

European Retail: Investors' favourite facing a transformation

Stationary retail was indisputably one of the defining factors of the consumer society of the 20th century. European city centres became shopping high streets and shopping malls embodied the spatial manifestation of a consumer-based economy. Due to stable growth as well as opportunities to achieve high prime rents and yields, including diversification effects in a multi-asset-portfolio, retail was a traditionally attractive target for investors, up until now.

Nevertheless, it can be determined that retail has undergone a deep, structural transformation in the past years. In times of changing and volatile shopping preferences/ consumer demands because of ongoing digitalization, the concept of stationary retail seems to be undergoing a large structural change.

Not only inner-city retail, with its pedestrian areas and high-street premium locations, but also large retail facilities as in Shopping Centres, the “cathedrals of consumption”, are being put under pressure to increase their appeal for consumers. These shifts drive investors of established properties to counteract by expanding spaces for food services and leisure concepts on the one hand and by establishing attractive global brands in the fashion segment on the other.

Catella Research sees this structural transformation not so much as a fundamental shift of retail locations in Europe or even the short-term demise of classic concepts, but more as a necessary adaptation of stationary retail to the transformed spatial and temporal consumer preferences – the transformation drives them towards innovative thinking.

Changing consumer preferences

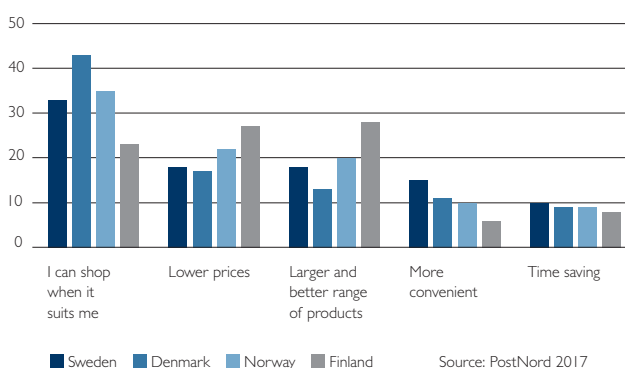
Retailers are feeling the effects of their customer's new demands towards shopping. Especially young, urban people are increasingly demanding individuality, ideally as fast as possible, instead of mass products which can be found everywhere.

The focus of consumer behaviour is also shifting: a pan-European trend can be noticed of consumption being more focused on experiences than on long-term material objects. It almost seems as if a fancy dinner or a ticket to an exclusive event can hold more social prestige than owning the latest smartphone.

At the same time, digitalization and e-commerce affect the business concepts of stationary retailers more than any other megatrend. Today, only a minor share of customers doesn't use the internet to purchase goods and services. For 2017, a pan-European turnover in e-commerce of approx. EUR 250 bn is forecasted, which accounts for approx. 10 % of the total European Retail turnover.

From a customer's perspective, the advantages are obvious: the goods are available anytime and are conveniently delivered to their front door. The range of products is wider and prices are often lower. Fig. 1 shows which aspects motivate customers to shop online, by example of the Nordic countries. The possibility to shop at any time is the main reason to use e-commerce, more than price or range of products.

FIG. 1: ADVANTAGES OF ONLINE SHOPPING IN %



Catella is a leading specialist in property investments, fund management and banking, with operations in 12 European countries. The group has sales of approximately EUR 2.1 billion and manages assets of approximately EUR 16 billion. Catella is listed on Nasdaq Stockholm in the Mid Cap segment. Read more at catella.com.

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Even from a retailer's perspective, online retail tends to be more lucrative than location-based retail. Cost factors such as employees, limited opening hours or rents affect stationary retailers much more than online-based retailers. Because of this, the scalability of an online shop is much easier than of an offline-shop, as with growing turnover the cost of stationary retail increases much more sharply than for online-based retail, where the costs remain relatively stable. The haptic experience of choosing and purchasing a product in-store, however, is left out of this seemingly rational explanation. This seems to be a crucial advantage with a large share of consumers, even if this share is continuously decreasing.

