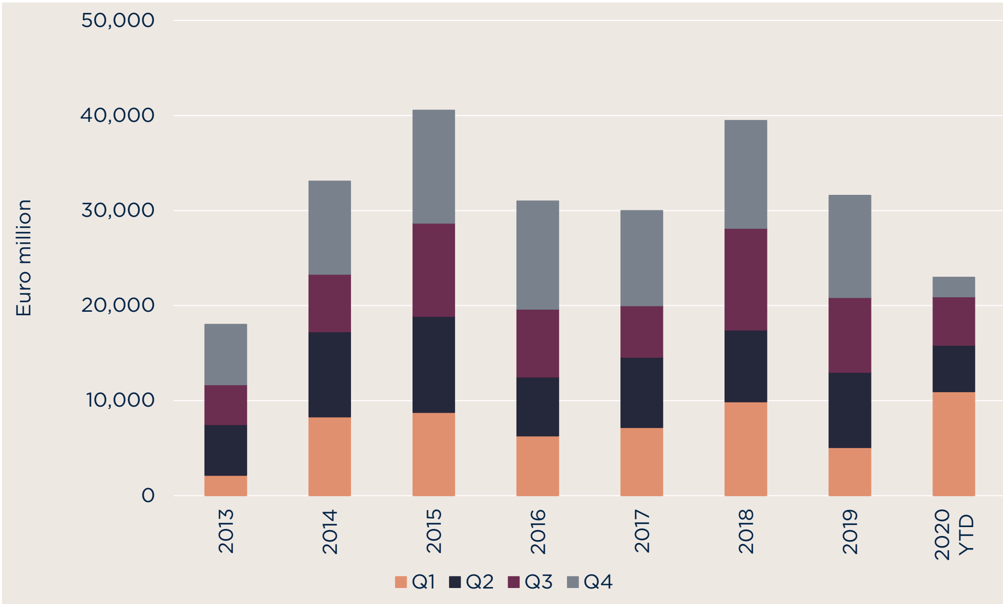
European retail investment Q3 was the lowest since 2013, but 5% above Q2



Source: Savills

Retail investment

After a strong start of the year, retail investment slowed down in Q2 and Q3 and is 11% below the five year average

Second lockdown weighs on consumer confidence

Europe's major cities remained in the midst of a second lockdown, further denting business confidence as the economic recovery shifts from a 'V' shape to the previous downside scenario of a 'W'. Focus Economics latest November 2020 Euro Area GDP growth forecasts indicate a slump to -7.9% yoy during 2020, with a 5.3% yoy recovery in 2021. Forecasts could be revised up, following the announcements of the effective vaccines, that could be distributed as early as next year.

Consumer confidence again dropped in October from -13.9 to -15.5 as a result of reinstated lockdowns and gloomier sentiment over the economic outlook, hindering planned retail expenditure. Despite the extension of a number of Europe's furlough programmes and increased Eurozone household savings ratios during Q2 2020 to 25% of income, the potential for a quick consumer bounce-back appears limited.

In September, EU volume of retail trade fell by 2.0% on a monthly basis, following a 4.2% increase in August. However, on an annual basis retail trade was 2.2% above last year's levels. This has been supported by online activity (17.4% yoy), but also electrical goods and furniture (10% yoy), electronics and books (2.9% yoy) and food (2.9% yoy).

Mixed trends in retail investment

The trends in the retail investment market have been diverse this year, reflecting the sector's ongoing transition. Q1 was one of the strongest on record with over €10.8bn invested in prime shopping centre portfolios and single assets, supermarket portfolios and retail warehouses. A number of mega deals took place in Southern Europe, although activity was spread across markets with sizeable deals also in Germany, France, the UK, Netherlands and Norway. The supply of product has been driven by investors who are aiming to reduce their exposure to the retail sector and owner-occupiers who are trying to raise capital through sales and leasebacks.

In the second quarter we were already in the heart of the pandemic and after a lockdown that has caused major disruption to retail formats that sell non-essential goods. Retail investment

> "Supply of product has been driven by investors who are aiming to reduce their exposure to the retail sector and owner-occupiers who are trying to raise capital through sales and leasebacks."

17% Is the share of total real estate investment in our survey captured by retail between Q1 and Q3 this year

Retail trade was 2.2% up yoy in September, underpinned by 17.4% yoy rise in online activity

Q1-Q3 2020 retail investment volume amounted to €20.9bn, 11% below the five year average.

Supermarket investment in the countries we monitor was close to €5.2bn in the beginning of Q4, 40% up yoy.

Retail investment activity in Germany, France, Sweden, Portugal and Spain has already exceeded last year's levels.

The share of shopping centre investment dropped from 44% in 2013 to 25% in 2020

recorded the lowest quarter since 2013 at €4.9bn. Ongoing portfolio deals in France, Germany, the UK and Poland kept market activity going.

