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REPORT
Savills Research

European Commercial – Spring 2019

European Omnichannel

savills

> Fast, cheap and good, today's consumers want to have it all.

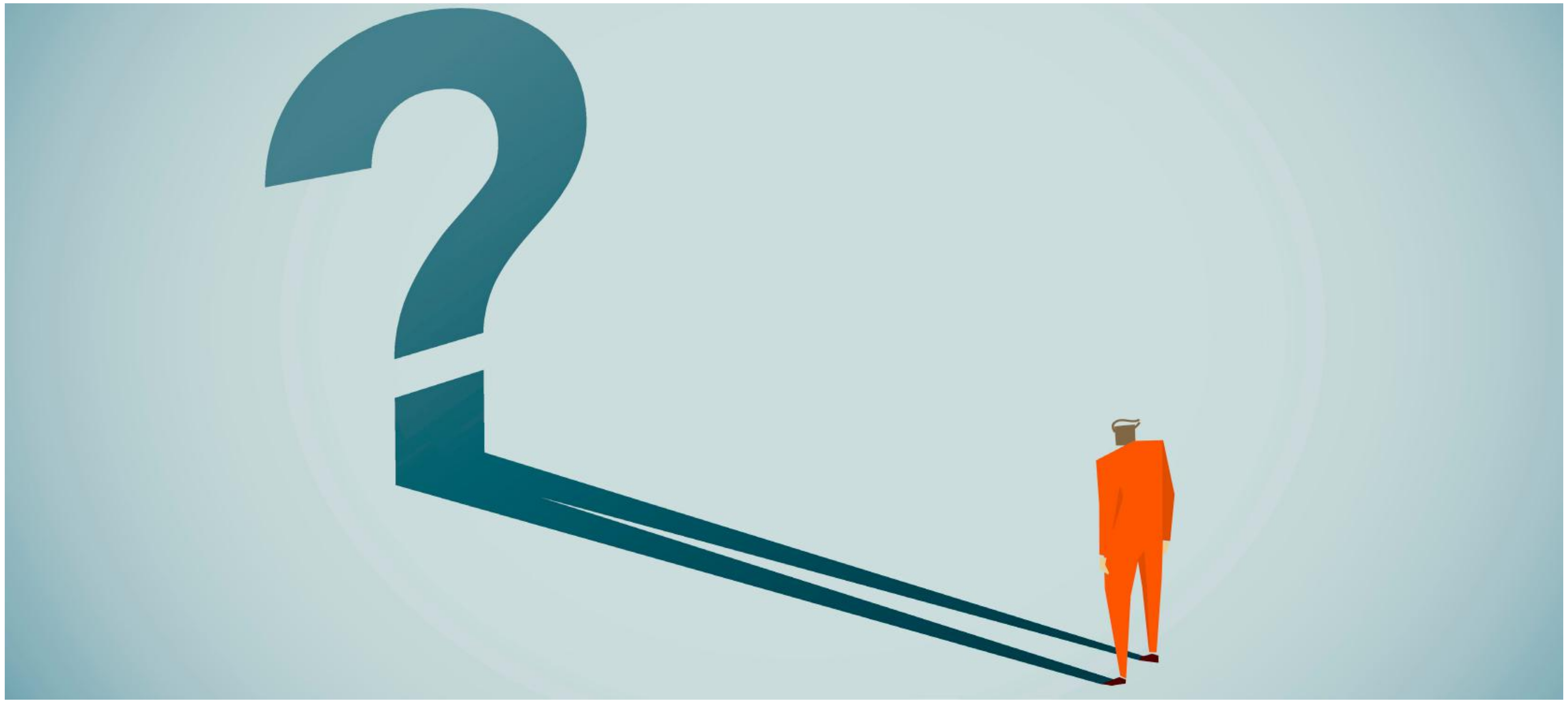
The customer truly is king

Whilst retailers were enjoying their golden age, consumerism has given rise to new and wider expectations from shoppers.

Internet of Things, augmented reality, artificial intelligence and 3D printing have all in some ways marginalised the retail industry. Today's consumers have the ability to amass all the necessary information and knowledge to make a purchase decision on their own, most notably with online reviews becoming the Holy Grail for customers to seek out "impartial" feedback on brands.

With the customer empowered more than ever, the iron triangle concept of "Fast, cheap, and good, pick any two." no longer holds and is fading into an old cliché. Consumers want it all, which is forcing retailers to above and beyond, when it comes to their offering.

What does it mean for the industry? Retail and logistics will have to merge to make the most out of the opportunities triggered by new consumer's habits, notably in order to surf on the ecommerce wave. For its first omnichannel report, Savills looked into various indicators and metrics to identify where in Europe, this merge is most imminent.



The retail conundrum

The retail industry has reached a point of no return where long-held certainties and beliefs vanish into thin air. Adaptation to these quickly changing consumer behaviours is difficult given the lack of hindsight, but solving this conundrum has become paramount for retailers in order to attract and retain customers.

Despite the sensational headlines about store bankruptcies and closures, predominantly occurring in the US, consumers still put on shoes to go shopping. However, since the act of buying has become as simple as a click, buying is no longer the first motivation to go shopping; it has to be fun or convenient, if not both. Hence, the traditional brick and mortar store is a powerful asset when it comes to creating a shopping experience.

For retailers, floor-space has become a gateway to "show-room" their products and their brand philosophy to customers, to get to know their clientele better. It is also, a competitive advantage compared to pure eretailers as "Click & Collect" and "Return to Shop" services have proven to trigger a rise in the average customer basket.

Yet, footfall does not always directly translate into in-store sales. According to Ipsos, 70% of shoppers prefer to buy online with retailers that have a "brick and mortar" presence. Hence, the main problem for retailers is that traditional retail metrics paint an unflattering picture of their store performance, which in turn, brings the property cost into question.

The structural decline of in-store sales requires a rationalisation process which focuses on locations with strong existing footfall or with potential for growing footfall. Based on retail sales and total sales area per capita, we have identified the countries that are likely to be most exposed to an excess of retail space (graph 1).