As the offline-counterpart to online retail, a large selection of products and services in one place, the (formerly) in-demand asset class of Shopping Centres seems to be affected by the market shift towards electronic retail. For this reason, Catella Research developed a scoring model in order to rate the performance of the European Shopping Centres. Some of the top-ranked countries will be subject of the following analysis.

TAB. 1: KEY INDICATORS FOR E-COMMERCE IN 2016

Country	Online shoppers (mn.)	Share of total population (%)	Average estimated expenditure per person/year (EUR)	E-commerce growth 2015 – 2016 (%)
Denmark	4.5	79	3,111	17.9
Netherlands	12.9	77	1,242	16.1
Finland	3.7	71	2,170	9.6
UK	43.4	67	3,625	10.6
Germany	51.6	64	1,157	13.3
Norway	3.2	63	2,467	1.7
Sweden	5.8	60	1,668	12.0
Switzerland	4.7	58	1,815	12.3
France	36	55	1,780	10.0
Austria	4.3	51	1,759	14.3
Ireland	1.9	41	3,143	15.2

Source: Catella Research

Tab. 1 summarizes key figures of the performance of e-commerce across Europe. Denmark, The Netherlands and Finland are the countries with the highest percentage of online-shoppers, while Denmark stands out with strong growth of the e-commerce sector as well as high expenditure in online shopping per person.

Market analysis

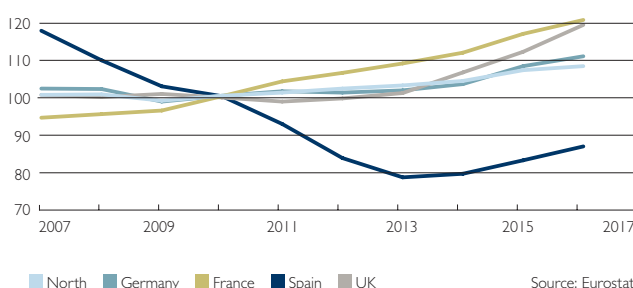
As the results of the Catella Shopping Centre Scoring Model (Tab. 2) show, the Nordics as well as UK and France lead the ranking. With a Shopping Centre density of approx. 900 sq. per 1,000 people, Norway provides the best coverage of Shopping Centres across Europe. All of the leading countries offer a high space productivity of over 6,000 EUR per sqm., which indicates that retail is very mature in those countries. The retail turnover index shows that most of the European retail market is flourishing and displays stable growth rates in the UK, Sweden and France (Fig. 2).

TAB. 2: SHOPPING CENTRE RANKING

SC-Score	Country
3.8	Sweden
3.6	Finland
3.6	Norway
3.6	Denmark
3.6	France
3.6	UK
3.3	Germany
3.3	Spain

Source: Catella Research

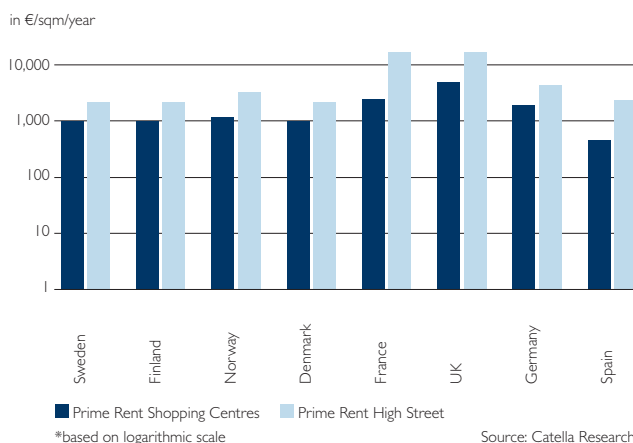
FIG. 2: RETAIL TURNOVER INDEX 2016 (2010 = 100)



In contrast to the growing retail turnover, the stock of Shopping Centres remained stable across Europe. Even for the future, forecasts predict only a slight growth for Shopping Centres. This can be explained with the markets being saturated in terms of Shopping Centre space per capita. This observation contradicts the statement "Shopping Centres are no longer timely", as no decrease of retail space can be seen.