The third quarter, although it was still the lowest since 2013, it was 5% above Q2 at close to €5.1bn. The transactions' list was led this time by portfolio transactions of retail parks/warehouses and supermarkets in France, Spain, Italy and the UK. On an annual basis, Q3 was down across all markets by 35%, with the only exception being the UK, where a total of €1.65bn worth of retail transactions were completed in Q3 this year, 128% above last year's level. Supermarket portfolio transactions, but also retail warehouse and shopping centre sales underpinned the activity.

All in all, Q1-Q3 2020 retail investment volume amounted to €20.9bn, compared to €20.8bn last year and was 11% below the five year average. Retail maintained its proportion of the total real estate investment in our survey area at 17%, compared to a five year average of 18% and above last year's 16%. It is worth noting however, that some of the retail assets transacted, may be repurposed and change use in the future.

Germany accounted for 30% of the activity, UK for 19% and France for 14%. It is worth noting that activity in Germany, France, Sweden, Portugal and Spain has already exceeded last year's levels.

Supermarket and convenience on top of investors list

In Germany, the sectors that have registered the highest increase in Q1-Q3 2020 compared to their five year average (full year) were Cash&Carry (€819m, 307%), Supermarkets (€2.2bn, 197%), Shopping centres (€957m, 106%), Discounters (€536, 83%), Department stores (€2.25bn, 62%) and DIY stores (€486, 60%). Investor confidence in the German market has been further enhanced this year, as the economy is holding up better than other countries during the health crisis.

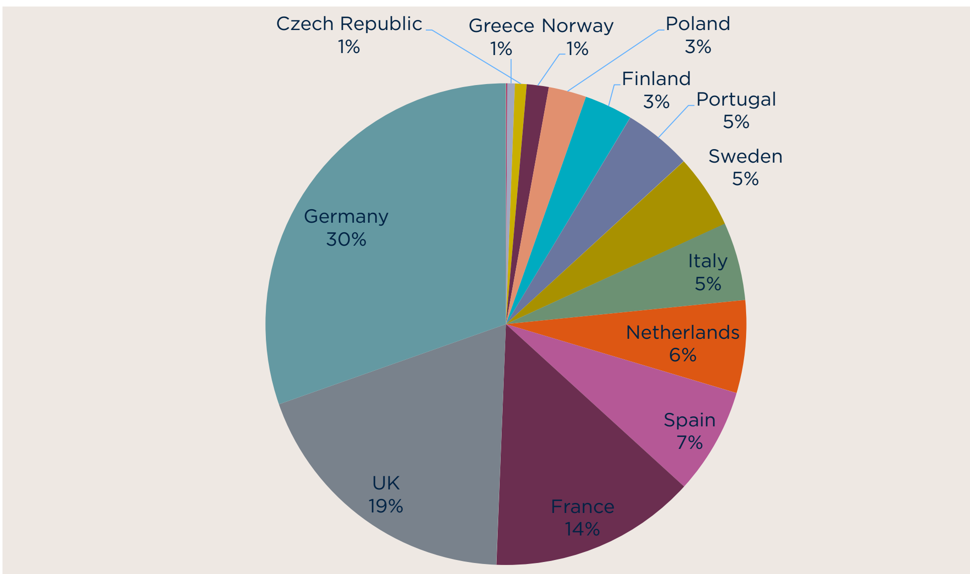
The Iberian markets saw €608m of Supermarket/Hypermarket deals up to early Q4, which was 120% above the full year five year average. Retail warehouse investment activity was 36% above the five year average at €179m, while shopping centres were 53% below the trend, despite the large deals that took place in Q1. During the lockdown the food retailers increased their turnover (eg Mercadona), while post lockdown retail parks/retail warehouse concepts, have been more resilient - as in many places in Europe.

Supermarket transactions were also above the five year average in Poland (64%), Italy (76%), while in the UK the sector had already picked up significantly over the past two years and sustained its high levels of activity at over €1.1bn.

Total supermarket investment in the countries we monitor was close to €5.2bn in the beginning of Q4, 40% up yoy. The lions' share was captured by Germany (€2.2bn), followed by the UK (€1.2bn) and Spain (€608m). Between 2013 and 2019 supermarkets (including hypermarkets and discounters) accounted for no more than 7% of total retail investment. In 2019 their share increased to 19% and in 2020 jumped to 23%.