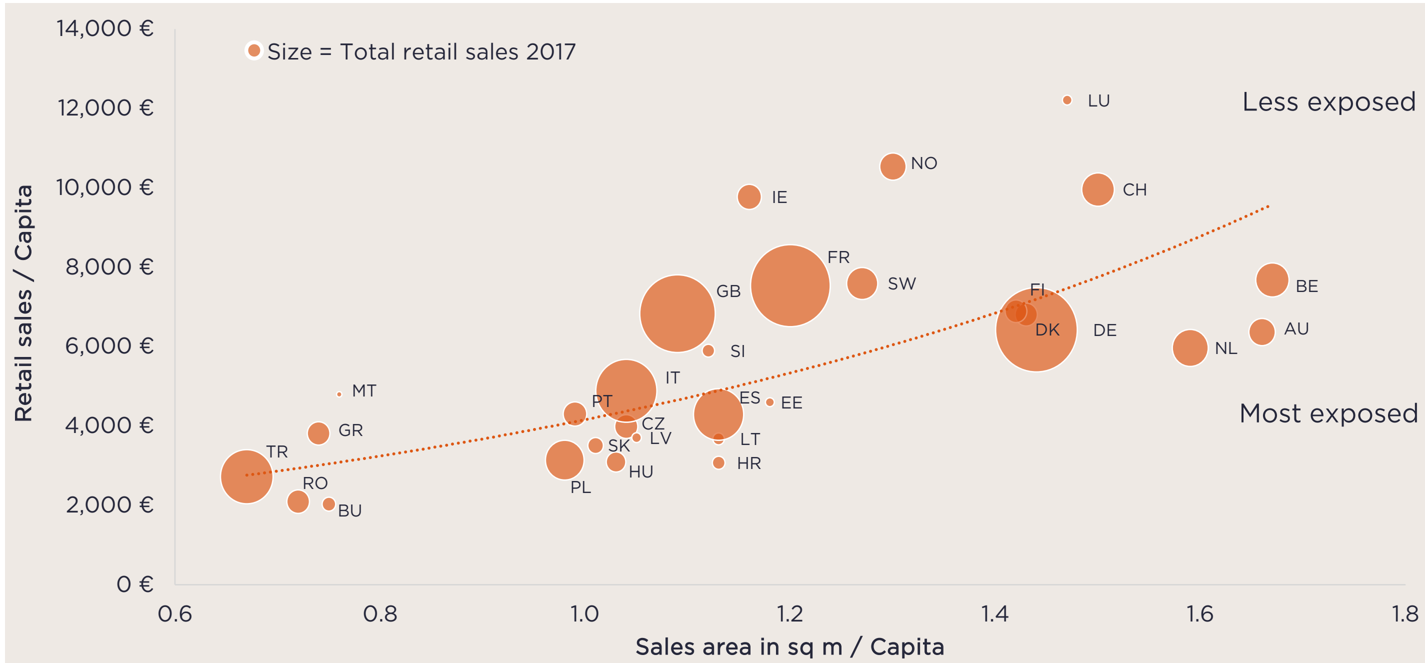
70%

Of shoppers prefer to buy online with retailers that have a "brick and mortar" presence.

1.16 sq m

Average retail sale area per capita in Europe.

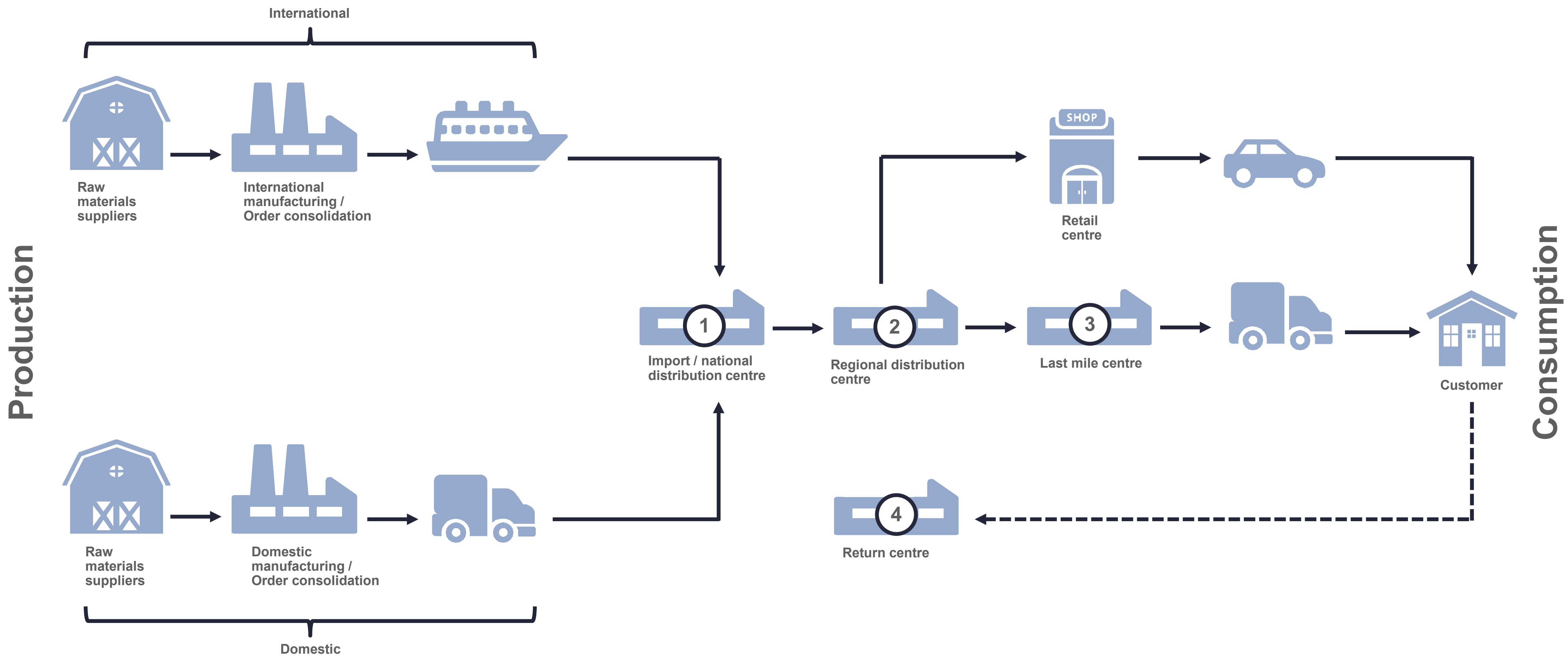
Graph 1: Potential excess of retail floor space



Source Savills Research based on Oxford Economics and Gfk retail

> "Omnichannel supply chain is the backbone of the new retail era."

Ecommerce creates new requirements at consumption-end



Graph 2: Role of the brick and mortar store in the supply chain

Source eft Supply Chain & Logitics Business Inteligence - 2017 survey ; 218 retailers' respondents worldwide

15%-20%
of goods purchased online are returned.

