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Food retail: a resilient investment income stream and strong buy for core/core+ investors

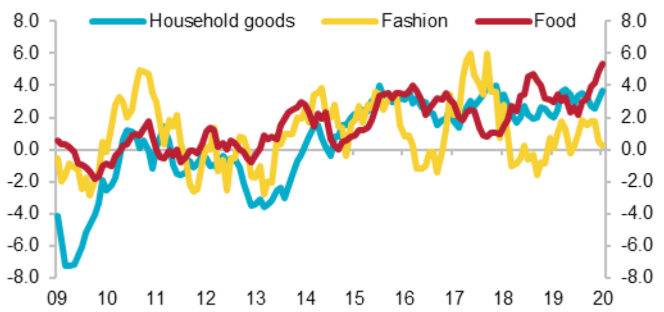
Summary and recommendations

- **Supermarkets and grocery stores are relatively immune to economic downswings.**
- **Consumers still prefer to buy food in store, making the segment less vulnerable to e-commerce disruption.**
- **Grocers offer long, inflation-linked leases, and investors can benefit from attractive supermarket valuations.**
- **Sale and leaseback transactions are an opportunity to source property that provides secure income streams.**
- **Throughout the COVID-19 lockdowns most grocery retailers have largely continued to pay rents to landlords.**
- **Since online shopping is increasing, though, investors should focus on grocers with the best in-store and online offer.**
- **Investors must consider local competition, planning regimes, construction site availability and tenant covenants.**
- **We like integrated, regionally dominant and food-anchored retail parks and neighbourhood schemes including convenience elements in larger cities across Europe.**
- **We recommend a minimum catchment area of about 80-100,000 inhabitants for retail parks, whereas solus supermarkets of 1,200-1,500 sq m require a minimum catchment area of about 5,000-10,000 inhabitants.**

Food retail: why it is resilient

- **Groceries are non-discretionary purchases. Even during recessions, people must drink and eat, and most consumers still prefer to buy food in store.**
- Food retail is more immune to economic downswings than other retail sectors, such as apparel, home goods and electronics (figure 1). Also, average annual sales growth is much higher in the food sector whereas volatility of growth is notably lower than in the other sectors (table 1).

Figure 1: Retail sales by sector (EU-28, % per annum, three-month rolling average)



Sources: Eurostat, Macrobond, Savills IM

Table 1: Retail sales growth by sector (EU-28, % per annum, three-month rolling average)

	Household goods	Fashion	Food
Average annual growth (%)	0.5	1.0	1.5
Volatility (as of Jan 2009)	2.8	2.1	1.6

Sources: Eurostat, Macrobond, Savills IM

- At the current time, investors are seeking asset-backed, secure income streams, which is why food retail on long, inflation-linked leases look attractive.
- Consumers are reluctant to cut spending on food. A US survey shows that 30% of shoppers would cut their entertainment budget (which includes dining out) in the case of job losses in a recession, and 11% would cut their clothing budget. But only 8% said they would modify their grocery spending, according to research by PYMNTS.com.
- Restrictive urban planning regimes in a variety of European countries are also worth considering since they help to limit competition for those retailers and investors.
- Planning regimes are typically stricter in Northern Europe, particularly the UK, Germany, France, the Netherlands and Belgium, according to Cushman & Wakefield and PMA. Only in Italy, Sweden, Spain and Portugal is planning less restrictive, which is why investors must be more cautious there.

The occupier perspective

- **Retailers are currently focusing on five strategies to survive increasing competition with online formats and the rest of the industry. Investors must consider these and focus on the most innovative formats:**

1. **streamlining store networks**

- Customers are largely moving away from big weekly grocery shopping trips towards more frequent trips to nearby supermarkets and convenience stores. Therefore, large-scale grocery retailers are reducing their overall space, winnowing down their in-store offerings of non-food goods, according to Business Insider.
- While large stores continue to generate the majority of group profits, even the grocery giants are reconfiguring their networks to meet demand for flexible, convenient shopping, Cushman & Wakefield reports.

2. **enhancing the customer experience**

- Loyalty programs are increasingly used to personalise the shopping experience and gather data about the customers.
- Several supermarket operators are adding subtenants and restaurants as well as experience and enjoyment areas to their concepts to increase dwell time of their customers.

3. **optimising in-store technology**

- Physical stores are increasingly introducing in-store technology to make it easier for customers to find items, retrieve product information and receive rewards and promotions.
- Automated check-out is slowly replacing human employees in many supermarkets and, thus, maintain lower costs.

4. **developing omnichannel strategies**

- Food retailers are expanding and embedding omnichannel strategies to compete against purely e-commerce retailers such as AmazonFresh and Picnic.
- Although more difficult for grocers to coordinate, flexible pick-up/delivery is increasingly important to customers, including click and collect as well as home or locker delivery.
- Innovations such as online pre-ordering also help make a shopping experience more expedient, Forbes reports. This is why physical stores may increasingly become a hybrid of traditional formats and micro-fulfilment centres.

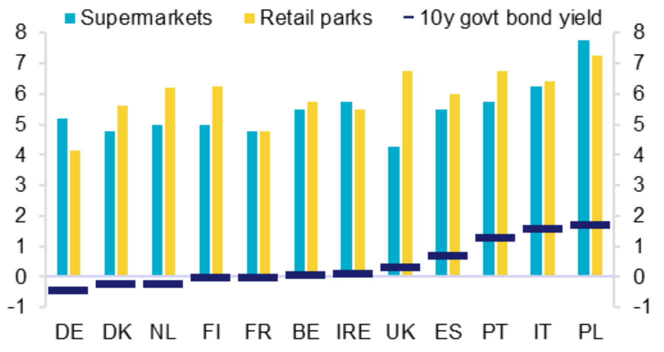
5. **upgrading or downgrading product ranges**

- Discounters have started upgrading their fit-out and product range by adding brand-name goods, whereas supermarkets are trying to target more price-sensitive customers by launching their own labels.
- Simultaneously, the healthy eating trend is driving growth of organic food retailers. Chain stores such as Biocoop, Whole Foods, Naturalia, La Vie Claire, denn's and allnatura are all expanding rapidly.

Grocery retail investment market

- **Supermarkets and food-anchored retail park valuations do not look overly stretched compared with other retail segments. They look particularly attractive compared to risk-free rates (figure 2).**
- While average prime property yields are still close to record lows, the average pan-European prime supermarket yield currently stands at 5.45%, CBRE reports. Thus, it is more than 500 basis points above unweighted average European 10-year government bond yields (figure 2).

Figure 2: Prime yield comparison (%)



Sources: CBRE, Macrobond, Savills IM

- In the UK, the resilience of grocery retail has also been reflected in the fact that operators have, by and large, continued to pay quarterly rents to landlords throughout the COVID-19 crisis, Savills reports. Therefore, we expect supermarkets will continue to be one of the standout subsectors of the retail investment market.
- The bigger European food retail chains by and large have good quality credit risks, which is why banks are probably willing to lend against their portfolio of assets.
- From an investor perspective, as long as the retailer offers a strong covenant, and retail units are in prime locations, sale and leaseback transactions offer the chance to source property and invest large amounts of capital that, in return, provides secure income streams, Savills Research reports.
- Depending on loan-to-value ratio and interest rates, investors should be able to achieve attractive yields, particularly since there is the opportunity to increase capital values by adding smaller units student housing, residents or the like on top of assets in densely populated cities. We think integrated facilities in growing urban locations close to customers seem to be best placed to outperform in this context.
- **In our view, food retail is a resilient investment income stream and strong buy for core/core+ investors.**

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