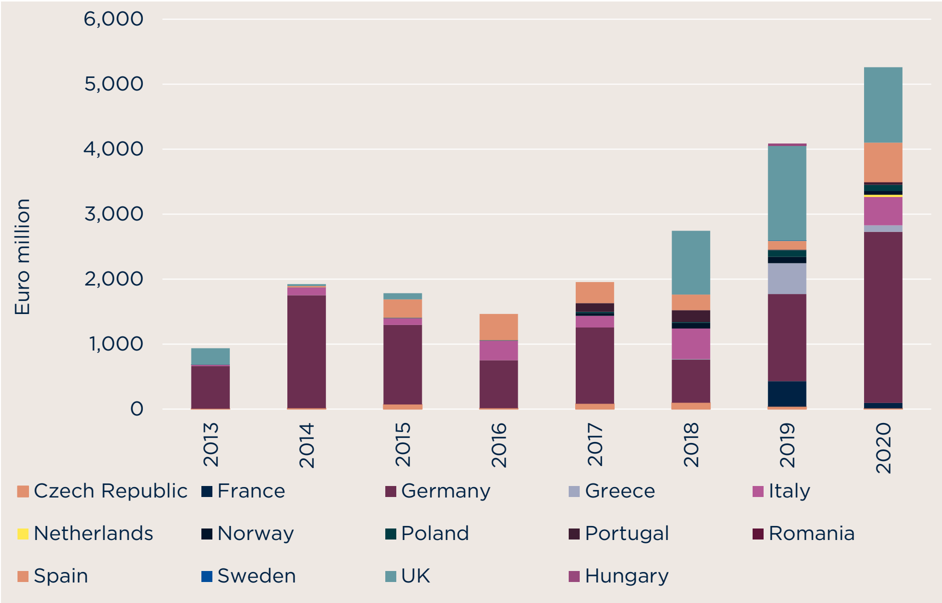
If we combine supermarket and retail warehousing investment, which broadly represents the convenience sector, we will observe that they account for 40% of the activity since the beginning of the year, compared to 22% in 2013. Conversely, shopping centres accounted for 44% of the activity in 2013 and their share has dropped to 25% in 2020, reflecting the opposite fortunes of the two market segments during the past years, which have been accelerated by the pandemic.

European retail investment share by country Q1-Q3 2020 The core markets accounted for almost two thirds of the activity.



Source: Savills

European supermarket investment UK, Germany, Spain and Italy accounted for 92% of the activity



Source: Savills

Convenience retail vs Shopping centre investment Convenience retail proves to be more resilient in times of uncertainty

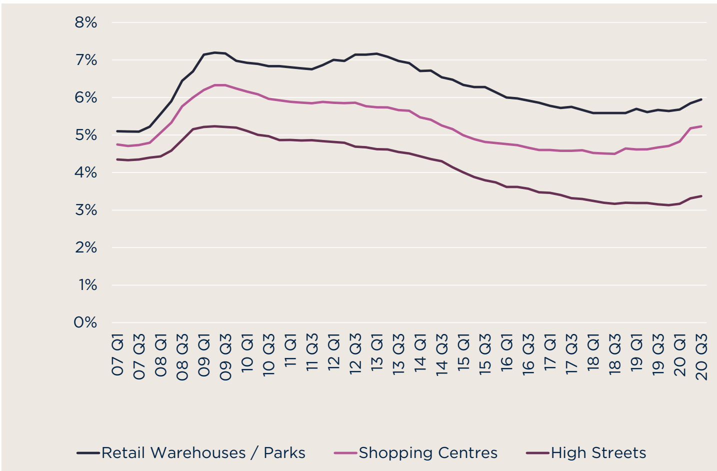
Source: Savills

40%

The share of total retail investment captured by supermarkets, retail warehouses, retail parks and discounters, since the beginning of the year.