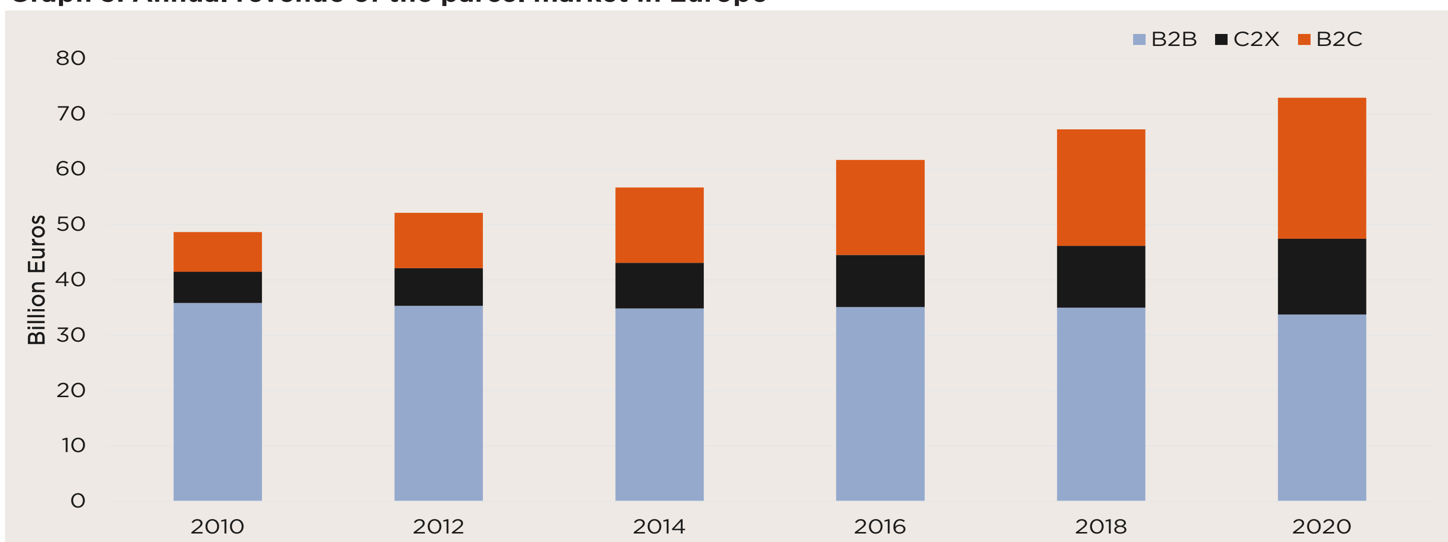
NEW DISTRIBUTION NETWORK

Generally, retailers have a regional distribution centre in the vicinity of their consumer's base but the booming demand for ecommerce puts pressure on their delivery strategies. In order to compete with pure online players, retailers have had to leverage their distribution centre, together with their stores, to adopt omnichannel rather than multichannel strategies.

The standardisation of same-day delivery also raises the stakes for retailers. In order to shorten delivery routes and provide quick delivery services to online customers, they have to include smaller urban warehouses in their supply chain network or partner with third-party or fourth-party logistics providers (3PL or 4PL).

This last chain at the consumer-end of the logistics service has considerably boosted the Courier, Express and Parcel (CEP) industry. According to Apex Insight, the annual revenue of the CEP market in Europe reached €61.7bn in 2016, reflecting an annual increase of 4.5% since 2010. During the same time, the B2C parcel market increased by 23% pa on average (graph 3).

Graph 3: Annual revenue of the parcel market in Europe



Source Apex Insight

ECOMMERCE SALES IN FIGURES

18% Ecommerce sales grew by 18% in 2017 on average across Europe.

58% of all European ecommerce sales are generated in the UK, Germany and France.

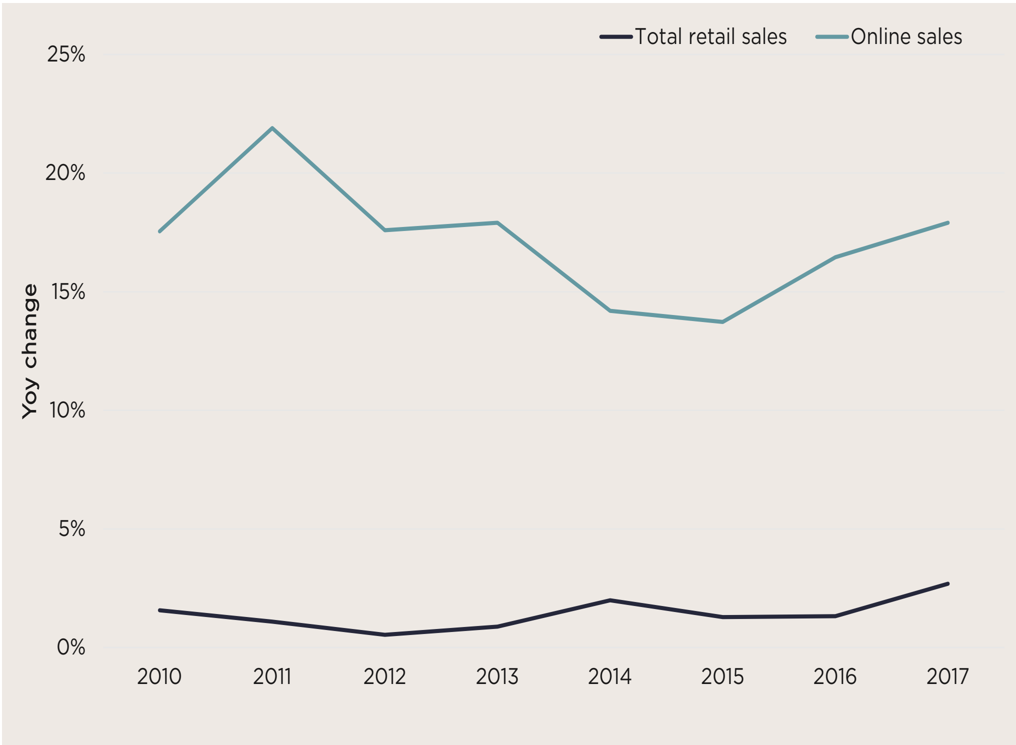
Online sales grew by **30%** pa on average in CEE countries over the past five years.

Largest spread between internet and ecommerce penetration rates in Romania, Cyprus and Bulgaria.

Ecommerce penetration **≥ 80%** in Denmark, Luxembourg, Sweden and the UK.

€1,733 is the average spent per eshopper in Europe.

Graph 4: Total vs online sales growth



Source Oxford Economics and Statista

Ecommerce: the goose that lays the golden egg?

Ecommerce is growing at a faster pace than overall retail sales, hence becoming a major driver in the retail sector. Over the past five years, the overall online retail sales increased by 21% pa on average across Europe. In the same time, the total retail sales increased by 2.5% pa on average (graph 4).

The large majority of the ecommerce sales (58%) is generated in core countries: the UK, Germany and France, partially as a result of the rapid adoption of internet usage but also due to the intrinsic quantum of the retail market of these three countries.

However, ecommerce is gradually spreading across Europe, picking up momentum in Central and Eastern Europe, with above 30% pa growth over the past five years. Ireland, Italy and Spain have also witnessed a 10-12% growth of online sales over the 12 months, according to Statista.

