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investment management

SECTOR FOCUS
CONVENIENCE SHOPPING

Convenience shopping in the Netherlands – an investment perspective

Day-to-day convenience shopping in the Netherlands can be an attractive real estate investment opportunity, research by Bouwfonds Investment Management (Bouwfonds IM) shows.

Bouwfonds IM, the real asset investment manager of Rabobank, is putting together a targeted real estate investment portfolio focused on convenience shopping in inner cities or convenience shopping centres in other locations, comprising one or more supermarkets and a cluster of convenience stores including owner-operator shops.

Figure 1: Map of the Netherlands

This research paper explains the attractiveness of this segment of the Dutch real estate market as follows:

- The Netherlands is a stable investment market with a solid economic outlook.
- While the Dutch retail industry as a whole is struggling, closer analysis reveals food and daily household categories buck the overall trend in Dutch retail.
- Dutch convenience shopping real estate provides a strong investment proposition.

The Dutch retail market – a 'bird's-eye' overview

The Dutch retail market is a highly competitive and relatively transparent market. Total retail space in the Netherlands, comprising the full range of shopping real estate from the largest shopping centres and major department stores and supermarkets down to the smallest single-owner/tenant-operated shops, was around 31.5 million m^2 in 2016. This amounts to approximately 1,850 m^2 of retail space for every 1,000 inhabitants, more than in any other country in Europe. The Netherlands also has a large stock of shopping centres, comprising total shopping floor space of about 7.6 million m^2, or approximately 457 m^2 per 1,000 inhabitants – putting the country in second place in Europe after Norway, and before Sweden, Finland and Luxembourg. This floor space is divided between a relatively large number of locations, as most shopping centres in the Netherlands are small – those covering less than 20,000 m^2 accounting for 75% of the total stock. Very large shopping centres (> 80,000 m^2 retail floor space) are virtually non-existent in the Netherlands; the country has only three centres that fall into this category.

In the Netherlands, 31 municipalities have a population of over 100,000 and only four – Amsterdam, Rotterdam, The Hague and Utrecht – are considered 'large' cities, with more than 250,000 inhabitants. The Dutch shopping centre landscape owes its distinct profile of many relatively small shopping centres to government zoning policies, as public authorities in the country have traditionally sought to maintain the vitality of city, town and village centres by protecting their function as a shopping destination. From the 1950s onward, shopping centre developments on the outskirts or outside cities were prohibited in order to ensure urban centres remained attractive to consumers. Exceptions included new residential areas built from scratch, where permits were issued for shopping centres intended to serve the local catchment area. Another exception provided for in zoning regulation concerned developments for specific retail branches (notably bigger-ticket items such as furniture and cars), which required more space than city centres and most shopping centres could provide. Such retail categories are often located in themed retail parks, where strict limitations are in force under the country's 'PDV/GDV' regulations concerning the retail categories that are allowed to set up shop at these locations. The Netherlands has a relatively large number of such themed retail parks, often casually referred to as 'boulevards' (e.g., 'furniture boulevard', 'car boulevard'). In addition to the country's strict zoning policies, strict regulation has also capped the share of durable goods in the permitted product range of supermarkets, again in a bid to protect smaller supermarkets and grocers, and keep out hypermarkets. The larger supermarkets in the Netherlands generally do not exceed 3,000 m^2 per location. Over the past decade, policy makers have started to loosen regulations slightly, decentralising decision-making on certain planning issues and opening hours.

THE NETHERLANDS : A STABLE INVESTMENT MARKET WITH A SOLID ECONOMIC OUTLOOK

The Netherlands ranks 131st worldwide in terms of geographical size, 66th in terms of population size, 17th in economic size (nominal GDP in dollar terms, 2016), came fourth in the 2016-2017 global competitiveness ranking of the World Economic Forum, and in January 2017 was named the world's second most economically stable country in the world (after Switzerland and followed by Luxemburg, Hong Kong and Norway) by the consulting and accountancy firm KPMG. The country is a parliamentary democracy whose governments tend to rely on coalitions of political parties.

The Dutch political landscape has become more fragmented and volatile in recent decades, but leading parties tend to adhere to the traditional cornerstones of Dutch national government policy – notably EU and NATO membership, an open and trade-based economy, an inclusive society, and sound government finances.
The Dutch economy is considered structurally well-balanced and sound by economists, and since 2014 it has been recovering from a string of recessions (2009, 2012 and 2013) which were triggered by the 2008 financial crisis. Unemployment and the government budget deficit have been on a consistent downward trend since 2014, and investment and consumer spending have recovered since the crisis – supported by a recovery in housing prices and new residential building activity stimulated by temporary tax incentives aimed at promoting home ownership and reducing private mortgage debt.

In the aforementioned ranking of economically most stable countries, KPMG noted that the leading countries on its list were relatively closely integrated in the global economy and possessed very strong public institutions. It noted these countries had unambiguous and high-quality regulation, well-defined public policy, an independent judiciary and effective government – key characteristics which provided a solid basis for future economic growth and prosperity.