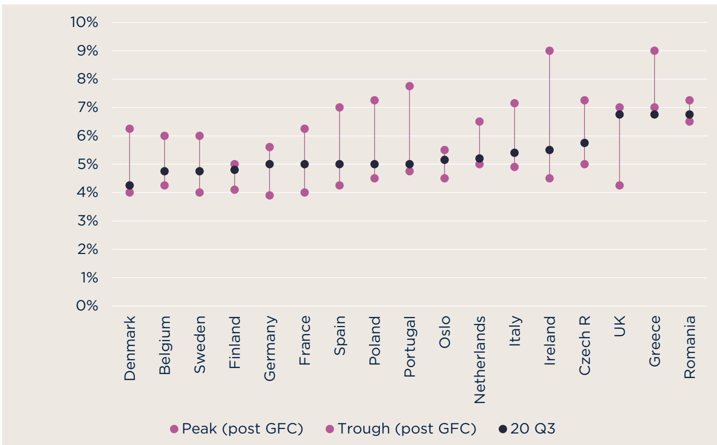
Photo by Irina Lo on Unsplash

Prime retail yields in an early upswing stage of the cycle



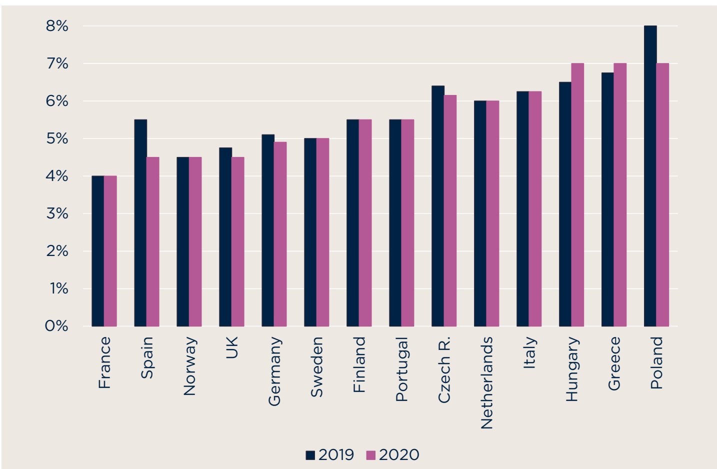
Source: Savills

Post GFC prime shopping centre yields Peak, trough and current levels



Source: Savills

Prime supermarket yields remain stable in most markets



Source: Savills

RETAIL YIELDS ARE MOVING OUT

It should not come as a surprise the pick-up in activity in the UK market lately, as it is the market that has experienced the strongest prime retail yield correction over the past three years. Prime shopping centre yields have moved out by 250bps since their latest peak (post-GFC) and by 125bps only the past four quarters. The prime shopping centre yield in Q3 reached 6.75%, very close to the past cycle's trough.

The other markets where prime shopping centre yields have corrected substantially over the past year are Germany (100 bps to 5.0%), Ireland (100 bps to 5.5%) and France (100 bps to 5.0%), while across all markets prime shopping centre yields moved out by between 20bps and 75bps yoy.

If we use the previous cycle as a benchmark, we will notice that on average the peak of the average prime shopping centre yield pre-GFC was at 4.7%. After the Global Financial Crisis (GFC), prime yields moved out by 162bps over the course of two years. Economic contraction, rising unemployment and a drop in consumption, hit hard retail performance and investor sentiment at the time. Post-GFC, prime SC yields reached once again an all-time low of 4.5% in Q3 2018. Ever since they have been moving out, reaching 5.23% in Q3 2020. This time investor sentiment has been damaged by concerns over the negative effects of e-commerce on physical retail. Since the outbreak of the pandemic, these concerns have been exacerbated, as retailing has been one of the hardest hit sectors due to the lockdowns.

In Q3 2020, Denmark, Belgium, Sweden and Finland would still command prime shopping centre yields below 5%, with the UK, Greece and Romania quoting prime achievable yields at 6.75%. We expect yield softening to continue next year, especially in the markets with higher supply of retail space, such as Germany, Belgium, Netherlands and Sweden.

Retail warehousing yields moved out overall more modestly, the average prime retail warehousing yield in Q3 was at 5.94% compared to 5.67% a year ago. The countries with the most significant outward yield shifts yoy were Ireland (100bps to 5%), UK (50bps to 6.75%) and France (50bps, 5.5%), while in a few markets prime retail warehousing yields moved in, namely in Amsterdam (-50bps, 6.5%) and Helsinki (-5bps, 6.2%). They remained stable in Athens (7.25%), Lisbon (6.5%) and Oslo (5.25%). Overall retail warehousing and retail parks, fared better this crisis, as post lockdown consumers felt safer shopping in these retail formats, which offer convenience, easy car access, parking and spacious indoor and outdoor shopping and leisure areas.

Regarding prime supermarket yields, a sector with high transaction activity lately, have compressed in some markets (Spain -100bps, Poland -100bps, UK -25bps, Check Republic -25bps, Germany -20bps) while the rest have not experienced significant yield movements yet. The lowest yields can be found in France (4% for urban store, 5.25% for regional store), Spain, Norway and the UK at 4.5%. Yields are still at 6% or higher in CEE markets and the Netherlands (6.0%).

New scene for grocery shopping

Supermarkets have been one of the most resilient sectors during this crisis, but they are not immune to disruption caused by online shopping.

During times of uncertainty investors are seeking sectors with defensive characteristics and stable income streams. Supermarkets have been one of the most resilient sectors during this crisis, as they were among the few retail formats that remained open during the lockdowns. Combined online and onsite sales have driven turnover growth, compared to previous years.

Food retailing has also remained largely immune to digital disruption—until recently. Although generally consumers prefer to shop fresh products in physical stores, since the outbreak of the pandemic online food sales have grown strongly around the world. In China, for example, Carrefour's deliveries for the New Year, which took place a few weeks after the outbreak of the epidemic, increased by 600%. The situation in Europe is no different: in Italy and Spain, the number of e-food users doubled and in Germany, sales in online food retailing in the second quarter of the year rose by 90% compared to 2019.