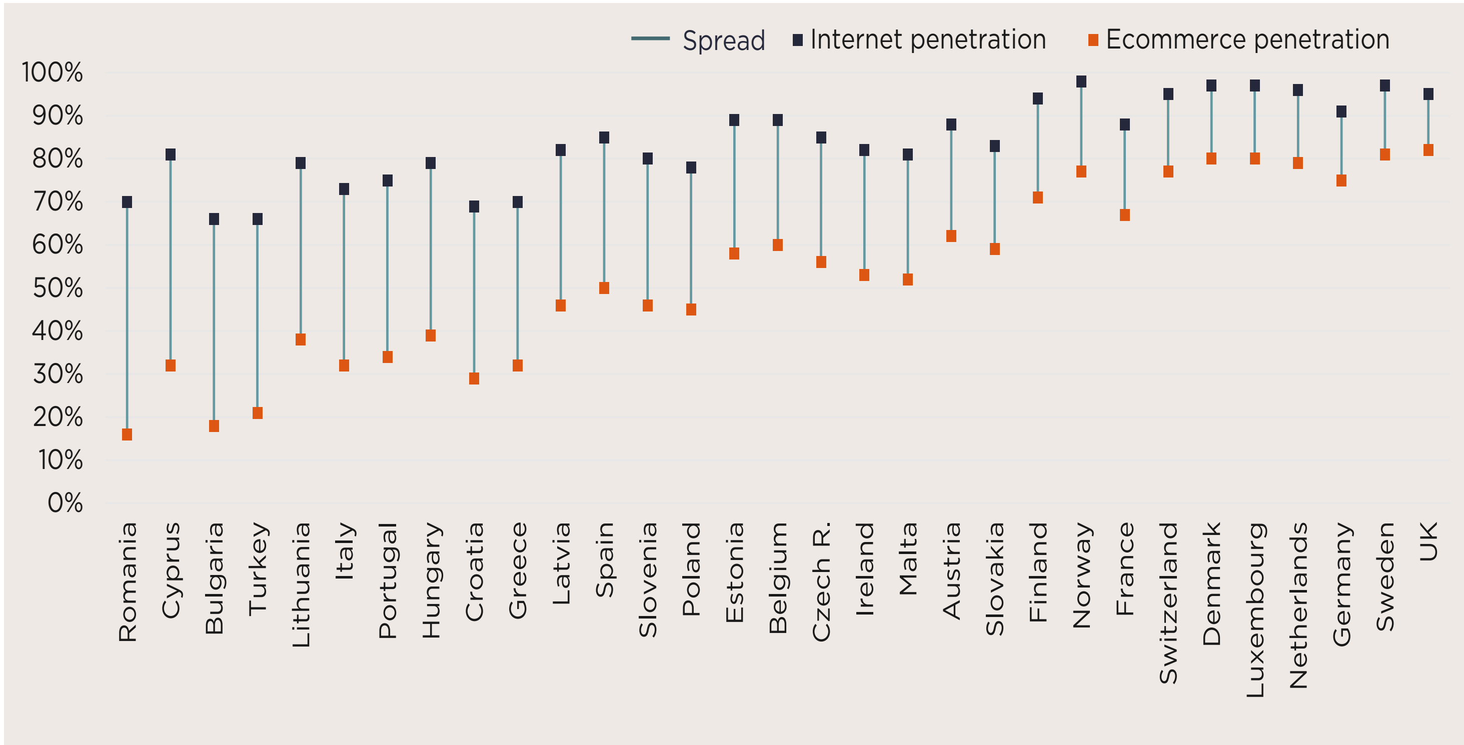
The spread between internet usage and the ecommerce penetration rate gives us a clear view on where there is a high potential for ecommerce growth (graph 5) and highlight three different levels of maturity in consumer habits between European countries (graph 6).

On average, ecommerce sales represent 7.5% of the total retail sales, with large discrepancies between countries, with the UK clearly leading the way.

7.5% Is the average share of ecommerce across Europe.

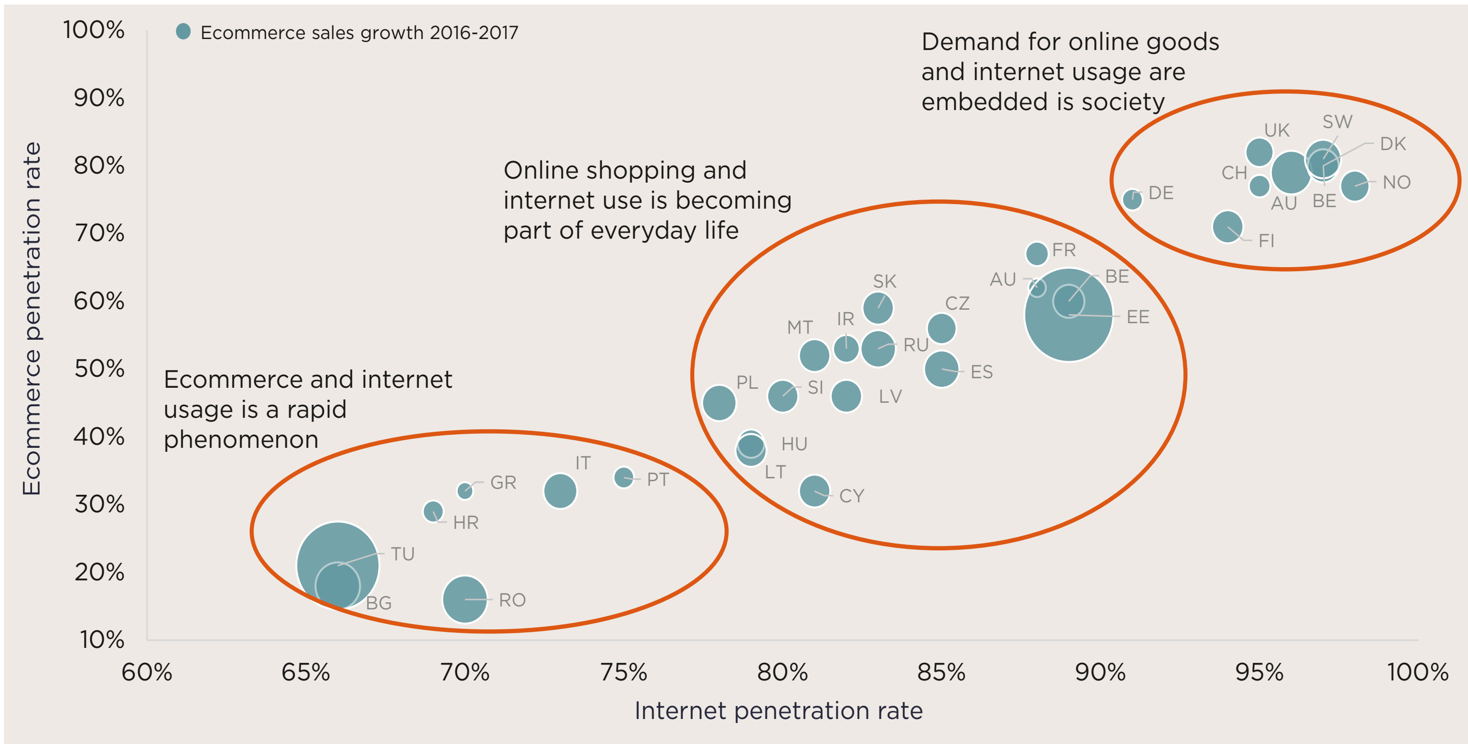
“Consumer online habits are at contrasting levels of maturity.”