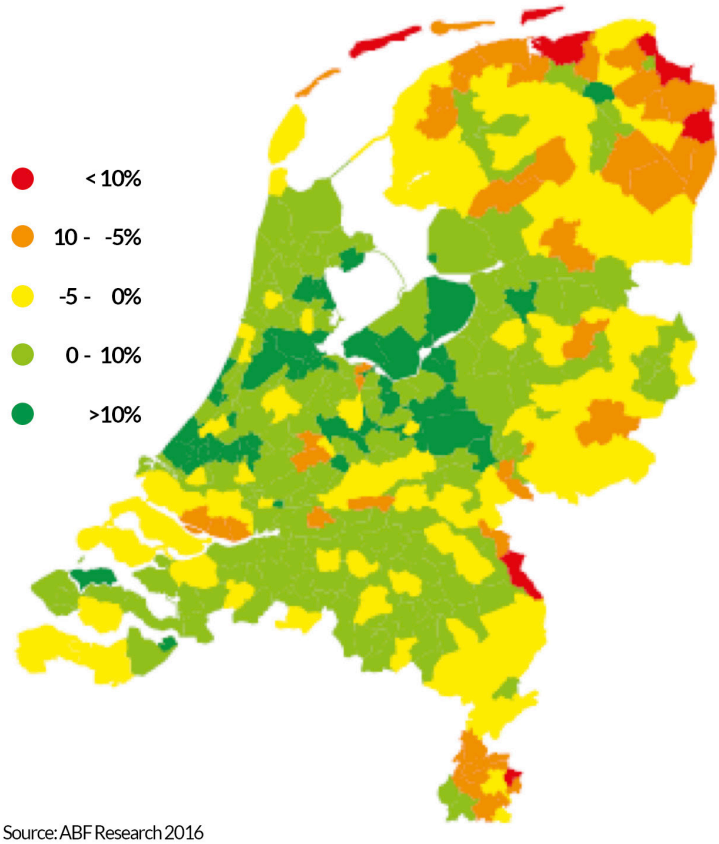
The country's overall investment characteristics are sound:

- The Netherlands has triple-A credit ratings from all the leading international credit rating agencies (Dutch national public debt currently at less than 65% of GDP and trending towards the EMU target ceiling of 60%).

- The Netherlands ranks 5th on the 2015 lowest-to-highest perceived corruption index of 168 nations compiled by Transparency International.

- The Netherlands consistently has sizeable trade balance and current account surpluses, the ultimate proof of a competitive economy.

Figure 2: Population development in the Netherlands by municipality, projection for 2015-2020



Source: ABF Research 2016

Population growth looks set to continue at a mild pace, although demographic development is uneven across the country (see Figure 2). The Dutch economy is expected to grow at around 1.5% in the coming years, which is slightly higher than private consumption growth that is averaging 1.25%. Other economic indicators such as inflation, investments, exports and imports, current account balance and unemployment show a solid economic development (see table 1).

Table 1: Key indicators of the Dutch economy 2015-2020 (annual percentage change, unless specified)

	2015	2016	2017	2018	2019	2020
GDP	2.0	2.1	1.8	1.4	1.3	1.2
Private Consumption	1.8	1.6	1.3	1.2	1.2	1.2
Investment	9.9	6.5	3.6	2.0	1.5	1.6
Government Consumption	0.2	0.6	0.8	1.1	1.1	1.0
Exports	5.0	3.2	2.3	2.1	2.0	2.0
Imports	5.8	3.7	2.8	2.3	2.2	2.1
Consumer prices	0.6	0.3	1.6	1.6	1.7	1.7
Current account balance (% GDP)	8.7	7.6	7.5	8.3	8.2	8.3
Government budget (% GDP)	-1.9	-1.1	-1.0	-1.1	-1.2	-0.8
Unemployment (%)	8.7	7.3	6.4	6.3	6.1	6.0

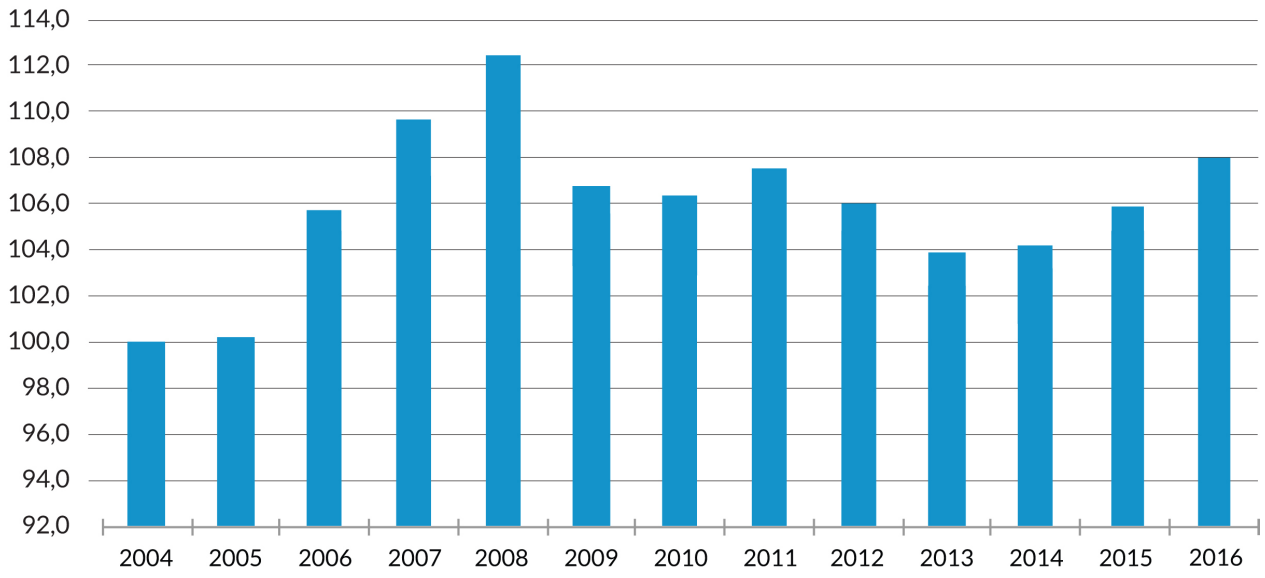
Source: Oxford Economics (19 January 2017)

