Real Estate market insight

Dutch retail market cycle is turning and unlocks new investment opportunities

Bouwinvest | Real Estate Investors

Executive summary

The main retail trends

In the past decade, Dutch high streets and convenience centres have been going through vastly different market cycles, both for consumers and for investors. This was due to the combination of gradual but major trends and brief, but high-impact events. In this short paper we will describe these trends and events and their effects, but also make predictions for the next 3-5 years.

Highlights:

- The main trends include the growth of online shopping, socio-demographic changes, the shift towards an experience economy and the increasing demand for sustainable real estate. All of these trends are defining the future retail landscape.
- High street retail has been through a turbulent decade and is still facing severe challenges. Vacancy will continue to rise in the near term and city centres will eventually become more compact. However, provided they respond effectively to the opportunities presented by changing consumer behaviour, they will also become more attractive and change from places to buy to places to be. As market rents are bottoming out, Bouwinvest sees increasing opportunities for investment.
- Convenience centres have earned their place in real estate portfolios over the past decade by providing strong returns. They did so by gradually adapting to changing demographics and consumer demands. The coming years will be no different as, here too, polarisation will continue. Bouwinvest expects this segment to remain stable and thus add value to any retail portfolio.
- Due to the ongoing polarisation in both market segments, picking the right retail property, either high street or convenience, is only becoming more important.
- In addition, investors, retailers and local authorities need to work closely together to address the environmental challenges of future-proofing retail properties, as well as local surroundings.

Mind: definitions for high street retail (also: experience or comparison retail) and convenience retail (also: convenience centres) are listed in the appendix.

Starting point
trends defining the retail landscape

Online shopping: the gamechanger

Online shopping received a huge boost during the Covid period and its share of total retail spending increased to 15.6% in 2021[1] from 10.8% in 2019. Post-Covid, as people returned to high streets, this share fell back to 13.9% in 2023, but is expected to expand further to 17.8% in 2028. Especially as younger generations are adapting more readily to online shopping.

Over the past decade the growth of online sales has had a substantial impact on both high streets and convenience centres, with some subsectors hit harder than others. The total number of stores in the centres of the largest cities in the Netherlands declined by 9.0% in the period from January 2020 to January 2024[2].

Online supermarket sales are also growing, but at a more moderate rate. The share of online sales peaked at 5-6% in 2022 and dropped slightly in 2023. Despite the apparent determination with which consumers do their grocery shopping in-store, online sales are likely to increase further in this segment too.

At the same time, pressure on online retailers is mounting, as investors are demanding a focus on profit and away from increasing market share. As a result, business models are gradually changing (e.g. consumers paying for return packages) and several online retailers have had to reduce their overheads and lay off people.

Gradual socio-demographic shifts

Young people and young families are overrepresented in terms of visits to city centres, while older generations generally prefer nearby (district) shopping centres. However, with the exception of the largest cities in the Netherlands, the 15-55 age group has stopped growing[3], and the over 55s are becoming increasingly dominant.

In addition, elderly people generally buy fewer goods than younger people, wealth accumulation among younger generations has been much smaller than among older generations and starters on the labour market face much poorer job security, which also influences spending patterns.

The ageing of the inhabitants in the catchment areas of convenience centres is not necessarily a negative trend. Elderly people generally tend to spend their income closer to home, while they have on average more accumulated wealth than younger generations and, finally, the demand for local healthcare-related functions will increase.

On the other hand, the share of single-person elderly households in these catchment areas will also increase, possibly resulting in a population decline and thus shrinking total sales potential.

Towards an experience driven economy

In people's spending patterns, we are seeing a continued shift away from goods to experiences. There is a profound upward trend in things like eating out, visiting concerts, going to the cinema and travelling. High street shopping trips are also back on the agenda and footfall in the Netherlands increased significantly in both 2022 and 2023 (but remains behind pre-Covid figures).

Future proofing retail real estate

Sustainability for retailers was previously focused primarily on the production process of items sold in-store, as well as logistics. It is only in the last few years, with several supermarket chains at the forefront, that attention has started to shift to retail real estate.