Graph 5: Internet and ecommerce usage



Source Savills Research based on Eurostat

Graph 6: Ecommerce's level of maturity across Europe



Source Savills Research based on Eurostat and Statista

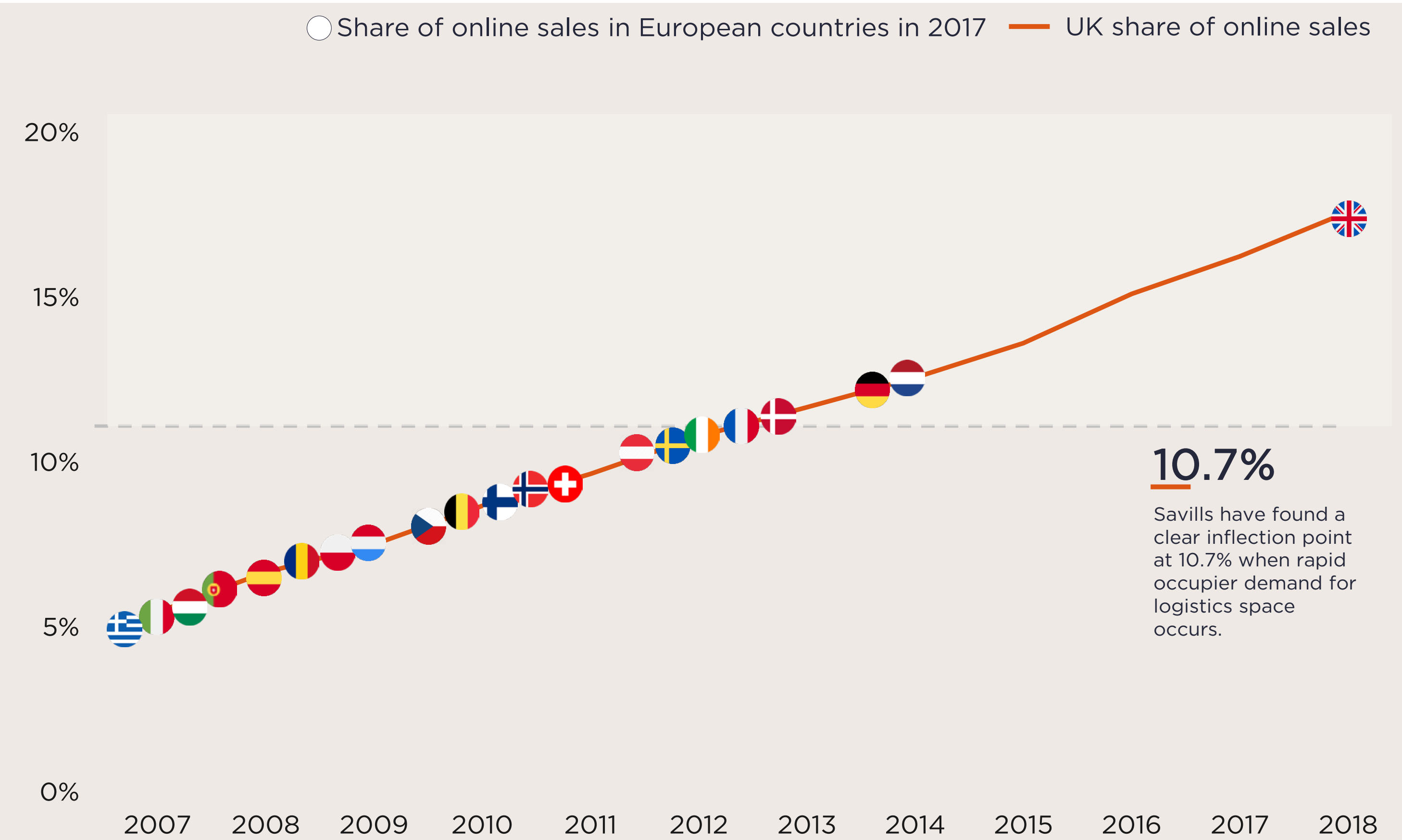
Ecommerce and logistics tipping point

As retailers scramble to adapt their supply chains, the logistics market is progressively seizing the opportunity opened up by the rapid rise of ecommerce.

In the UK, the logistics market has undergone significant positive change since 2012, when B2C online retail sales reached approximately 11% of the total retail sales. Vacancy rates have fallen to lows of 5%, whilst prime quoting rents have risen by as much as 95% in certain markets with land prices also soaring. Additionally, retailers, parcel firms and logistics companies accounted for 64% of take-up in 2018, highlighting the scale of the impact ecommerce has had on the logistics market.

The UK which has always been ahead in the property cycle and in terms of market maturity acts as a very useful case study for investors looking for potential opportunities on the European continent. Of course, one size does not fit all, but by looking at the different European logistics markets and where they are compared with the UK in circa 2012, it should help to forecast how this rapid shift in demand might be replicated (graph 7).

Graph 7: Where European countries sit compared to the UK?