By comparing the rent levels of Shopping Centres and High Streets, a gap can be seen (Fig. 3). These differences among all countries can be led back to the fact that shopping centre operators can offer better rental conditions due to their more efficient management and their overall lower risk. For this reason, Shopping Centres have an economic advantage compared to High Streets, so that it can be assumed that Shopping Centres are in a better position regarding future transformation.

FIG. 3: RENTS IN HIGH STREETS & SHOPPING CENTRES 2017*



Strategies for retailers to face the transformation

The market analysis shows that the performance of retail in general and Shopping Malls in particular is not as low as one could expect, although e-commerce and other structural shifts in the retail sector are threatening the business model of stationary retailers.

It becomes clear that stationary retail cannot compete with the advantages of web-based retail. Instead, retailers should focus on their own strengths. The great advantage of virtual traders may be the efficient distribution of products, but the advantages of physical traders lie in anything that goes beyond the pure product. Shopping can be much more than the satisfaction of a consumer's need. The ongoing urbanization reduces the amount of public spaces, which gives Shopping Centres the opportunity to become new social hubs. In this understanding malls can be places of interaction, leisure and entertainment. Shopping can mean having a coffee, meeting some people, eating together and eventually buying a product.

Especially Shopping Centre operators can react more quickly to changing consumption needs by integrating more leisure facilities and attractive food concepts into their property or portfolio. Following the guideline "food is the new fashion", "food stops" will be created that attract people and increase revenues. A wider range of restaurants can be offered in order to address customers who seek a more flamboyant dining experience. Shopping Centres have to implement more features in addition to their stores, as in food courts, cinemas, gyms, swimming centres etc.

Furthermore, digital technologies can be used to analyse customers' behaviour and to place target advertising, e.g. through social media. Likewise, a digital infrastructure can be used to enhance consumers convenience in the shops, e.g. by providing indoor-navigation or a digital overview over the supply.

Is retail an obsolescent target for investment?

When looking at cap rates and pricing in the European retail sector, an upward trend for retail property prices can be seen, while cap rates seem to decrease (Fig. 4). This can be seen as an indication for high demand for retail property, which causes increasing prices and decreasing cap rates. Furthermore, this general trend can be interpreted as that rents for retail facilities are undervalued in relation to the purchasing prices. Despite sales losses caused by e-commerce, retail property still seems to be in demand as an asset class.

By analysing the distribution of Shopping Centres by year of construction, it is striking that in the strongest Shopping Mall markets (Denmark, France, UK) the stock mainly consists of facilities built prior to 1980 (Fig. 5).

The markets in these countries are dominated by established facilities in lucrative locations. Furthermore, the Shopping Centres landscapes in general are quite mature, which, in the Nordics for instance, causes relatively low prime yields compared to other European countries in which Shopping Centre distribution is less developed and potential for new developments is higher. However, because the markets are more mature in countries with a high Shopping Centre

Score, the yields in retail are more stable and the risk of Shopping Centre investment in existing facilities is lower. The established stock in the top-ranked Shopping Centre markets can also be an opportunity for investors.

The "renovation jam" in the older facilities opens up the chance for asset management measures, which could generate the potential for higher rents by moderate capital investment. Because of this, investments in existing Shopping Centres could generate stable yields from a relatively low capital investment and moderate risk compared to new developments.

