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Mapic 2012: In Western European retail markets, prime locations are facing aggressive expansion from retailers explains BNP Paribas Real Estate

In Western European retail markets, prime locations are facing aggressive expansion from retailers. But the current availability in those locations is not matching the strong demand and consequently, prime retail rents in the majority of markets continue to increase at a notable pace. In the investment market, retail volumes remain largely behind compared to last year according to the European Retail Market Report published by BNP Paribas Real Estate and launched at Mapic.

Highlights 2012 for retail in Wertern Europe

No improvement in economic activity expected before 2013

- *Slight economic recession anticipated in the EU-15 in 2012*
- *Rising unemployment and austerity measures continue to affect consumer spending*

Prime locations continue to enjoy strong demand from international retailers

- *Significant expansion led by fashion retail brands*
- *Ongoing shortage of prime supply is supporting rental growth*
- *Prime rents are rising in Germany, France and Central London*
- *Retail rents in secondary locations are struggling*

Retail investment in Western Europe in significant contraction in the last 12 months

- *The scarcity of prime retail assets is largely behind the current trend*
- *Only France recorded a rise in investment boosted by some large deals in Paris*
- *Average prime yield was almost stable, with marked differences at a country level*

France: the "prime" shopping centre segment maintains strong occupier fundamentals with rental growth

In France, fashion and accessories, beauty & healthcare brands and fast-food retailers are amongst the most active occupiers, significantly expanding their activities. In the meantime, new fashion retailers like Primark, JD Sport and Lander Urquijo are targeting the market. In the first half of 2012, a record-high prime rent was set in Paris Champs-Elysées at € 18,000/m² by M.A.C within the beauty/healthcare segment, but marked rental growth occurred in regional cities as well with double digit year-on-year growth rates in Q2 2012 in Lyon, Nice, Toulouse and Bordeaux. Indeed, besides the Paris market, international retailers are increasingly considering prime areas in these cities as entry points into the French market.

The "prime" shopping centre segment in France maintains strong occupier fundamentals with rental growth supported by renewals and low level of vacancy rates. Construction activity remains significant. Several large projects are currently in the pipeline but due to the delays most of them should be completed in 2014-2015. In 2012 so far, we can mention the completions of projects like "Atoll", "Confluence" (Lyon) and "So Ouest" (Central Paris), all of them with a GLA above 50,000 m².

France was the only major European country to see an increase in retail investment over the past four quarters (+17%). This result was achieved thanks to some large transactions in the Paris region, whilst activity was particularly weak in the regions. The lower share of shopping centre deals - as the availability of these products has been reduced - was compensated by strong demand for prime high-street retail, represented by the largest European transaction of the year so far (€ 500 million mixed-used retail/office deal by Qatar Investment Fund).

Prime yield levels reflect well current trends in the investment market. Prime high-street yields are pushed down by particularly strong interest for assets in those locations, whilst limited availability of prime shopping centres in the market led to a significant yield compression since 2011. Currently, France has the lowest prime high-street and shopping centre yield at 4% and 4.90% respectively. Yields for retail warehouses continued to drop as well and reached 5.80% at the end of Q3.

United Kingdom: Central London is not representative of overall UK trends of struggling retailers and high vacancy rates

United Kingdom retail sales have picked up in Q3 from a low basis, as consumer spending benefited from a fall in inflation and a moderate boost from London Olympics. As regards the occupier market, Central London is not representative of overall UK trends of struggling retailers and high vacancy rates. Indeed, London remains Europe's most attractive target for retail brands thanks to its status of international shopping destination. The prime rent in Oxford Street managed to increase by 10% since Q2 2011 but rents are also on an upward trend in surrounding areas of Oxford/Bond Street thanks to growing demand from the luxury segment. In regional cities, vacancy rates have risen since last year and prime rents remained flat.