FOOD AND DAILY SHOPPING CATEGORIES ARE BUCKING THE OVERALL TREND IN DUTCH RETAIL

Overall, the Dutch retail sector is struggling

The Dutch retail sector was hit hard by the repeated recessions that followed the 2008 financial crisis, as consumer spending was knocked by a sharp rise in unemployment (to which traditionally thrifty Dutch consumers responded by sharply increasing their savings), and subsequently by government spending cuts and tax increases (including an increase in VAT by two percentage points to 21%) in a bid to bring government finances back under control following the financial and economic crises.

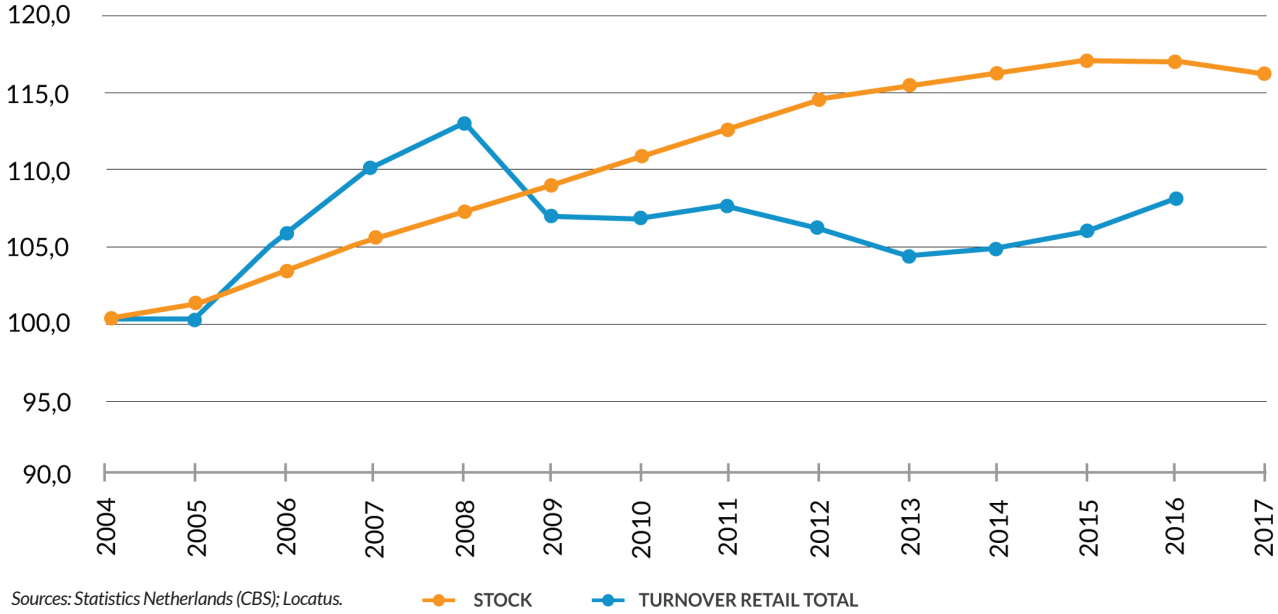
Figure 3: Index of retail sales in the Netherlands (2004=100)



Source: Statistics Netherlands (CBS).

However, in spite of the pressure on overall consumer spending and the resulting decline in retail sales (see Figure 3), the stock of retail floor space continued to increase throughout the 2008-2013 crisis period – for a total increase of over 15% between 2005 and 2015, when it peaked (see Figure 4).

Figure 4: Indices of Dutch retail stock and total retail turnover (2004=100)



Sources: Statistics Netherlands (CBS); Locatus.

Key insights into the effects of e-commerce on 'high street' retailing in the Netherlands

A study by Bouwfonds IM (2013) of Dutch retail locations' fundamental vitality, as well as their vulnerability to e-commerce, provides the following insights:

- Large and very large shopping centres are prone to lose sales to online retailing (depending on their branch mix), but this vulnerability is partly offset by consistently high traffic to these centres. Such centres need to provide dynamic and experience-rich destinations for the general public. If they do not succeed in this, the future of these centres is gloomy.
- Medium-sized shopping centres will find it more difficult to provide experience to consumers and need a strong convenience base. Especially small shopping centres are often more convenience-focused and therefore not very vulnerable to e-commerce.
- The centres of major cities often have many shops in categories which are vulnerable to competition from e-commerce, but experience shows that these centres are very dynamic, which is illustrated by their ability to attract new tenants for vacated premises, although perhaps for functions or uses (e.g. hospitality, residential) other than retailing.
- The centres of small and medium-sized towns will suffer from the growing popularity of e-commerce due to their generally low levels of footfall and dynamism.

Specialised retail areas such as retail parks, factory outlets and theme-oriented shopping centres are only somewhat vulnerable to competition from e-commerce, but in those places where such competition does have an effect, it is expected to have a significant impact due to the often low level of dynamism and the limited pool of potential new tenants.