Still, retail real estate faces major challenges in complying with the Paris Agreement, both in terms of the real estate itself (often historical) and the energy consumption of daily retail operations.

High street occupier market
Rents and yields are bottoming out

High street retail: recovering from Covid-19 and cost increases

Recent years have been extremely challenging for retailers: in addition to the effects of a number of major long-term trends, there was Covid-19, followed by the steep increases in wages, rents, energy costs and procurement.

On the positive side: from 2022 onwards high street footfall returned strongly. Recent research by Locatus[1] states that in spring 2024 footfall in the largest cities in the Netherlands even exceeded 2019 figures. Smaller cities on the other hands, which faired relatively better during Covid-19, are not yet on the 2019 level.

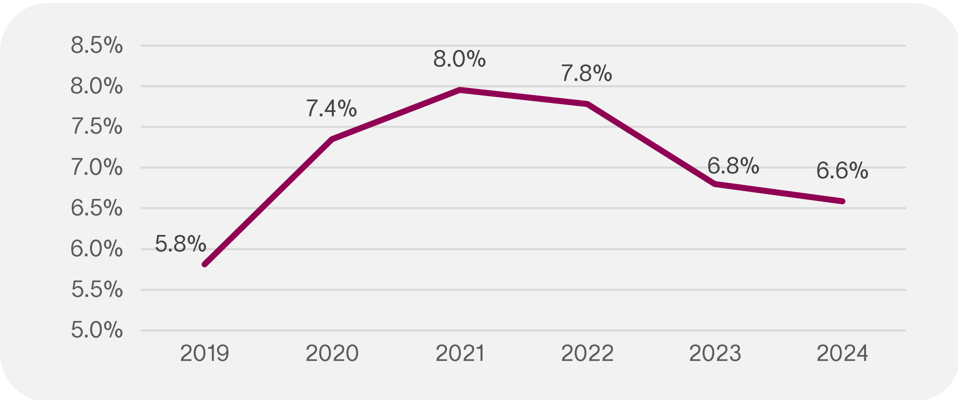
While retail revenues remained positive over the past two years, this was mainly due to price hikes. In 2023, the total retail sector recorded a revenue increase of +5.6%, but actual sales volumes dropped by 2.4%. The fashion sector showed similar results: revenue increased by 4.4% and sales volumes declined by 2.8%[2]. This trend seems to have halted in both Q4 2023 and Q1 2024, when actual volumes increased in all sectors.

Supported by the government's support during the Covid period, the level of retail insolvencies has been extremely low in recent years. At the same time, the transformation of vacant stores led to a substantial drop in the number of vacant stores: from 8.0% in January 2021 to 6.6% in January 2024[3]. As there is no longer any deferral for the repayment of Covid-related debts, insolvencies returned to pre-Covid levels in Q4 2023 and are likely to remain high. Coupled with retail chains reassessing their footprint and closing their least profitable stores, plus store owners unable to find successors, high street vacancy is likely to increase somewhat in the coming 2-3 years.

Vacancy is lowest in the largest cities[4] and is forecast to remain lower than in secondary cities. The city centres of the top five cities in the Netherlands have significantly lower vacancy rates than smaller cities, once again showcasing the trend of further consolidation and polarisation.

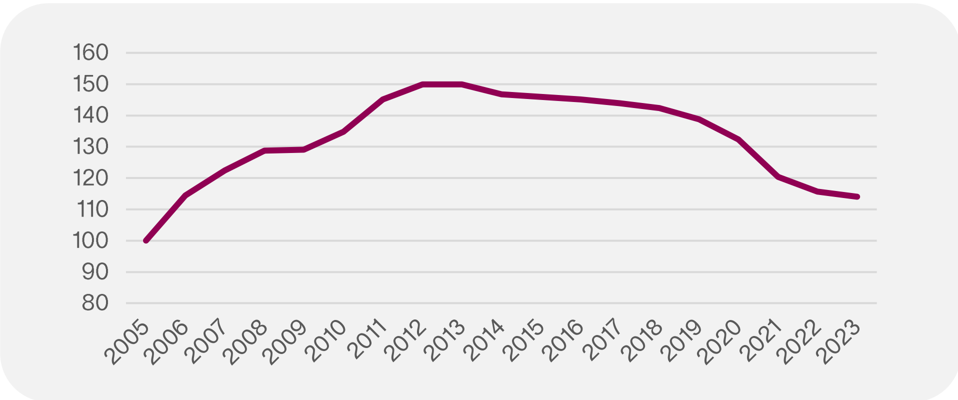
High street rent levels peaked in 2016-2018 and were already dropping well before the Covid-19 outbreak started to affect the market. However, after the substantial drop in market rents over the past 6-7 years, rents in Dutch retail high streets seem to be bottoming out. While Bouwinvest forecasts a minor drop in market rents in 2024, we are also foreseeing a return to nominal growth of market rents in the years after this, despite the expected uptick in vacancy.