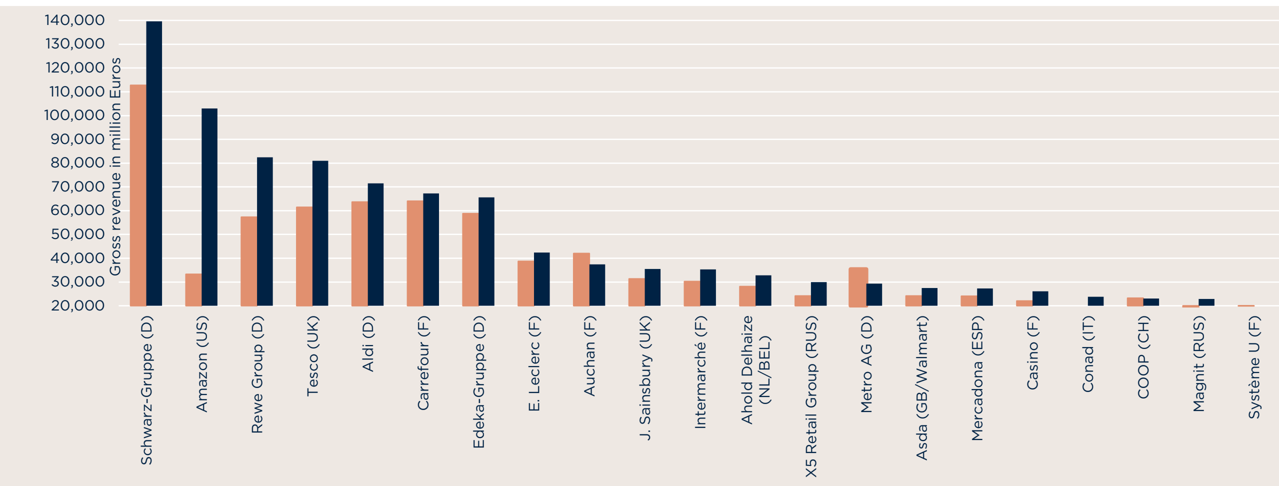
According to a survey of PwC in May, more than a quarter of all European consumers in urban areas (28%) bought food mainly online during the first lockdown. And the longer the pandemic lasts, the greater the effect of this new habit is likely to be, especially since online trading seems even more convenient than it already is, in view of the measures of social distancing that apply to physical retailing for as long as the virus spreads. It is therefore predicted that more than 80% of consumers who bought food online for the first time during the pandemic want to continue doing so. Newcomers in this field have had positive experiences with the convenience and quality of fresh food. This has helped them to overcome quality concerns, which had previously deterred them from shopping online.

Improvement of online shopping experience has become one of the main priorities of grocery groups. In Spain, Mercadona invested €20 million in updating its online sales website already in 2018 and has recently set up a 15,000 sq m distribution centre exclusively for online services. El Corte Inglés and Carrefour offer deliveries in less than two hours, or collection from stores. The Schwarz Group, which owns Lidl, has bought one of the largest e-commerce sites in Germany. In Italy, discounter Penny is experimenting with an online delivery service in Milan and Catania, Sicily, called "Penny a Casa". Likewise, UK grocery retailer Sainsbury's has announced that it will continue to expand its online offering in the coming months and already delivers 700,000 orders per week, twice as many as before the start of the pandemic.

The rising investment in omnichannel strategies and the costs related to e-commerce and logistics, put pressure on retailers' margins. Grocers are seeking alliances to achieve economies of scale and develop concepts, which will attract and retain customers. In Spain, Amazon has an agreement with DIA and in the UK with Morrisons, for delivery and distribution in different parts of the country. Following the immense increase in demand for home delivery during the lockdown, some retailers have partnered with delivery companies. In Spain, Glovo has signed agreements with Carrefour and in Dublin Aldi has signed an agreement with Deliveroo. In the UK Aldi is also in cooperation with Deliveroo, which started in May, was extended to 130 shops recently and more are expected to follow.

From a real estate perspective, grocers are getting more value from their existing stores by using them in some areas as fulfilment centres for last mile delivery. Additionally, they develop pick-up stations, drive-in counters for Click & Collect services and even micro-fulfilment centres attached to the stores. The improvement of their online services and the wider customer reach they achieve, will also allow them to consolidate their network of stores and focus on new expansion strategies, such as convenience stores or additional services, such as catering and others. In the following section we discuss some of the latest trends that have an impact on food retailer's space requirements.

