# Investors cast net wide in search for retail bargains

As demand for retail property has soared over the past two years, secondary assets are now being sought after by hungry investors – and they are prepared to look at all corners of Europe.

Investment in European retail property has continued to rocket during 2015. Yields are sharpening rapidly, money is flooding into the continent from further afield and, as a result, investors are casting their nets more widely in terms of the type and location of assets they are looking to buy. The big question is whether or not the occupational market will rise to the same level of activity before any further substantial economic changes come into play.

Those active in European retail property investment all agree that the market is in a very different place compared to 12-24 months ago. According to research from CBRE, total investment in retail property in Europe in the third quarter of 2015 was €19.1bn, up from €16.2bn in Q2 2015 and €11.9bn over Q3 2014 (see graph, far right).

"A couple of years ago, investor sentiment was that retail was waning," says John Welham, head of European retail investment at CBRE. "That has now turned around and we're getting very strong demand from domestic and cross-border investment."

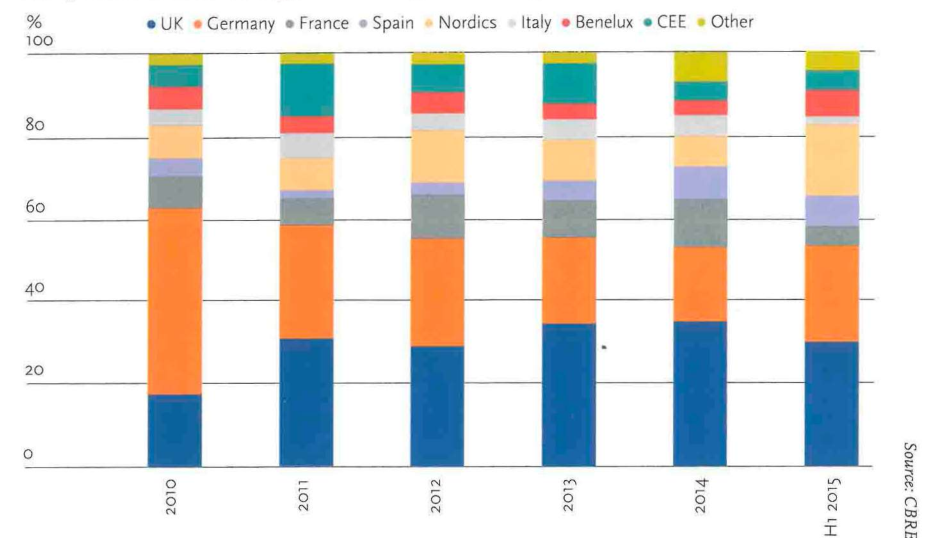
Though Welham says that selling activity has been slower than might have been expected given the speed of the recovery, and that he believes stock to be low, enough investors are selling to boost transaction levels. One reason for this is that a number of funds established during the early 2000s are coming to an end. Those that bought during the recession are also looking to cash in on the buoyant market.

So where are investors heading? "I'd say compared to two years ago, there is a very wide playing field today," says Florencio Beccar, head of EMEA retail at CBRE Global Investors. "You could invest in any European country today. The more peripheral countries have higher yields, but there is appetite to invest in all."

Activity is still concentrated on the most established markets, however. Though the UK remains the biggest single retail investment market. CBRE figures show that other countries within northern Europe are

**Retail investment by country 2010-H1 2015**

**Norway has been one of the biggest drivers of growth in 2015**




performing particularly strongly. Investment in Germany reached €3.7bn in Q2 2015, up €1.6bn on the same period last year. Though not a cheap location, investment activity is likely to remain high due to the country's attraction as one of the most stable economies in Europe.

"The German market is logically catching up with where it should be given the size of its GDP and the number of strong cities," says Welham. "This isn't a blip, it's a new norm for Germany. It's a healthy market with strong domestic investors and there is lots of investment from elsewhere in Europe as well as North America and Asia."

## Nordic targets

The Nordics are also proving to be strong targets for investment, Sweden in particular is attractive due to its stability. TH Real Estate's recent *THINK Europe – Retail* report highlighted the region as having good potential for retail growth, particularly as the market allows investors to easily reposition or improve an asset.

"The Swedish economy has been an outperformer," says Giles Wintle, regional director for Europe at Grosvenor Fund Management. "It's a flexible, well-managed economy that tends to outperform the rest of Europe and it's relatively transparent. The Swedish social model is quite resilient for retailers because there's a lot of protection for the individual, so less distress in a crisis. Longer term, the main retailers tend to be local or regional, except in the big centres, so there's enormous potential for that to change and for managers to add value."

Though there continues to be a level of activity in France, it appears to be less of a target, despite continued low vacancy levels and a stable economy. Ewen Hill, director at Enagh Estates, attributes this mainly to foreign investors' dislike of lease structures. In contrast, Spain remains a key target. A flurry of activity in the last 12-18 months has compressed yields and increased competition, but many still believe opportunities are to be found in the country.

"We weren't investing in Spain 18 months ago – now look at the market," says Beccar. "Quick yield compression has happened almost overnight. We weren't expecting yields to be so sharp so quickly and a new tone has been set. There are still lots of opportunities in Spain, however, mainly for dominant centres in secondary cities such as Valencia where yield levels are about 6%."