Source Savills Research based on ONS, Statista and Forrester

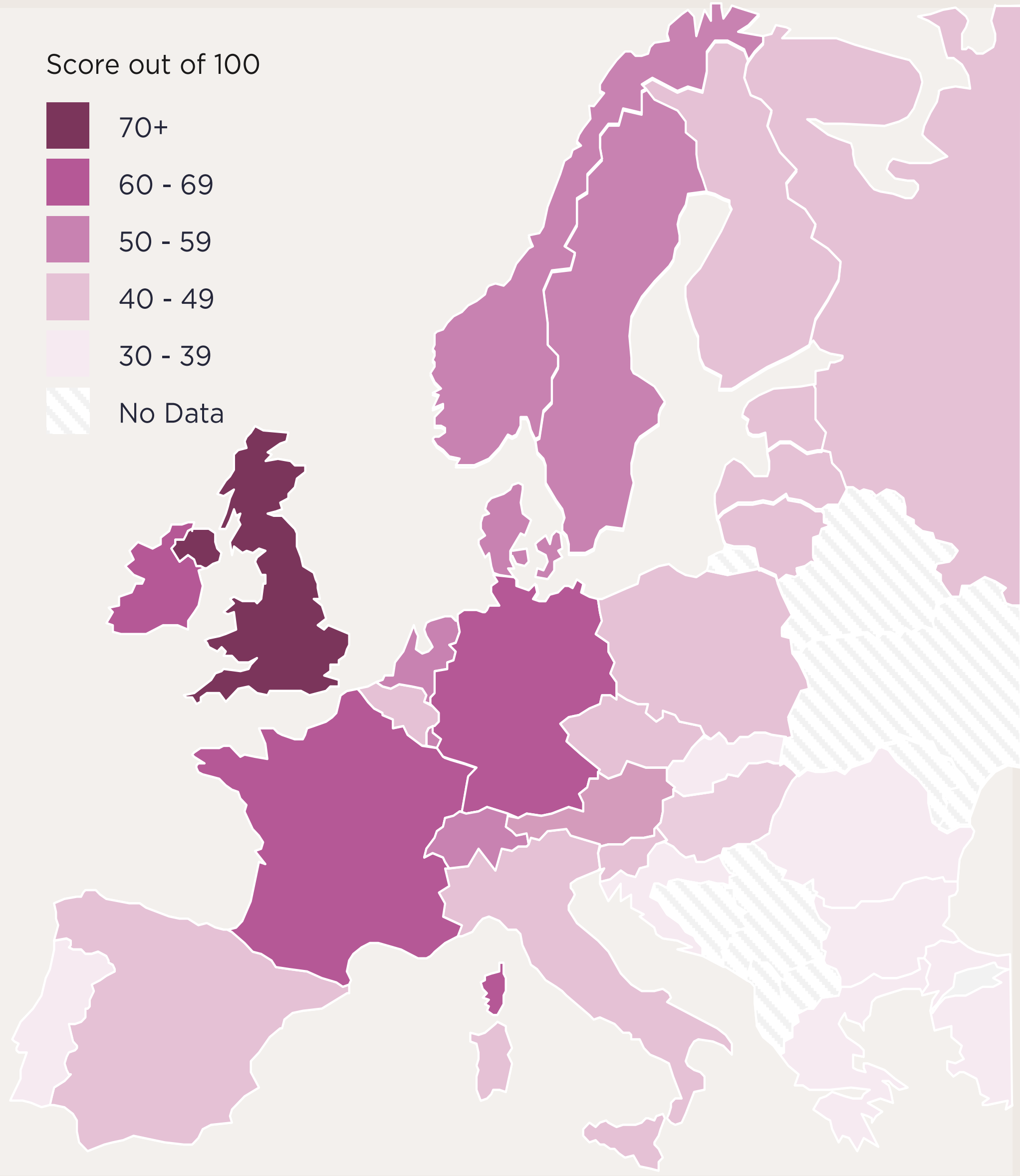
European Omnichannel

Logistics Market Attractivness

Matrix results and methodology

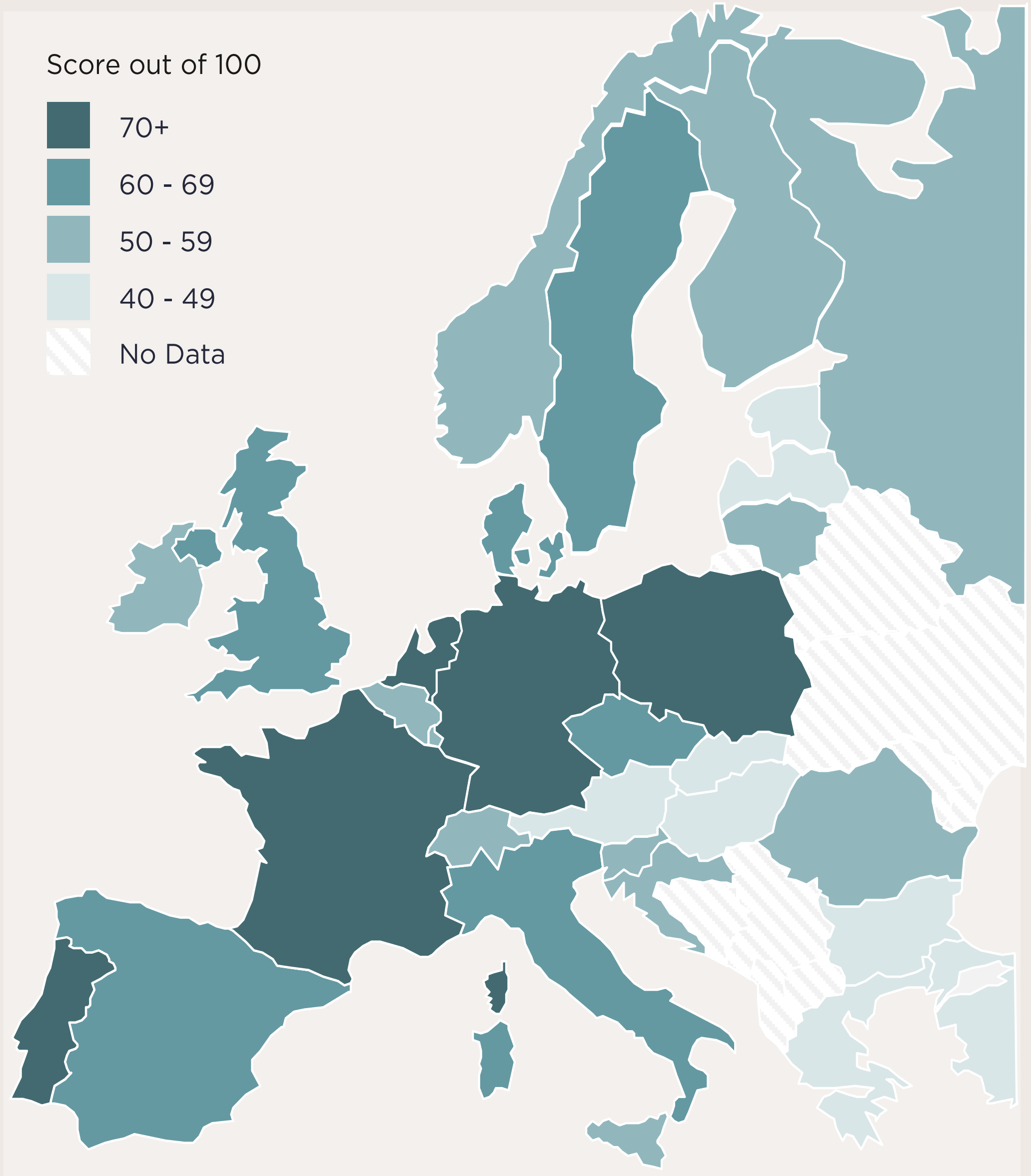
To establish where in Europe the ecommerce revolution is likely to have the biggest shift in logistics, Savills formed a Logistics Market Attractiveness Index. The index measures 32 European countries against 23 metrics, which assess the strengths of ecommerce and identifies the best opportunities for expanding logistics activities.