Sensitivity of retail branches categories to the online channel

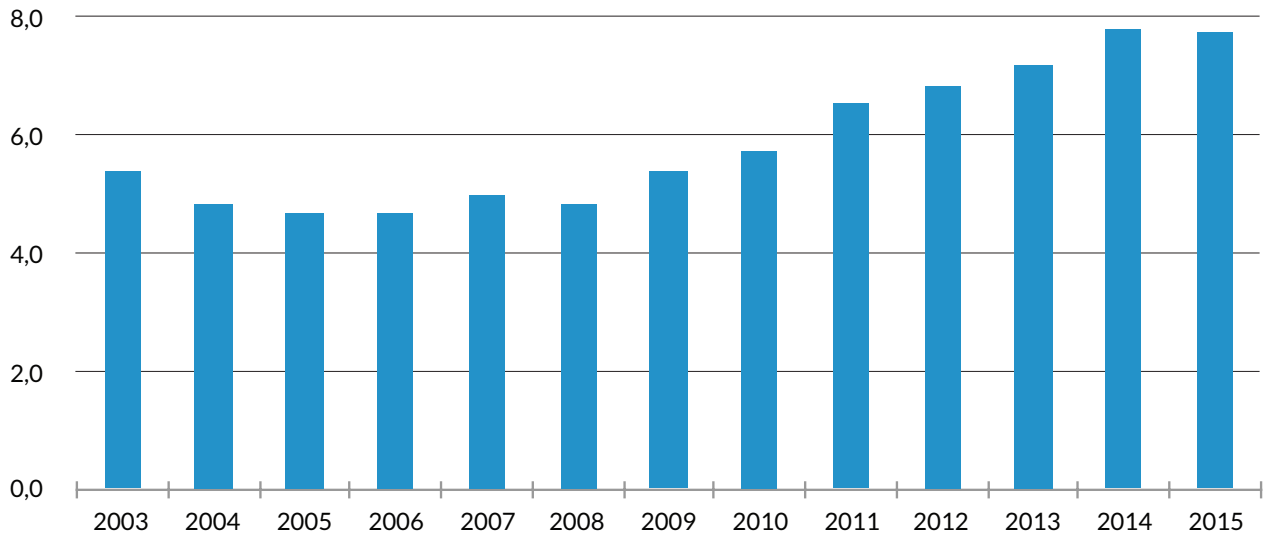
OFFLINE CHANNEL'S SENSITIVITY	BRANCHE
Considerable	Travel, tickets, erotics, computer software, DVD's, insurance products, music, photo / film appliances, home entertainment software, (mobile) telecom, computer hardware, consumer electronics for car use, books / magazines / newspapers, audio / video equipment
Moderate	Toys, fashion / shoes, white goods / household & kitchen appliances, bikes and bike accesoires, interior / furniture, cars, sports goods
Insignificant	DIY / decoration / hobby, personal care, gardening, animal goods, optician, plants, flowers, food / groceries

Effects of e-commerce on types of retail areas (summary)

TYPE OF SHOPPING AREA	DYNAMISM OF SHOPPING AREA	E-COMMERCE SENSITIVITY OF SHOPPING AREA	EFFECT OF E-COMMERCE ON SHOPPING AREA
(Very) large shopping centres	**High**	**High**	**Negative**
Medium shopping centres	**Average**	**Low**	**Limited**
Small shopping centres	**Average**	**Very low**	**Very limited**
Retail Parks	**Low**	**Average**	**Negative**
Factory Outlet Centres	**Low**	**Average**	**Negative**
Theme-Oriented Centres	**Low**	**Average**	**Negative**
Large cities, Inner-city, high streets	**Very high**	**Above average**	**Limited**
Small and medium-sized town centres	**Low**	**Above average**	**Very negative**
Other shops (solitary)	**Low**	**Low**	**Limited**

Source: Bouwfonds IM Research

Figure 5: Total vacancy rate in Dutch retail, 2003-2015 in % of total

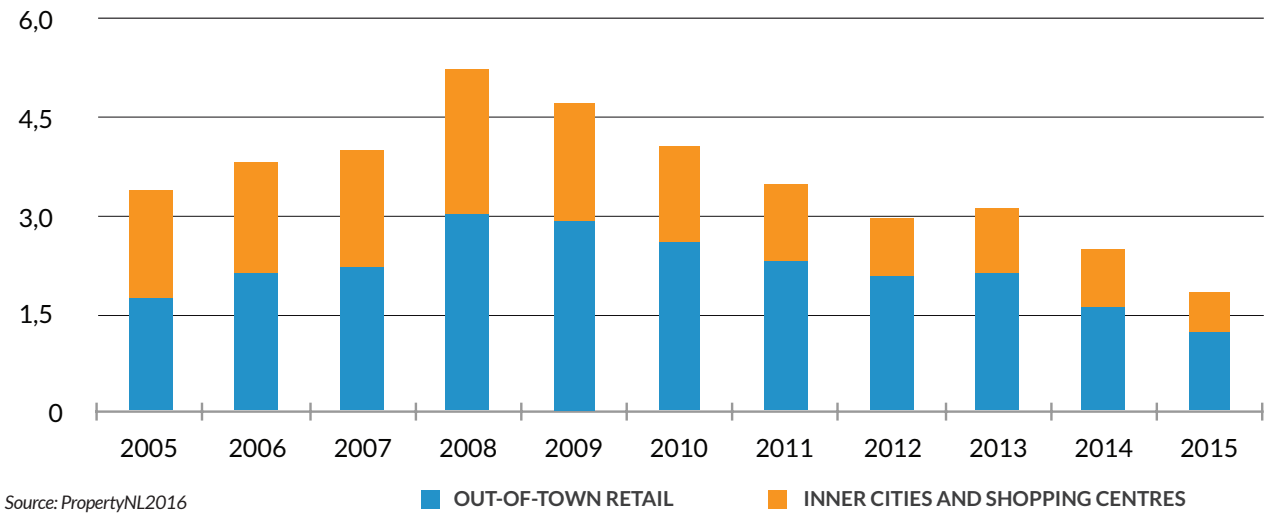


Source: Locatus.

