European Commercial – November 2019

European Retail Investment

CONSUMER CONFIDENCE BROADLY STABLE

In spite of the slowing down European economy, consumer confidence has remained on a broadly flat trajectory since the beginning of the year off the back of strong labour markets and low interest rates. In September 2019, the Consumer Confidence Indicator (CCI) increased to -6.40 from -7.00 the previous month and still well above the long term average of -10.00. Retail sales are expected to rise by 2.1% this year and 1.9% the following two years on average across Europe. At the same time, European online sales are forecast to expand by 11.5% per annum through to 2023.

RETAIL INVESTMENT ACTIVITY DECREASING

Whilst the retail market is adapting and reshaping itself to meet new consumers' demand, investors are still restraining their exposure to the sector. European retail investment activity has been slowing down since its last peak in 2015. During the first three quarters of the year, activity was down 19% yoy at over €24.5bn. The biggest drops were recorded in Spain (-59%), Poland (-58%) and Portugal (-57%) on the back of particularly strong retail investment activity last year, whilst at the other end of the spectrum, France (+13%), Ireland (+13%) and Romania (+7%) performed relatively well. Overall the largest markets in terms of total transaction volumes remained Germany (38%), the UK (16%) and France (10%), which capture about two-thirds of the activity. Italy and the Netherlands follow with about 6% and 7% share respectively.

Decreasing investment activity was widespread across all types of retail formats although still more pronounced for shopping centres. Hence, the breakdown per retail type is slowly getting to an even spread between high street (27%), retail park (25%) and shopping centre (34%). This is somehow demonstrating that retail defensiveness is less dependent on the property format than on the right combination of location, size, mix and design to stimulate consumer experience.

The retail investment market was underpinned by repricing and redevelopment opportunities, attracting both retail-specialist and non-retail specialist investors, including notably REIT, equity funds and investment managers. In line with the past five years, nearly half of the capital invested in the sector was cross border, mainly coming from the US (30%) followed by Austria, France, UK and Germany.

LARGE PORTFOLIO AND SALE AND LEASE BACK DEALS STILL ON THE RISE

This year again, the total retail volume was boosted by large portfolio transactions. Some 128 portfolio deals were closed during the first three quarters of the year accounting for 39% of the total retail turnover, up from 114 during the same period last year (35%). The majority of these deals took place in Germany followed by France, Sweden, UK and Netherlands. Consolidation and rationalisation motivations are behind the drivers of some of these larger transactions.

Whilst the overall European retail investment activity is slowing down, the number of retail sales and leaseback (SLB) transactions is growing, showing some distressed sales signals. Approximately €2.2bn of retail properties were sold and leased back over the course of the past 12 months, according to Real Capital Analytics. During Q1 and Q3 2019, retail SLB accounted for 11.1% of the total retail investment volume, a record high since 2007 (11.3%).

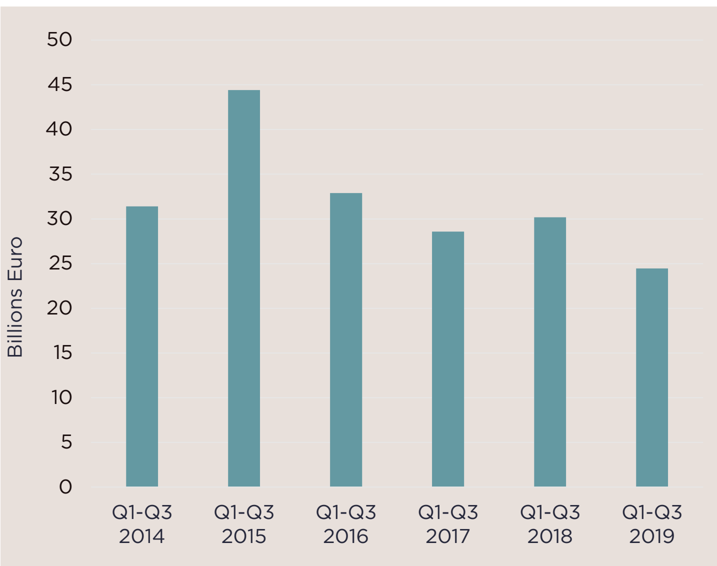
During the first three quarters of the year, retail SLB amounted to approximately €1.7bn, equivalent to the amount recorded for the full year last year and 30% above the average of the past 10 Q1-Q3s. Based on pending transactions and an increasing number of negotiations around the subject, we can expect more of this type of deal during the remainder of the year and beyond. More than half of the retail SLB was concentrated in the UK (39%), and France (34%). Spain (13%) and Poland (8%) also accounted for a fifth of the total retail

39%
Share of shopping centres

26%
Share of high street

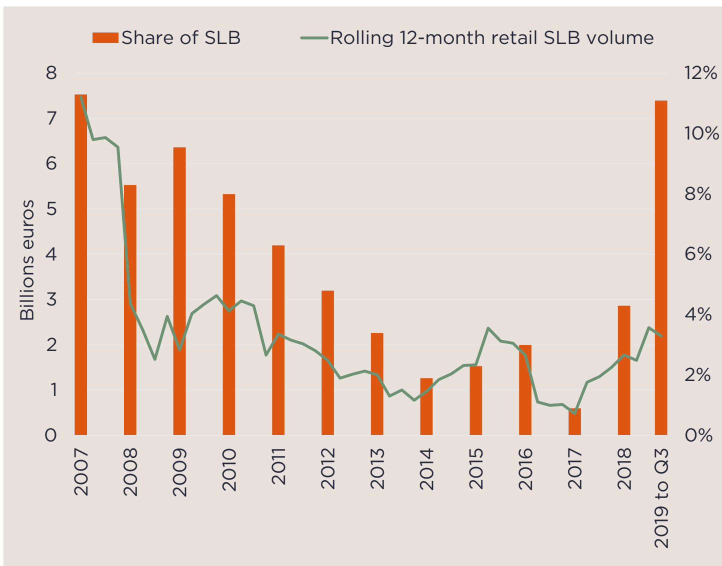
21%
Share of retail warehouses and retail parks

Retail investment volume



Source Savills Research

Share of retail sale and lease back



Source Savills Research/RCA

SLB volume recorded since the beginning of the year.