The pipeline in 2012 has been sharply reduced in the United Kingdom following the delivery of "Westfield Stratford" at the end of last year, reaching the lowest level since 2007. Before the delivery of "Trinity Leeds" (93,000 m²) in 2013, the supply of new shopping centre space will be represented by the extensions and renovations of regional shopping centres.

Due to historically low volumes reported during the first half of the year, retail investment was almost halved in Q3 2012 on a rolling year basis compared to Q3 2011 but still remained the largest retail investment market in Europe accounting for € 7.8 billion. Activity even picked-up in the 3rd quarter, driven especially by shopping centre deals. Geographically, given the challenging occupier market conditions and higher risk aversion in the regions, investment activity held up better in London.

The current difficulties of the retail occupier market, except for Central London, were translated in slightly rising yields for all types of retail assets. Prime high-street yields rose to 5.0% (+15 bp) whilst shopping centre yields edged up to 6.0% (+25 bp) in Q3 2012.

Germany: focus of demand from retailers represented predominantly by foreign fashion brands

Thanks to the superior performance of its economy relative to other Western European countries, Germany has been particularly in focus of demand from retailers represented predominantly by foreign fashion brands. The rising competition between occupiers for best locations led to a 5% average growth in high-street prime rents in the 6 major cities since Q2 2011. In Frankfurt and Munich, the increase was the most significant with 12% and 6% year-on-year growth respectively. Further rental growth is expected given the unbalance between strong demand and very limited prime retail supply, particularly in places like Frankfurt, Berlin and Hamburg.

Strong occupier demand and the good shape of the economy are supporting shopping centre development activity. Following a 50% rise in completions in 2011, the upward trend is expected to continue in 2012 and 2013. This year's most representative project is the 76,000 m² "Boulevard Berlin" delivered in Q2 but several centres of smaller size are to be finalised during the second half of the year, with refurbishments having a significant share.

In Germany, the rising trend in retail investment started in 2009 came to an end in 2012: total volume invested in retail properties in the Big Six markets contracted by 40% to € 6.9 billion on a rolling year basis in Q3 2012. In the meantime, the occupier market enjoyed a high level of demand and rental growth has been maintained over last year thus making German retail the safest choice for investors. Consequently, the key issue is the lack of prime retail property to buy which significantly limited investment opportunities this year.

Retail prime yields remained flat at low levels over the past four quarters. The shortage of prime supply is behind the current yield levels. In the high-street segment, yields ranged between 4.20% in Munich and 4.50% in Berlin whilst yields for the best shopping centres stayed at 5.0%. As regards retail warehouses, prime yields were flat as well at 6.50%.

Spain: retail market heavily impacted by austerity measures

In the Spanish retail market, heavily impacted by austerity measures, the resilience in rents is only limited to prime high-streets in Madrid and Barcelona where availability is scarce. These top spots ensuring high footfall remain in focus of international retailers.

The retail market outlook has worsened since the start of the year and economic downturn is financing large projects. Currently no significant development is taking place.

Weak economic activity and higher risk significantly reduced retail investment in Italy and Spain to € 855 million and € 392 million respectively on a rolling year basis in Q3 2012. In Spain, austerity measures have a particularly strong impact on retail markets, worsening the outlook for occupiers while vacancy rates are already high. In these conditions, investors remain very cautious and the market is dry with only few small deals.

In Spain, in the absence of transactions in the prime segment, the retail yield remained stable at 5.50% in Q3 2012 but strongly under upward pressure. Indeed, owners are unwilling to sell property at the yields currently asked by investors.

Italy: a significant pipieline

In Italy, which has a relatively low shopping centre density at a European level, the current pipeline is significant with most construction taking place in Central and Northern regions and retail remains the most popular asset class.

The prime high-street yields started to rise slightly in Q3 2012 (4.60%) following several quarters of stability. This confirms investors' expectations of rising property yields, given the high level of government bond yields.

The European Retail Market Report, published by BNP Paribas Real Estate, will be available on November 14th on stand R2901 (Riviera, level 1).

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