Revenues of the leading companies in the food retail sector in Europe in 2018 and 2020 Most grocers will see their revenue grow this year



Source: LZ Retailytics, via Statista

Buy online, pick-up elsewhere

Click & Collect, Click & Drive or Pedestrian Drives are some of the delivery formulas that are gaining more weight every day. The aim is to make shopping easier for the customers by adapting to their lifestyle. In Spain, BonÁrea supermarkets offer the possibility of delivering the products in boxes so that they can be picked up later during the day and at a time that is most convenient for the customer. In Europe, home delivery systems are already being tested at times when the customer is not there (While you're away) or in the boot of their cars.
In France 68% of the consumers that shopped online in 2020 chose a Pick-up & Go location for their orders, while 28% opted for Click & Collect directly in the physical store (Statista based on FEVAD,CSA). In Italy, the volume of Click & Collect tripled in February (Nielsen). Esselunga is developing its Click & Collect service (Click & go locker) by allocating lockers in supermarkets for this purpose (also suitable for refrigerated food) in order to pick up in store. Additionally it is developing the Click and go concept along busy commuting routes, with space where people can drive through and pick up their shopping, without stepping out of the car.
In the UK, Aldi will expand its Click & Collect service from the current 18 to 200 shops by Christmas, serving around a quarter of its 900 shops. In Germany discounter Netto is trying out a pick-up service while supermarket REWE is opening hundreds of Click & Collect pop-up stations.
The Click & Drive format is also gaining ground, as it saves retailers from home deliveries and the costs associated with the last mile delivery. Instead they invest in drive-in locations where consumers can pick up their goods without having to get out of their cars. This concept has been established in France already for more than a decade by supermarket retailers such as Auchan, Intermarché, Leclerc, Cora, Carrefour and Casino. The model has since been very successful and the number of drive-in stores was still expanding over the past two years.

Downsizing for convenience

During the lockdown periods, smaller (<1,000 sqm), neighbourhood supermarket stores have seen higher turnover density, due to accessibility. A shift that had already started pre-Covid, was indeed the focus of large chains in medium to small sized units in urban locations, easily accessible by customers. This is a trend embraced both by main stream as well as value chains. In Italy Esselunga has announced plans to expand the rollout of its La Esse proximity store format. Aldi last year rolled its first Aldi Local concept in London revealing its plans to increase its number of new standard-sized and high street-focused stores. Lidl has also reduced its size requirements, looking to expand in urban locations. SPAR Netherlands has launched a new convenience concept, SPAR City small. These stores are designed for high traffic locations, with the first store having opened in Utrecht and are aimed at urban and millennial shoppers. The new concept is just 80 sq m.

Dark supermarkets

Most supermarkets prepare the orders from the shop itself with the consequent impact on cost or the lack of available product at the time of the order. Dark stores arise to respond to these needs. These are operational warehouses for the preparation and shipment of orders arriving from the online shop. Located in densely populated areas, their distribution is the same as that of a shop, however, the main point of difference is that they have not been designed for direct sales. For many retailers, this could become an effective way of converting poorly performing stores into dark stores that add value to the online retail infrastructure.

"Grocerants" and other innovations

Supermarkets have also been working on upgrading their offer with freshly made food and even areas of onsite consumption such as bars and restaurants (Esselunga in Italy, Albert Heijn in the Netherlands) Catering and food come together and the concept of "Grocerants" is created as a hybrid concept between a food shop and a restaurant. Such is the case of DIA in Spain, which has introduced Dia&Go where they have a breakfast service in the supermarket, El Mercado de Carrefour that offers food halls with different spaces dedicated to food or Mercadona that has included a take-away section in its supermarkets. In Italy, La Esse in Milan combines a café/restaurant, a co-working space, and a traditional supermarket space. In the Netherlands Jumbo has included in its store in Utrecht on site food preparation such as Mexican street food and Hawaiian poke bowls, while the Albert Heijn concept store in Hoofddorp includes a self-serve herb garden, patisserie and cocktail island.