SLB activity was mainly driven by supermarket retailers. The fierce battle on food price to maintain market shares against the growing mass market grocery retailers has substantially squeezed profit margins in the sector. Examples of supermarket retailers employing this strategy include mega-deals such as the sale and leaseback of the Sainsbury's supermarket portfolio in the UK by Realty Income for over € 0.5bn, the sale and leaseback of the Casino supermarket portfolio in France to Fortress Investment Group (€392m), the purchase of the Netto portfolio of 14 properties in Germany bought by x+bricks AG from Edeka (price undisclosed) and finally the Metro portfolio of 11 properties located in Poland, Czech Republic and Hungary bought by FLE Gmbh from Metro group for c. €249m.

In the face of the rising tide of e-commerce, sale and leaseback is seen as a financial strategy to take capital out of real estate assets and put it back in the core retail business. From an investor's perspective, it is an alternative opportunity to source property and to invest large amounts of capital, which in return, will provide long income streams especially as the lease terms generally agreed are long. However, investors have to be choosy and focus on retail assets which are dominant in their catchment and tenants with strong covenants.

RETAIL YIELDS CONVERGING

So far in 2019, the average gross initial yield achieved is 25bps higher compared to last year at 6.47% a reflection of both the softening trend in retail yields as well as the rising number of value-add type of transactions.

Prime shopping centre and prime retail warehouse yields are converging slightly below 5%. The average prime shopping centre (4.74%) moved out by 17bps annually with strong adjustment recorded in London, Paris and Madrid (50bps), whilst in Warsaw and Lisbon the prime yield moved in by 25bps yoy. In the same time, the average prime retail warehouse yield (4.83%) hardened by 10bps yoy notably due to downward price correction in London (75bps), Paris (50bps) and Madrid (25bps), whilst the format remained particularly resilient in Dublin (-50bps) and in the top six German cities (from -20bps to -40bps).

Over the past twelve months, the average prime high street yield (3.48%) remained stable with still inward movements recorded in Lisbon (-50bps) and in the major German cities (from -10bps to -30 bps).

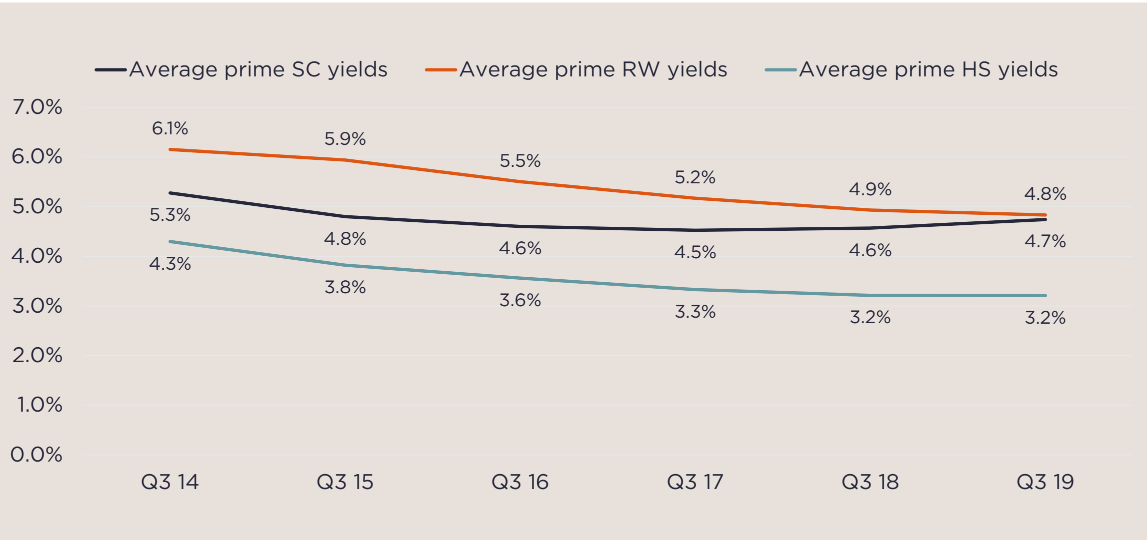
OUTLOOK – REPRICING, REPOSITIONING AND REPURPOSING

Overall repricing, repositioning and repurposing will be the leitmotiv of retail investment activity in the next 12 months.

Further prime yield softening is expected in the sector notably in the UK, France, Norway, Sweden, Spain and Portugal, whilst it should remain stable in Germany, Netherlands, Italy and Poland. Romania will be the only exception where further inward movement is anticipated in the coming year. Repricing will bring more opportunities to the fore, including a growing number of portfolios. It may notably convince some retailers to sell their properties in anticipation of continuing downward price correction. Hence, we expect the number of SLB deals to keep increasing.

As the role of physical retailing is rapidly evolving, bringing in its wake new concepts requiring adjustment and adaptation, where yields have repriced, there are growing upside opportunities for value add investors to look into repositioning options of prime existing schemes. The rise of e-commerce will inevitably lead to more rationalisation movements. Some existing secondary retail formats may be repurposed to service the rising property needs of e-commerce to provide local fulfilment centres, click and collect points or urban warehouses for last-mile delivery.

Prime retail yields



Source Savills Research

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