However, when the financial crisis hit in 2008, new retail development activity in the Dutch market immediately went into a steep decline – from over 5 million m² under development in 2008 to 2 million m² in 2015 – the out-of-town development 'pipeline' shrinking by half, and the inner-city shopping centre development 'pipeline' declining by more than two-thirds (see Figure 6). The Dutch economy has been recovering since 2014, but new building activity in the retail industry has nevertheless remained low, with projects currently underway or planned largely concentrating on redeveloping existing sites.

The combined effect of lower retail sales and continued expansion in retail floor space led to a marked increase in the vacancy rate in Dutch retail, from less than 5% in 2008 to around 8% in 2016. Many retailers – from single-store operators to prominent high street brands – collapsed due to the combined pressure of the economic recession and the simultaneous strong growth in online sales.

Figure 6: Development pipeline in million m² for new retail floor space in the Netherlands, 2005-2015



Source: PropertyNL2016

Closer analysis reveals clearly diverging trends between non-food and food retail

As stated, the Dutch retail sector at first glance presents a picture of markedly lower sales levels than before the financial crisis, reduced shop productivity and significant overcapacity as well as vacancy levels in retail stock. But this overall impression obscures several important distinctions in the Dutch retail industry.

First of all, there is an important distinction to be made between first-tier and second-tier cities. The downward trend in retail sales predominantly applies to medium-sized and smaller cities across the Netherlands. Due to renewed urbanisation, larger cities are growing faster than smaller cities. Also, consumers tend to seek out the larger urban centres for shopping, giving these a larger piece of the consumer spending pie.

Furthermore, daily household or convenience categories are doing much better than non-food categories (see Figure 7), with supermarkets and drugstores showing continued sales growth (see Figure 8). For one, experience shows that consumer spending on food and other key household items tends to hold its own even during crises, as consumers will first save on 'discretionary' non-food categories. Moreover, sales on food items are also supported by a growing tendency among consumers to spend more money on healthy food and other health-related products. Sales in categories between non-food and food, which do cater to consumers' daily needs but are more sensitive to the state of the overall economy than food, have suffered, but less so than the non-daily product categories.

Figure 7: Index Retail Turnover in The Netherlands (2004=100)

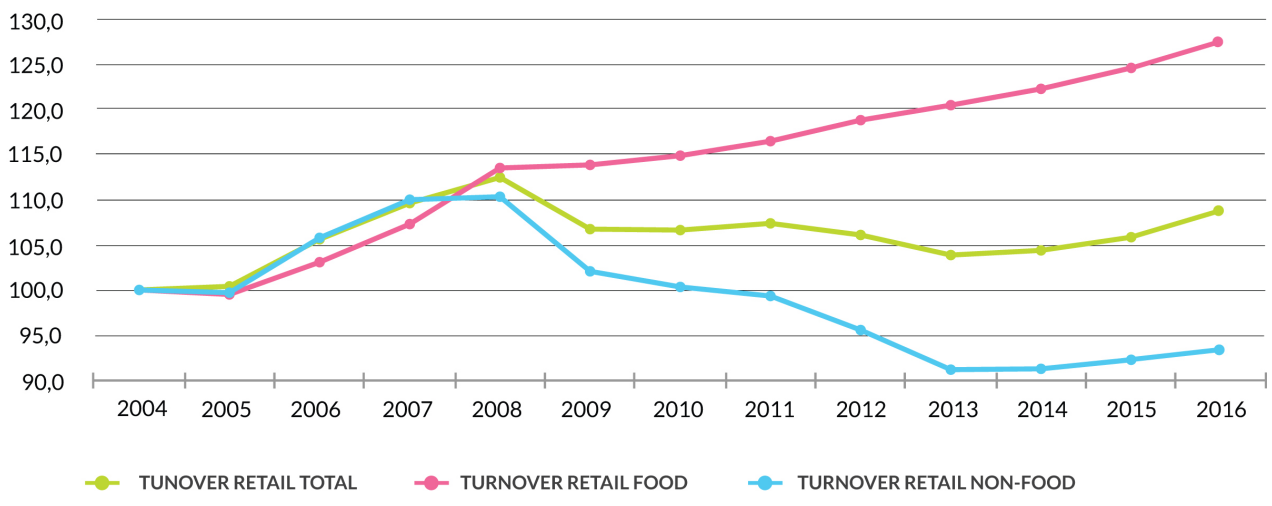
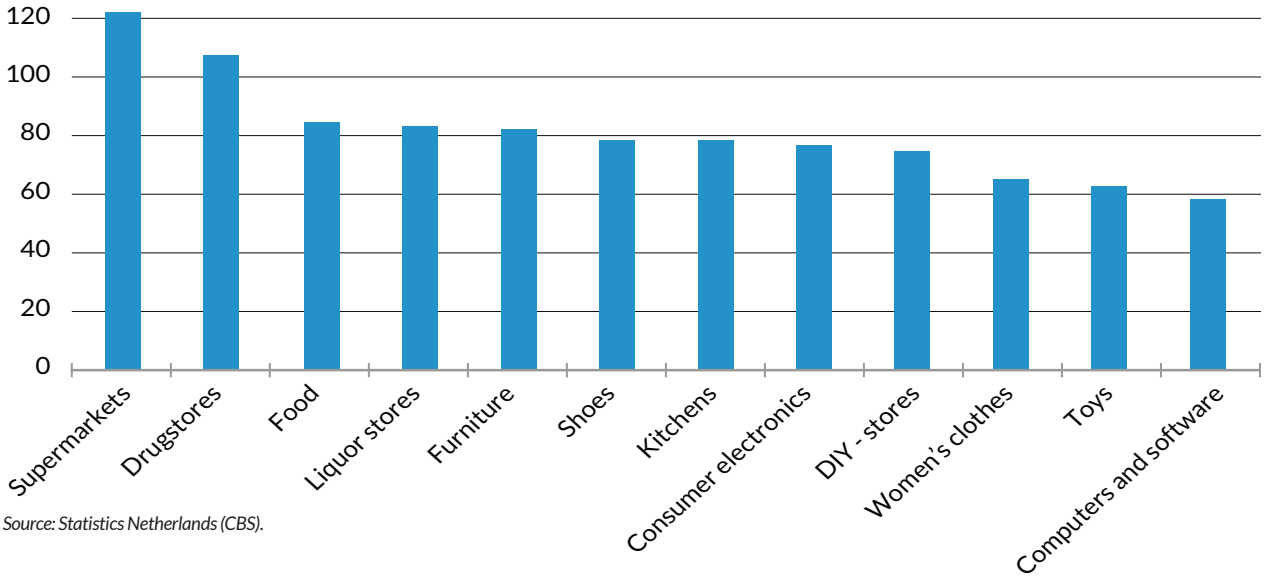