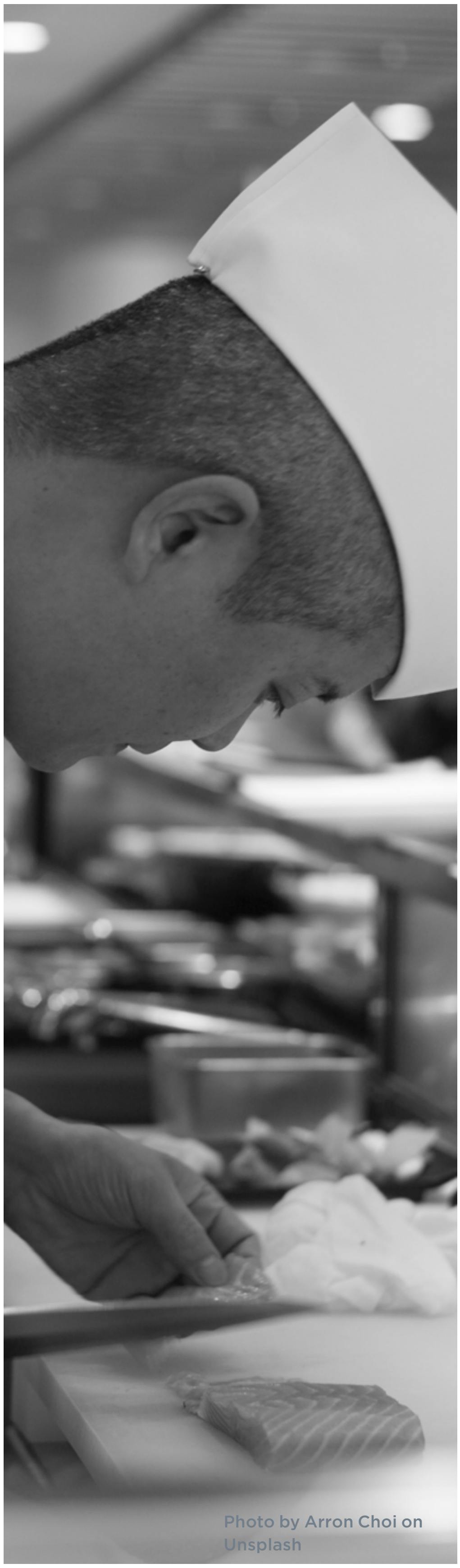
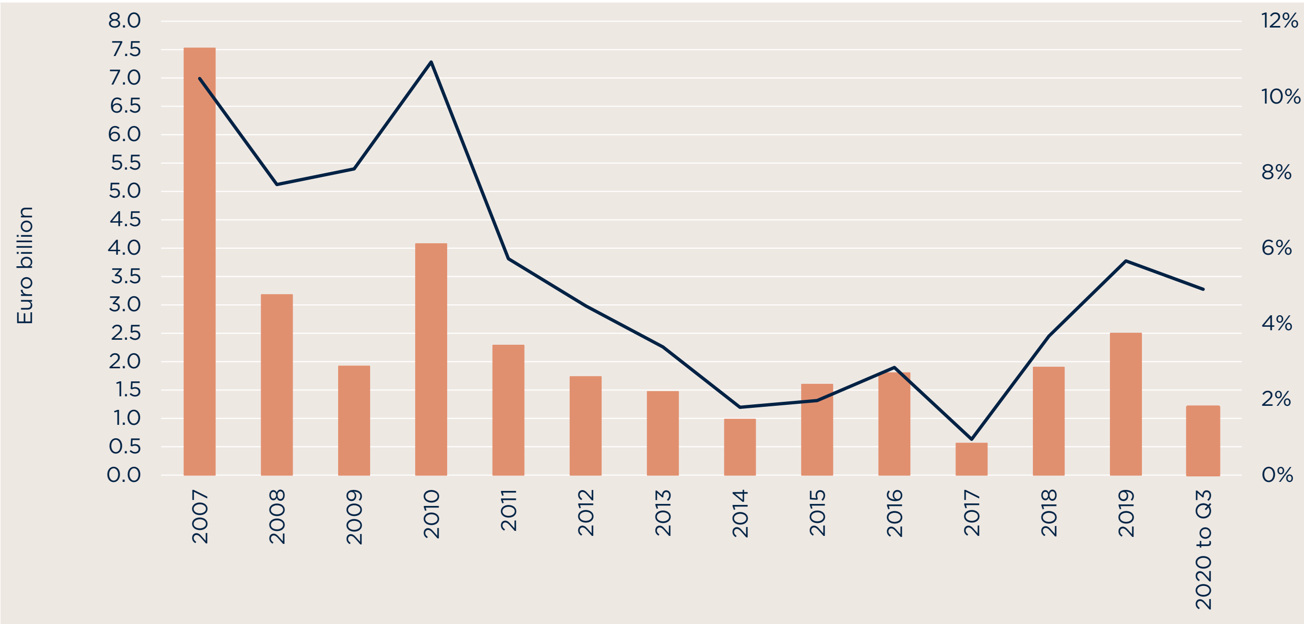


Photo by Arron Choi on Unsplash

During the first three quarters of the year, European SLB amounted to approximately €1.2bn

Volume and share of sale and leaseback transactions More than half of the retail SLB deals this year were concentrated in Spain and France



Source: Savills based on RCA data

Sale and leaseback

Sale and leasebacks can unlock capital that could be reinvested in the core businesses of retailers. Activity has already been growing over the past two years.

Rent collection and rental negotiations

The capital required for these investments can be easily raised through sales and leasebacks. Several supermarket chains have shown a preference in owning their assets where possible, or this has been the way through development to secure the desired spots for their expansion. Currently they can unlock this capital and take advantage of the high investor appetite for this product.

During the first three quarters of the year, European retail sales and leaseback (SLB) amounted to approximately €1.2bn. This is 46% down compared to the same period last year but in line with the past five-year average. The third quarter recorded particularly strong activity in the sector with multiplying numbers of notable SLB deals transacted, including the Adeo European portfolio bought by Batipart and Covéa for approx.€500m, the Mercadona portfolio in Spain bough by LCN Capital for €180m, the Eroski portfolio in Spain bought by WP Carey REIT for circa €87m and more recently still in Spain the Toys″R″Us six-property portfolio acquired by Sports Directs for €34m. More than half of the retail SLB was concentrated in Spain (39%) and France (20%), followed by the UK (14%), Germany (10%) and Italy (7%).