FIG. 4: SHOPPING CENTRES CAP RATES AND PRICING IN EUROPE

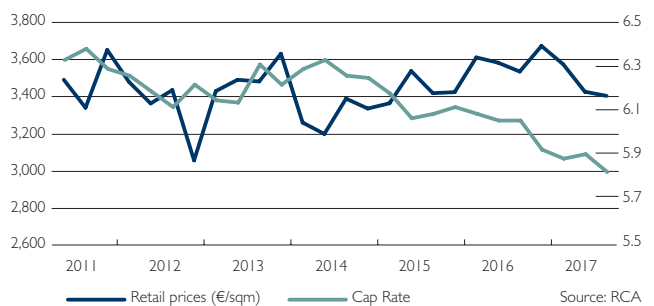
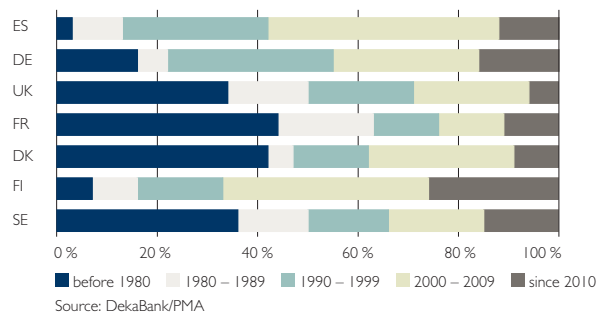


FIG. 5: SHOPPING CENTRES BY YEAR OF CONSTRUCTION



Conclusion

To summarize from an investor's perspective (especially with a value-add approach), investments in retail properties remain highly attractive, in respect of the opportunities and risks presented above. Independent of the structural shift in the retail sector, the established stock of Shopping Centres in the top-ranked countries in combination with the estimated undervaluation of rents, offers investors an opportunity to invest in retail and generate decent yields through moderate capital investment. The concept of a "market place", be it the centre of a European city or simulated in a Shopping Centre, will remain the leading shopping destination. Structural distortions stem from a lack of innovation and underestimation of the expected digitalisation on the consumers' side.

Market Situation in the European SC-Segment

FIG. 6: RESULTS OF THE EUROPEAN SC-SCORING 2017

SC-Score	Country	Share of retail expenditure in %	Space productivity in €/sqm	SC-density GLA/1,000 residents	Prime yield 2017 in % (net)	Transaction volumes 2017 in bn. €
3.8	Sweden	39.2	More than 6,000	460	4.10	3.72
3.6	Finland	34.4	5,000 – 5,500	424	4.10	1.36
3.6	Norway	29.7	More than 6,000	921	4.25	1.02
3.6	Denmark	34.7	5,500 – 6,000	275	4.00	0.66
3.6	France	35.9	5,500 – 6,000	268	4.00	3.74
3.6	UK	28.0	More than 6,000	276	4.25	10.64
3.5	Ireland	31.5	5,000 – 5,500	338	4.50	8.51
3.5	Netherland	32.0	3,500 – 4,000	373	5.25	1.62
3.4	Austria	30.3	3,500 – 4,000	334	4.25	0.42
3.3	Germany	27.7	3,000 – 3,500	180	4.10	13.19
3.3	Spain	32.0	3,500 – 4,000	242	4.25	5.36
2.8	Switzerland	25.4	More than 6,000	262	4.55	1.19
2.7	Belgium	37.5	4,000 – 4,500	120	4.00	0.81
2.7	Estonia	44.5	3,000 – 3,500	657	6.40	0.13
2.7	Italy	27.6	4,000 – 4,500	232	5.80	2.38
2.3	Portugal	35.2	4,000 – 4,500	310	5.60	0.51
2.2	Latvia	34.6	2,500 – 3,000	318	6.80	0.19
2.2	Poland	35.5	Less than 2,500	103	5.25	1.63
2.0	Lithuania	34.5	2,500 – 3,000	340	6.75	0.092

Explanation of Scoring Model

To analyze the situation of Shopping Malls in this time of retail transformation, a scoring model was developed to rank the different markets across Europe regarding the performance of their Shopping Center landscape. The scoring model was formed of four categories with several sub-categories which cover a range of shopping center development indicators:

- Availability of shopping centres
- Socio-economic variables
- Shopping centre investment market
- Quality & status

For each category a score between 1 and 5 was given with 1 being the lowest and 5 the highest score. The results of the scoring are depicted in Tab. 2. The pie charts in the map of Europe depict the consumer behavior of the respective population. The percentages refer to the share of retail consumption of the total consumption.