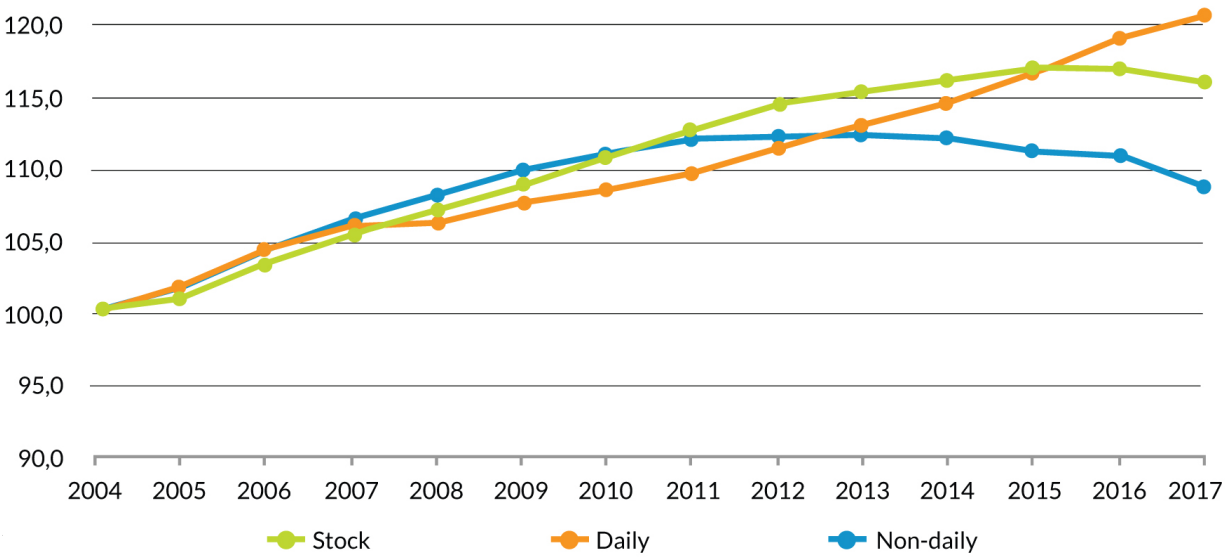
Figure 8: Index of Dutch retail sales by category 2015 (2008=100)



Source: Statistics Netherlands (CBS).