Ecommerce fundamentals

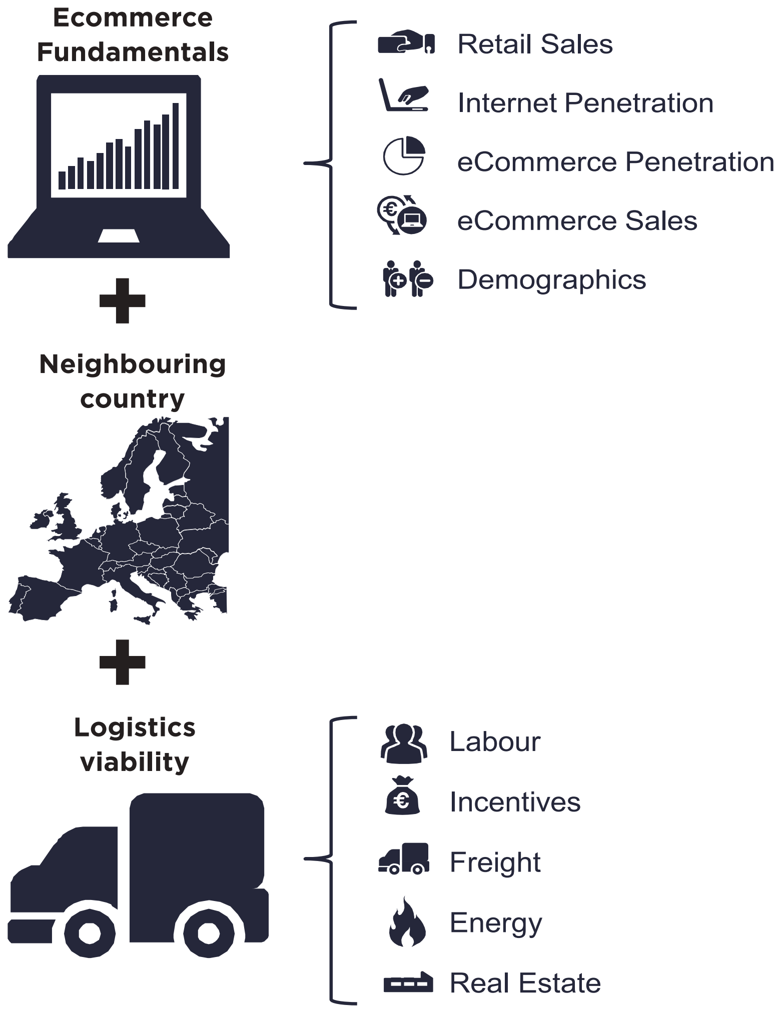


Source Savills Research

Logistics viability



Source Savills Research



METHODOLOGY

This research covers 32 European countries including Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the UK.

The analysis used to develop the Logistics Attractiveness index draws on 23 different indicators gathered into two matrices: Ecommerce fundamentals and Logistics viability. We also added a Neighbouring countries element in our final ranking, with each country impacted by the score of its neighbouring countries , to reflect the importance of cross border online sales.

The data used for the index was collected at a national level. Where possible these indicators use the latest annual data available and five-year forecasts, to ensure the index incorporates a forward-looking view.

The various indicators have been ranked and weighted across the 32 countries included in this report allowing us to develop the index. The results of the index does not determine the exclusive attractiveness of a given country to prospective logistics market players, it purely provides a macro guide for retailers and logistics market players to incorporate as part of their specific omnichannel strategy.

European Omnichannel

Logistics Market Attractivness

Final ranking and top five countries

The final results show that Germany, France, the UK, the Netherlands and Ireland top the index, all combining strong ecommerce fundamentals, solid logistics viability and high-scoring neighbouring countries.

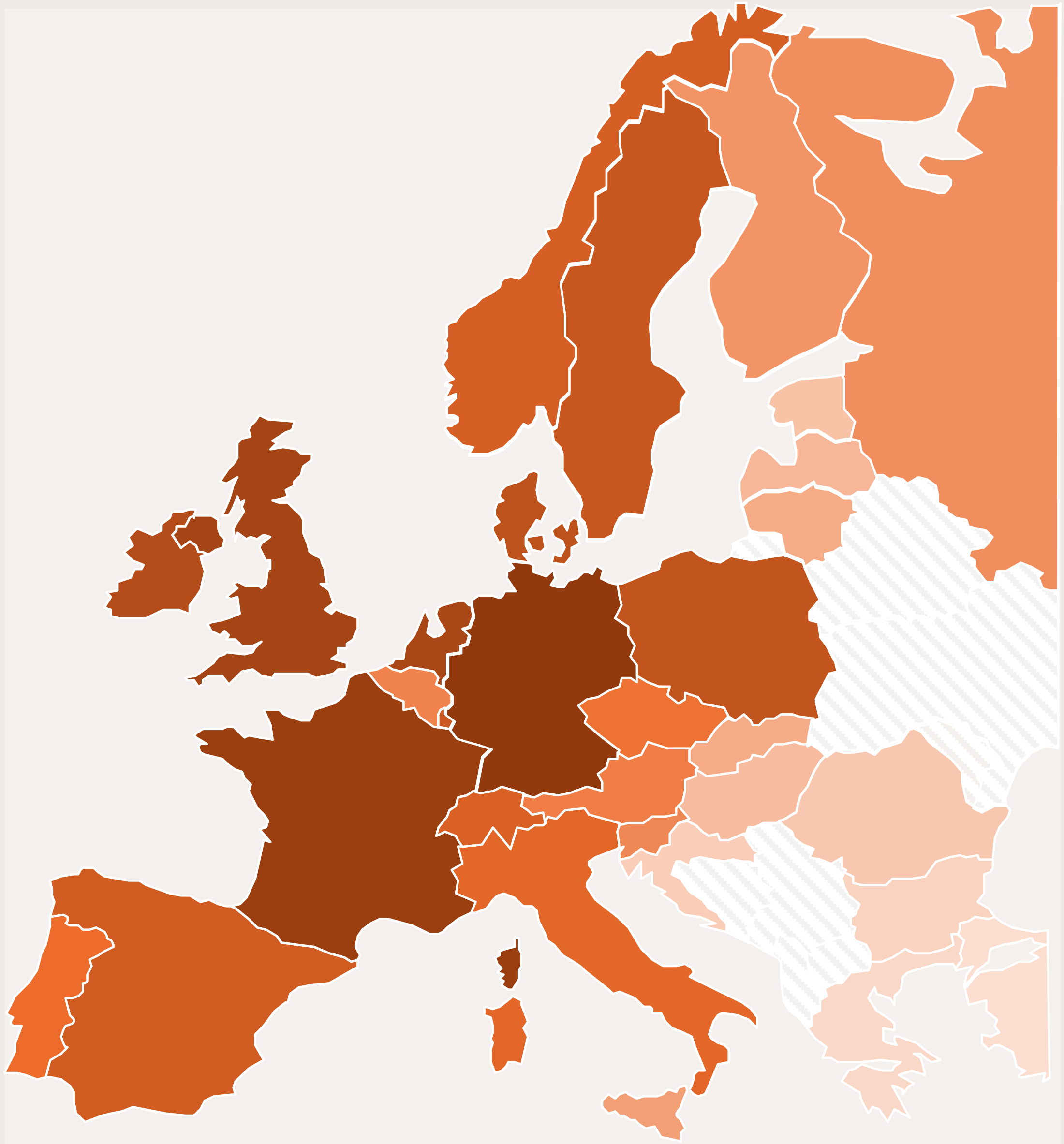
1 Unsurprisingly **Germany** is leading the table. This is notably due to the customers' fast adoption of ecommerce habits but also due to the scale of the retail industry and its proximity to large customer hubs in Poland, Czech Republic and Austria, and smaller ones in Switzerland and Luxembourg, where the share of cross border ecommerce is high. The central positioning of Germany, between the western and eastern flanks of Europe, is strategic for the logistics market. Extensive and quality infrastructure enable the country to generate some of the highest levels of both road and seaborne freight across Europe. The LPI score is the highest of all European countries benchmarked in this report. Strong investor interest for the logistics sector has pushed prime yields downward, by 300 basis points in Berlin over the past five years. Prime logistics yields range between 4.1 and 4.4% depending on locations, the lowest yield across Europe after the UK.