Vacancy high street retail the Netherlands



Source: Locatus

Index prime rent top 5 cities the Netherlands (2005=100)



Source: JLL; edited by Bouwinvest

Convenience occupier market
Continuously adapting to changing demand

Convenience centres: solid basis, but always adapting

While high street retail has been through high and lows over the past years, convenience centres followed a much more moderate path. The outbreak of Covid-19 even had a positive impact on revenues for the chains catering to the daily goods sector, especially supermarkets, as they were the ones that generally remained open to the public.

This trend is also very much visible in the vacancy levels over the past decade. Vacancy in convenience centres dropped from around 9% in 2015 to sub-6% in 2023, before rising somewhat again over the past year[1].

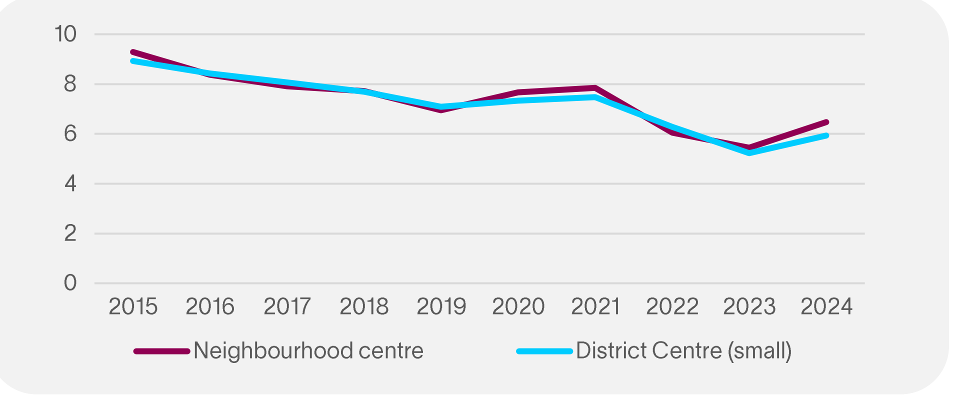
Taking into account that several large retail chains located in the convenience centre market are struggling, while private store owners are having difficulties finding successors, an increase in vacancy in the coming 2-3 years seems likely.

The convenience sector also had to deal with steep increases in wages, rents, energy costs and procurement in both 2022 and 2023. However, the stores in the food sector, including supermarkets, were able to transfer these increased costs to the consumers by raising prices[2].

Convenience centre rent levels registered nominal growth in the period 1995-2023[3]. While they outperformed high streets in terms of rental growth, they have, however, not been able to keep up with inflation. Long-term MSCI data shows an average annual gap of around 1.0%-point[4]) between inflation and market rental growth.

It should be borne in mind that the best performing 25% of the convenience segment saw market rental growth above inflation. For the coming 3-5 years, Bouwinvest forecasts nominal market rental growth for the convenience centre market, but rents will likely not fully keep up with inflation.

Vacancy convenience retail Netherlands (%; January data)



Source: Locatus

Bouwinvests' Gouda-Goverwelle shopping centre

Despite their stable appearance, convenience centres are continuously adapting to the changing market environment. An example is the Gouda-Goverwelle shopping centre, which has been part of our portfolio since it was built in 1993.