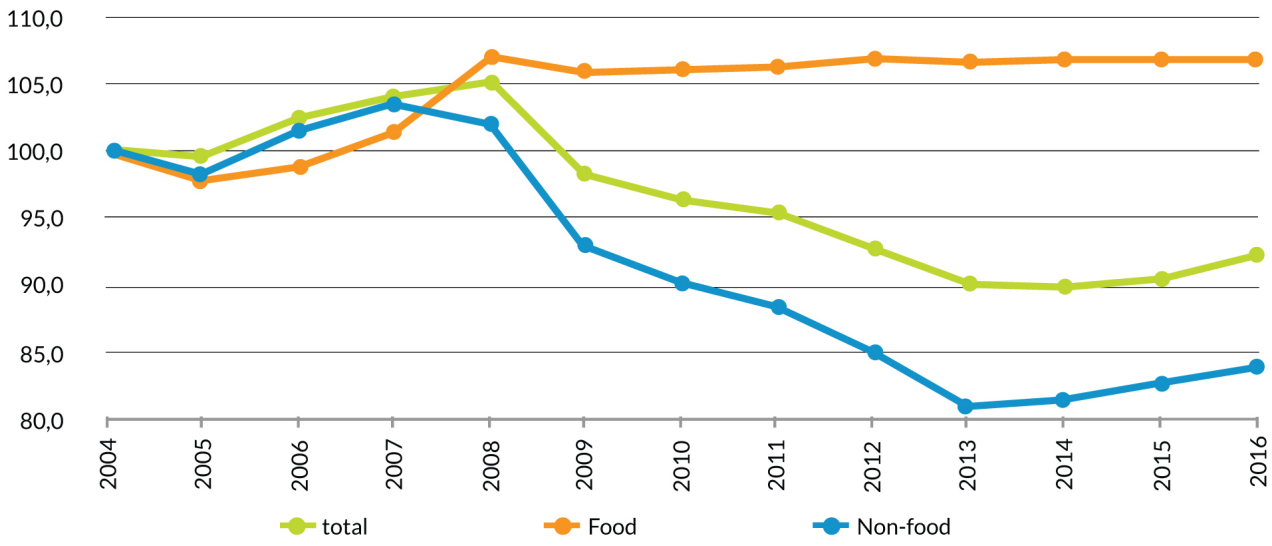
The difference in historical performance between daily and other consumer purchases is also reflected in the development of retail stock: whereas total retail floor space continued to expand until 2015, retail floor space catering to non-daily consumer needs peaked in 2010 and went into a decline from early 2014 onwards – whereas floor space focused on consumers' daily needs has continued to increase (see Figure 9).

Figure 9: Dutch retail stock, 2004-2017 indexed (2004 = 100)



Also, the sharp drop in floor productivity observed in the Dutch retail industry overall since 2008 reflects an even steeper decline in floor productivity in the non-food product categories, whereas floor productivity in food retail remained stable during the crisis years – supermarkets even consistently recording growth in sales per square metre during the entire crisis period.

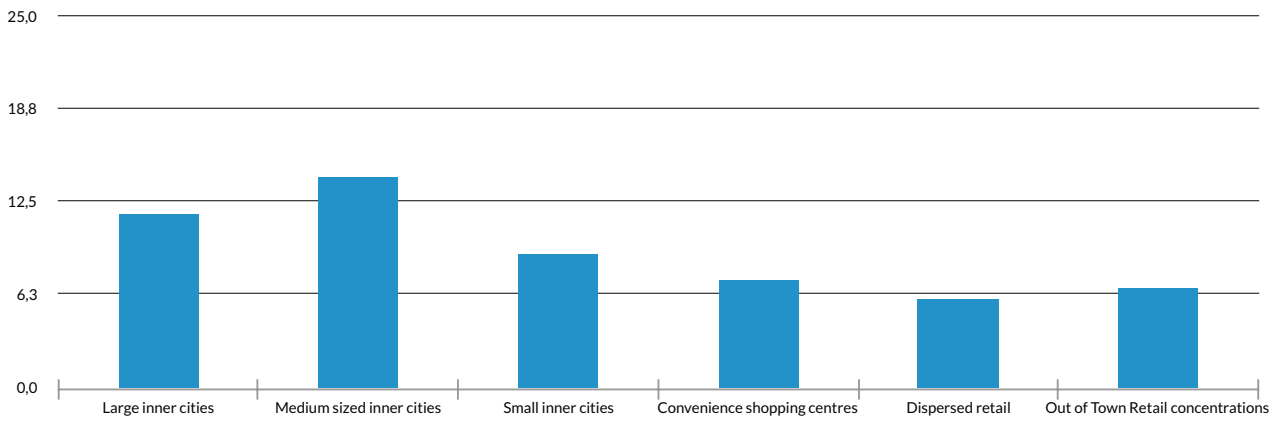
Figure 10: Floor productivity in Dutch retail, 2004 -2016, indexed (2004 = 100)



Sources: Statistics Netherlands (CBS); Locatus.

The differences in sales trends and floor productivity in the various product categories across the Dutch retail industry also show up in the vacancy rates. As shown in Figure 5, the average annual vacancy rate in the retail industry in the Netherlands overall has risen from nearly 5 to nearly 8 per cent in recent years. But the vacancy rate in convenience shopping centres, supported by the steady consumption of daily goods, stands at around 6 per cent (see Figure 11). In the centres of medium-sized and small cities, which have become less popular to consumers as destinations for non-daily shopping, vacancy rates are rising.

Figure 11: Vacancy in Dutch retail, by type of location, in % of total floor space, 2016



Source: Locatus.

DUTCH CONVENIENCE SHOPPING PROVIDES A STRONG INVESTMENT PROPOSITION

Based on its macro analysis of the overall trends in Dutch retail sales by category and types of location, Bouwfonds IM is proposing a Dutch retail property investment strategy focused on smaller shopping centres that meet the daily shopping requirements of consumers in their immedate catchment area, and which are either located in inner cities or occupy a strong position in their catchment areas.