2 **France** still has a strong growth potential for its ecommerce market. The spread between internet and ecommerce penetration remains relatively wide compared to that of the UK, Germany and the Netherlands, whilst its retail market is large with most notably a high level of retail sales per capita. According to Statista, online retail sales are forecast to grow by 9.8% per annum over a 5-year horizon. Both the levels of road and seaborne freight transport are amongst the highest in Europe, thanks to very good infrastructure. However, labour costs are amongst the highest in Europe. Investors interest for the sector is expanding hence prime yields are compressing (-275 basis point compared to five years ago). In the Île-de-France region, the prime logistics yield is currently at 4.75%.

3 The **UK** comes third, benefiting from having the most mature ecommerce market. The spread between the internet and ecommerce penetration rates is the lowest across Europe, meaning that high internet usage has fully translated to online purchases. Hence, the potential for further growth is now slowing down. According to Statista, ecommerce is expected to increase by 6.7% pa over the next five years, the lowest level anticipated in Western Europe. The rapid expansion of online sales has already translated into growing demand from logistics market players. Additionally, the UK is a strategic destination when it comes to labour costs having one of the lowest average wages in Western European after Portugal and Spain. The prime logistics yield in the London area is currently at 4%, the lowest in Europe and has come in by 175 basis points over the past five years.

4 The **Netherlands** is ranked fourth. Internet penetration is amongst the top five of the 32 countries benchmarked in the report and the limited spread with ecommerce penetration reveals the maturity of the market. Additionally, online sales are still expected to grow by 9.2% pa until 2022 according to Statista. Besides, the country has a close and long relationship with the freight and logistics industry, notably thanks to its major container port in Rotterdam which provides a gateway in Europe. The LPI score (4.02) is amongst the top five of the benchmarked countries. Since the logistics sector contributes to only 4.3% of the total employment in the Netherlands, compared to 5.6% on average in Europe, the main drag on the industry is the availability of workforce which is very limited. The amount of logistics investment is rising and the prime yield, currently standing at 5% in Amsterdam, moved in by 250 basis points over the course of the past five years.

5 Compared to the previous four countries, ecommerce in **Ireland** is not as mature but solid fundamentals are paving the way for strong future growth. The internet penetration rate (82%) is slightly below the European average (83%) and the gap with the ecommerce penetration rate is relatively wide. However, the scale of the retail market is large. The volume of retail sales per capita ranks fourth amongst the 32 benchmarked countries. According to Oxford Economics, total retail sales are expected to increase by 4.3% pa on average in the next five years, the second-best performance in all European countries after Poland (4.8%). At the same time, online retail sales are predicted to have a compound growth rate of 17.3%, according to Statista, the best performing of all 32 countries. On the logistics side, Ireland benefits from a relatively large pool of available and skilled workforce. Investors' appetite for logistics in Ireland is rising fast hence the prime yield in Dublin moved in by 300 basis points over the past five years. It currently stands at 5%, the same as in Amsterdam.



FINAL RANKING

Germany	70.2
France	68.3
United Kingdom	68.1
Netherlands	63.1
Ireland	62.6
Denmark	62.0
Poland	61.6
Sweden	60.6
Luxembourg	59.0
Spain	57.7
Norway	57.5
Switzerland	57.2
Italy	55.6
Portugal	54.3
Czech Republic	53.7
Austria	53.5
Belgium	53.1
Slovenia	51.0
Russia	51.0
Finland	50.6
Malta	48.7
Cyprus	48.3
Slovakia	46.8
Lithuania	46.4
Latvia	45.0
Hungary	44.7
Estonia	44.2
Romania	42.7
Croatia	42.4
Bulgaria	38.4
Greece	38.1
Turkey	36.2

Conclusion & Outlook

The US-China trade war, the resurgence of financial turbulence in Italy, the "gilet jaune" protests in France and the uncertainties surrounding the outcome of Brexit all undoubtedly have had a negative impact on consumer psychology. However, retail sales which grew by 2.2% last year are still expected to rise by 2.1% per annum until 2020, backed by the improving labour market, increasing wages across Europe and low inflation environment.

At the same time, ecommerce is forecasted to increase by 8.5% and 9.5% this year and the next, as the convenience of the digital world is rapidly influencing consumer habits. The ecommerce impulse will continue to have a positive knock-on effect on the logistics and CEP industries, which in turn will inevitably result in growing occupier demand.

Over the past two years, the total volume of logistics investment in the 32 countries covered in this report, increased by approximately 12% annually. We expect this trend to continue throughout 2019 as the strong performance and bright outlook of the sector are a magnet for investors, especially those seeking to step away from strong "office exposure".

Prime logistics yields will keep hardening in most European countries, except in Norway where they are expected to soften and in the UK, Germany, France, Netherlands and Italy where they are expected to remain stable. The sector will remain competitive compared to other asset classes. In fact, logistics is the only prime commercial asset offering yields above 5% in certain European countries.

According to Capital Economics, on average across the European countries, industrial total returns outperformed all properties by 297 bps last year. This outperformance is expected to reach 331bps in 2019 and 279bps in 2020.

Based on our index, we believe Germany, France, the UK, the Netherlands and Ireland provide an ideal combination of solid ecommerce fundamentals and logistics bases, triggering substantial opportunities in their respective market. But as internet usage and online purchases are rapidly spreading across all European countries, an important shift in logistics will follow in all large European consumer hubs and eventually into tier 2 and tier 3 cities when ecommerce will have reached maturity and Generation Z will lead the consumers world.

The future of logistics is quite bright but not all rosy. We have identified a number of issues that are likely to be a drag on the future performance of the sector.

1. Logistics costs are rising, notably land values. Land availability is shrinking and development activity is hardly meeting the demand and is pushing all prices up. Additionally, same day delivery, which is becoming the norm, requires logistics centres to be located close to shoppers. Industrial zoned-land, especially near cities, is hard to come by and commands a significant price premium.
2. The sector suffers from a shortage of qualified staff. Unemployment rates across Europe have fallen quite significantly over the course of the past few years. The modernisation of the logistics sector, notably going through automation, is also requiring new skilled labour.
3. The logistics sector is increasingly criticised for its negative environmental footprint. Recent protests around the globe suggest how imperative it is for the industry to take a step towards improving its green credentials..

Average	2018	2019	2020
Retail sales	2.7%	2.2%	1.6%
Share of online retail sales	8.3%	9.1%	9.9%
Logistics employment growth	0.8%	0.8%	0.3%
Total employment growth	1%	0.5%	0.4%
Logitics growth value added	2.6%	1.7%	1.9%
GDP growth	2%	1.4%	1.8%
Logistics rental growth	2.6%	1.5%	0.8%
Logistics total return outperformance (bps)	297	331	279

Source Oxford Economics, Forrester, Capital Economics

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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