The centre was upgraded and extended in 2020. While 1,000 m² were added, the number of stores dropped from 27 to 21. Gone are the photo store, the bank, the Chinese restaurant, two fashion retailers, the brokers and two bankrupt chains.

In their place, we can now find several smaller catering units, a computer repair shop, a larger health and beauty store, while - very importantly - a second supermarket was added, and the existing supermarket was enlarged.

Investor market
Combining retail strategies makes sense

Historic divergence between convenience and high street retail

Fuelled by strong direct returns, total returns for the retail sector as a whole were always positive up till 2020. Then Covid-19 hit the experience sector hard, resulting in a heavy fall in capital values for this retail subsector.

Backed by the strong financial performance of convenience centres, from 2021 onwards total returns moved into positive territory again. This was despite the substantial interest rate hikes in 2022 and 2023. The size of average retail assets and the diversity of their buyers kept the yield increase much more modest than in other real estate sectors.

The divergence in returns from high street (comparison) retail and convenience centres is made clear in the graph to the right. Over the past decade convenience has structurally outperformed high street retail. We forecast the coming years to provide a different view.

Looking forward

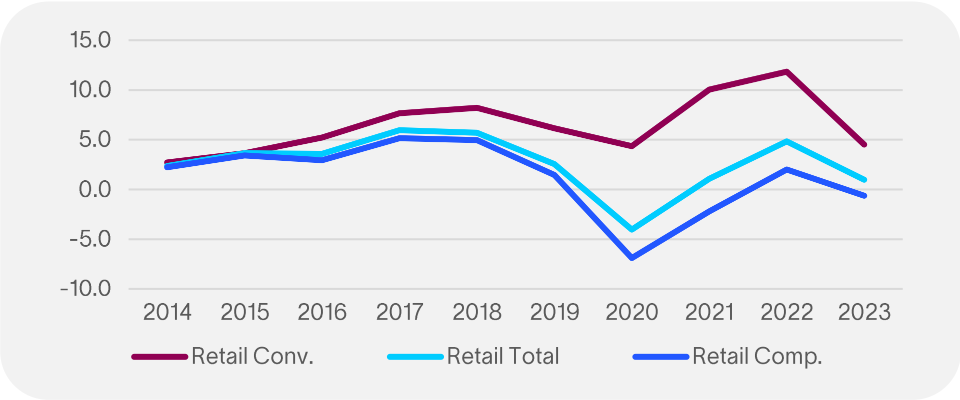
After a long period of dwindling market rents, Bouwinvest forecasts a return to market rental growth from 2024 onwards for high street retail, with an uptick in later years and Amsterdam leading the pack. We also foresee a minor drop in high street capital values in 2024, followed by a substantial recovery in the second part of our 3-5-year outlook. Again, with Amsterdam leading the pack.

For convenience centres, the forecast market rental growth is higher in the short term, in line with inflation, and will then subside to more modest levels in the second part of a 3-5-year outlook. We are forecasting continuing capital growth for this subsector, albeit at a more modest level than the experience sector.

The result of these forecasts are that we predict that in the second part of this 3–5-year outlook period the total returns of the experience sector will outperform those of the convenience sector. As such, the combination of both experience retail and convenience retail in our portfolio will have added value looking forward.

It should be borne in mind that our outlook very much depends on the future trend in inflation and interest rate levels. Should they continue to increase this will have a negative impact on the forecast. As it will on other financial or real estate sectors.

Total returns per retail subsector (%, MSCI)