The strategy, while focused on a relatively small market in terms of its investment volume potential, benefits from the Dutch retail real estate market's overall attractions:

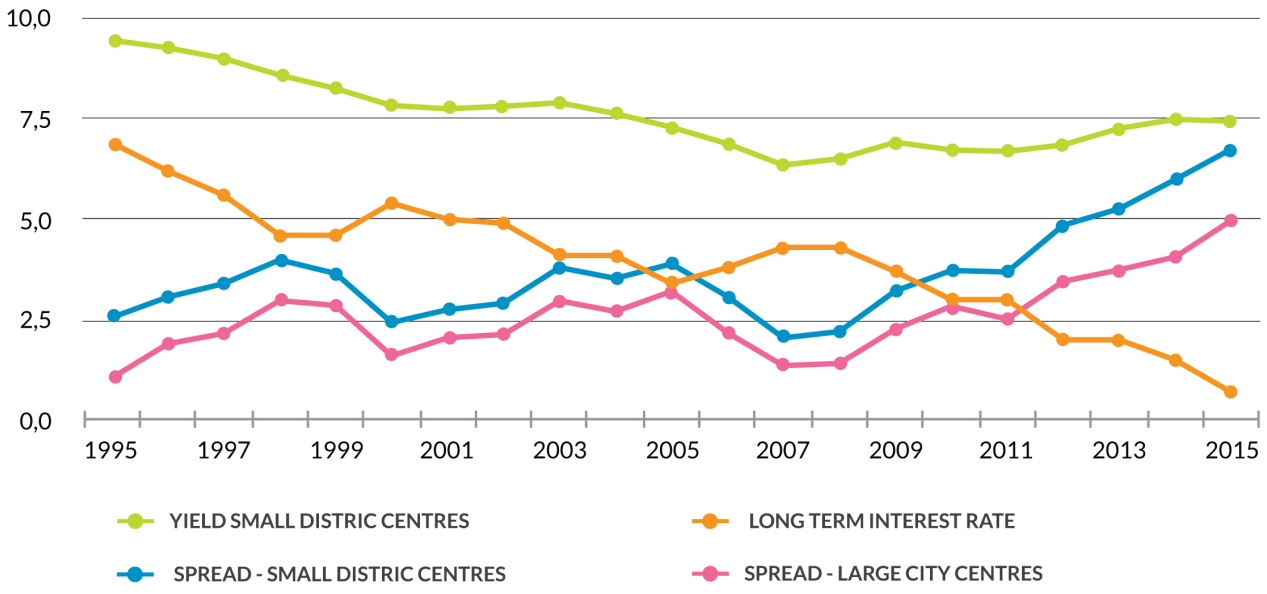
- A liquid market, especially in this specific segment
- Relatively low investor entry costs compared with other European countries
- A highly transparent investment market (cf. the country's top 5 position in the Transparency International index cited above).

It is also supported by findings from several other analyses, notably a recent study by the international policy research and consultancy company firm Ecorys, 'Investment in retail property in the Netherlands – a European perspective':

- Diversification hedge: because of its low or even negative correlation with other real estate investment markets, such as Germany, investing in the Dutch retail market helps reduce the overall portfolio risk.
- Attractive historical total return compared with other asset classes (liquidity, bonds, stocks).
- Attractive historical total return compared with other categories of real estate (offices, residential).

Looking at the different types of retail investment that are available, convenience shopping centres that primarily serve the day-to-day shopping needs of the local community stand out in terms of risk/return ratio. Their initial yields have risen since the start of the financial crisis, while financing costs have dropped dramatically. Consequently, the spreads on this type of real estate investment are currently at record highs (see Figure 12) and well above those on high street real estate in the major Dutch cities, where initial yields have declined due to a significant inflow of investment in recent years.

Figure 12: Initial yield retail, interest rate and spreads (%)



Sources: Oxford Economics; MSCI.

While retail turnover in non-food decreased during the financial crisis and subsequent years, retail turnover in the food category increased and continues to show sales growth.

Exhibiting a healthy floor productivity and rental income outlook, also bearing in mind the country's positive economic outlook overall, small convenience centres provide an attractive investment option.

It should be noted, however, that the insights and figures presented here are national averages for the Netherlands as a whole. Given the considerable differences in success factors across the country, the strategy's success will ultimately depend on the regions and sites selected for the portfolio.

Bouwfonds Investment Management (Bouwfonds IM) is the real asset investment management company of Rabo Real Estate Group, one of Europe's leading real estate companies. We offer distinctive investment products for institutional and private clients in selected real estate, infrastructure and natural resources sectors. Bouwfonds IM manages a portfolio with a total value of €6 billion, distributed among the following sectors: commercial and residential real estate, communication infrastructure, parking, and agriculture. Bouwfonds IM has local offices in the Netherlands, Germany, France, Poland and Romania.

Bouwfonds Commercial Real Estate invests in office and retail properties situated at prime locations. Dynamic inner-city business and retail areas are places where people want to shop, eat, work and live. These places will always attract people and will generate greater economic activity. Bouwfonds IM manages one of the largest retail portfolios in the Netherlands, with an investment value of €2.5 billion (84% retail/16% offices).

Jaap Gillis
CEO

Bart Pierik
Managing Director
Commercial Real Estate

Monique Korting
Head of Asset Management
Commercial Real Estate

Marcel van Thienen
Fund Manager
Commercial Real Estate

Kaj Deana
Senior Research Manager
Commercial Real Estate

Bouwfonds Investment Management
De Beek 18, 3871 MS Hoevelaken, the Netherlands
P.O. Box 15, 3870 DA Hoevelaken, the Netherlands
T: +31(0) 33 750 47 54
www.bouwfondsim.com

bouwfonds
investment management