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John Welham, CBRE

But some investors believe Spain is already too hot. Peter Todd, director at Resolution Property, says that although his firm finds Spain "interesting", he questions whether "yields and capital rates are slightly ahead of the occupational market".

This is perhaps evident in increased activity in the other southern European countries of Portugal and Italy. Oli Fraser-Looen, director in Savills' global retail investment team, highlights Portugal particularly as a strong market as clients look to markets where they can get better returns and value – he believes that the UK and Germany, for example, are overpriced.

"In Portugal, we're doing a lot of deals off market as a result of conversations started a year ago," says Fraser-Looen. "We'll see more deals in the open market now as sellers have more confidence that they don't need to have one-to-one conversations and might benefit from a fully marketed process. In Italy the story is similar."

While investors are becoming keener on these slightly less developed markets, most agree that one region is currently a step too far: Eastern Europe. Poland has for a while been considered alongside Europe's more developed markets and activity remains strong, but neighbouring countries are still considered to be too high up the risk curve.

"Poland has lots of stock with a reasonable turnover, so it's a good target market," says Welham. "Yields are down to the top of the last cycle. The Czech Republic has a similar level of interest. In terms of other Eastern European markets, investors are less keen on Hungary because of the economic and political situation. Slovenia and Romania were seeing activity before the recession but that really isn't going on at the moment. One problem is that the markets are so small that it takes more effort to find something to buy than in a secondary town in Germany."

The word "secondary" is becoming characteristic of where investors' interest is heading. As competition for prime assets has grown, some investors are discounting these assets altogether. Savills' Fraser-Looen describes prime opportunities as "near impossible to unlock" due to competition.

Welham believes "the secondary story" is the most important trend in Europe. "For prime, the best centres are really fully priced and there's lots of competition. But that recovery in pricing has not happened in the secondary market. It's quite easy to get a 6% yield even in Germany and returns could be 7.5-8%. Investors need to be careful about the fundamentals of a property as tenants are more cautious than before and landlords give greater incentives, but it's balanced by yields."

## Secondary focus

Investors that have the teams on the ground to make the most of secondary assets are already focusing business plans around these properties. Grosvenor's Wintle says that his firm's funds are focusing on "urban retail", catchment-driven centres rather than dominant centres as the "biggest story in retail is polarisation – good centres are getting better and the bad are getting worse. In the UK, prime and secondary yields have converged in the past. This hasn't happened."

Resolution Property is following a "value add" strategy focusing on successful "B" cities. "We don't focus only on capitals," says Todd. "The process of urbanisation is ongoing but there are big cities on the wrong side of that. What we look for is a fundamental scarcity or to create scarcity by repositioning an asset."

As Todd says, if Resolution does its job effectively, when it comes to selling an improved asset this may well be to an institutional investor seeking prime. However, this strategy also requires a belief in improving fundamentals.

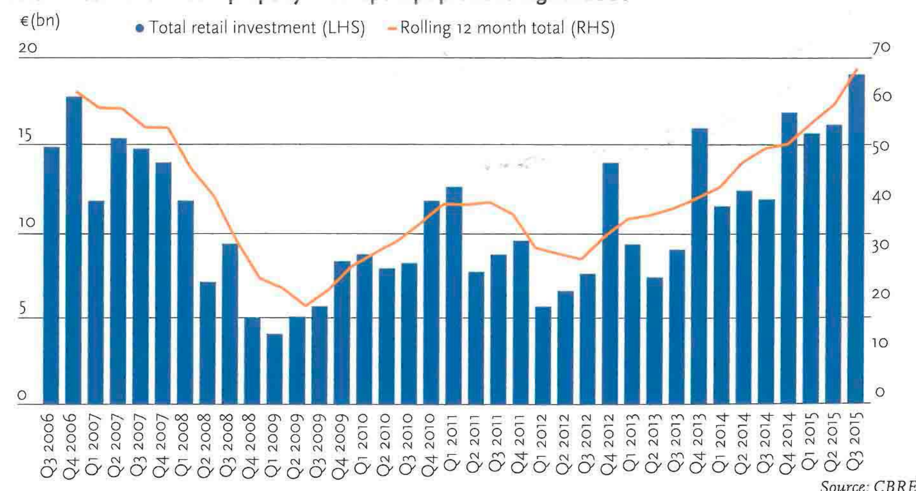
"Interest rates are now being priced into the market," says Todd. "Even if they rise there's still going to be a very positive environment for investment provided the economic growth we're anticipating does arise. What's critical is what's going to happen in occupational markets."

Rental growth is key to asset improvement and although the occupational market is growing strongly in the UK, this is not yet coming through in all countries. But TH Real Estate's White believes that although the industry may need to wait "six to 12 months or longer, depending on consumer spending", it won't be long before increasing occupier interest will lead to rental growth.

While Europe's economies remain steady, for now at least, that occupier interest will be the last piece of the jigsaw for the retail property sector to reach boom time.

**European retail investment turnover 2006-2015**

**Total investment in retail property in Europe tops previous high in 2006**




*Source: CBRE*