Retail SLB activity remained predominantly driven by the grocery sector, although recent transactions suggest investors interest is broadening to other business sectors such as DIY, as we anticipated in our last report (May). The resilience of the food sector as clearly caught investors' attention, whilst for food retailers, Covid-19 has highlighted the need to develop their omnichannel strategy by expanding delivery and drive-in services, which requires investment; hence a good match. The number of SLB deals from non-food retailers with strong covenants is also slowly rising. Sectors such as DIY, gardening centres and home improvement, which by essence, need both a physical and an online presence are typically good targets.

Historical data shows two large waves of retail SLB transactions. The first one in 2007, before the GFC, led by strong core investors' demand. Retailers were easily convinced by rocketing levels 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 average prime yield moved out by approx.130bps between Q1 2007 and Q1 2010. In Q3 2020, the prime retail yield was at 4.86% on average. This is 45bps above its lowest level recorded two years ago (4.40% in Q3 2018). The overall level of retail SLB will increase significantly during the second part of 2021 when downward price correction will be sufficient to highlight the retail risk premium over other assets classes and attract opportunistic investors.

“We expect retail investment activity next year to be driven by value-add opportunities and sales and leasebacks”

Major retail investment transactions in Q1-Q3 2020

Date	Country/ City	Property	Buyer	Seller	Price
Q2 2020	France	Shopping centre portfolio	Crédit Agricole Assurances and La Françaisee	Unibail Rodamco Westfield	€1,100m
Q1 2020	Portugal	Shopping centre portfolio (50% Sierra Fund)	Allianz / Ello	Sonae Sierra / APG	€750m
Q3 2020	Germany	Shopping centre portfolio	ECE Projektmanagement GmbH & Co. KG	ECE Projektmanagement GmbH & Co. KG	€500m
Q1 2020	Spain/ Zaragoza	Puerto Venecia Shopping centre	Unilmmo-Deutschland / Generali Shopping Center Fund SCS.	Intu Properties PLC / Canada Pension Plan Investment Board	€475m
Q1 2020	Italy	Supermarket portfolio (32.5% of shares owned by private company)	UniCredit	Private (La Villata / Esselunga)	€435m
Q2 2020	Germany	Supermarket portfolio	x+bricks AG	TLG Immobilien GmbH	€300m
Q3 2020	France	Retail park portfolio	Batipart/Covéa	Groupe Adeo	€300m
Q1 2020	Spain/Siero Asturias	Intu Asturias - Parque Principado	ECE European Prime Shopping Centre Fund	INTU (Canada Pension Plan Investment Board)	€290m
Q3 2020	Spain	27 supermarkets Mercadona	LCN Capital Partners	Mercadona	€180m

Source: Savills

OUTLOOK

Investor allocations towards retail have been shifting for a while. We have been observing the gradual loss of retail market share, especially in the more mature retail markets, where the e-commerce penetration has already been high, namely the US and the UK in Europe. Some investors are choosing to reduce their exposure to retail and others not to increase their allocations at all, going forward. However, there will be a price point where retail real estate can become attractive again. The future of problematic retail schemes lies in redefining their tenant mix and layout, introducing new uses or repurposing them altogether. These can be costly interventions, requiring significant investment that can draw back returns. However, these may be the only ways to lead to a better performing asset in the future and save it from obsolescence. The key question is the level of repricing required in order to attract the value-add/opportunistic investors who will be prepared to turn the asset around.

Retail includes a wide spectrum of formats, from neighbourhood and city centre retail units, retail warehouses, retail parks, factory outlets to neighbourhood and regional shopping centres. Not all segments are suffering or will suffer the same from the rise of e-commerce, as still at least 80% of shopping will be taking place in physical space, when life goes back to normality. We already observe that some formats have more defensive characteristics than others, such as supermarkets. This does not mean that it will be an easy ride for grocers either. Consumer habits are changing, demonstrating that some of the current formats do not fit-for-purpose, requiring investment and innovation.

We believe that 2021 will bring some more opportunities in the market, as investors are restructuring their portfolios and retailers are seeking to raise capital through sales and leasebacks. Market activity will also offer more evidence on pricing and will create more confidence and trust between buyers and sellers. We believe that yields will continue to soften, especially for secondary assets that can offer value-add opportunities. Prime yields may also move out further, but we do not expect them to reach the last cycle’s levels, as economic activity and spending are projected to bounce back in Q2 next year, on the condition that a vaccine programme will be rolled out in the beginning of 2021.

Savills Commercial Research
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