Source: MSCI

Final words
Asset allocation and selection is key

Asset allocation is key – for all retail segments

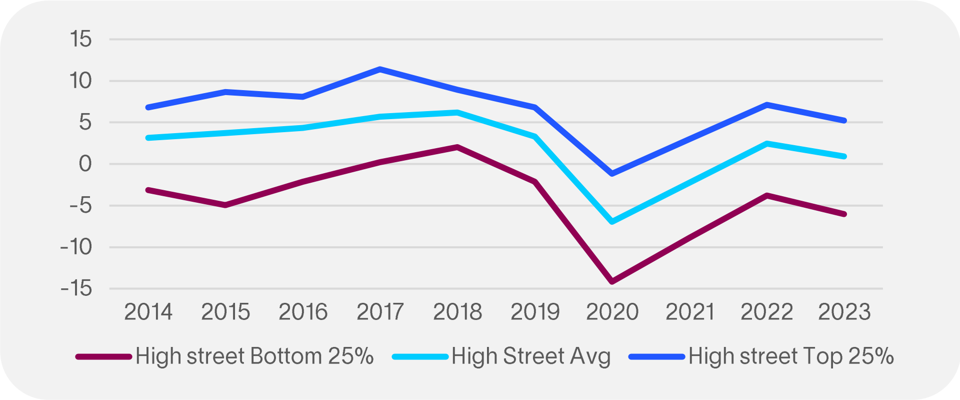
The challenge in investing in retail real estate is asset allocation and asset selection. For convenience centres, this is about picking assets that are and will remain dominant in their individual catchment areas. The centres should be easily accessible and visible, be able to adapt to changes in their catchment area, have a strong focus on daily goods and preferably two supermarkets.

For high street retail, it comes down to picking the right city, the right (part of) the best high street, the right asset and even the right brands. As polarisation is set to continue, city centres will become more compact and asset selection will only become more essential. The cities that will remain attractive are the ones where local authorities are actively working with all stakeholders to increase their attractiveness by creating centres that inspire, surprise and help people to connect[1].

The difference in performance between good and poorly performing retail assets[2] clearly shows that picking the right assets pays significant dividends. The graphs to the right clearly show that – both for high streets and convenience centres – returns for the best performing properties are materially better than the average, let alone the worst performing assets.

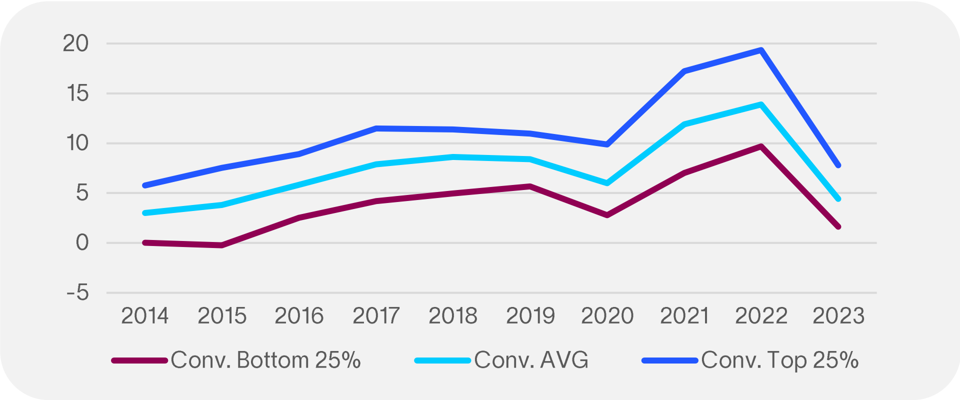
Finally, for both high street assets and convenience centres, investors, retailers and local authorities need to address the environmental challenges of future-proofing retail real estate and the surrounding areas. This also includes investments in combating heat stress and excessive rainfall.

MSCI High Street (Comparison) Retail - Total Returns (%)



Source: MSCI

MSCI Convenience Retail - Total Returns (%)



Source: MSCI

Reach out
for more detailed insights

Please contact us for more information

General contact details

Postbus 56045
1040 AA Amsterdam

+31 (0)20 677 16 00
info@bouwinvest.nl
www.Bouwinvest.nl

Jeroen Beimer
Head of Research
+31651364928
j.beimer@bouwinvest.nl

Jaap Landkroon
Director Institutional Clients
Open Funds
+31 6 5258 7027
j.landkroon@bouwinvest.nl

Appendix

Definitions

Comparison retail (Locatus):
The retail area is aimed at Fun/Experience, Fashion and Non-Daily. The retail floor space of the retail area is aimed at non-daily shopping for 70% or more.

Segments Comparison retail (MSCI/Locatus):
Comparison XL: > 100,000 m² retail floor space
Comparison L: 60,000 – 100,000 m² retail floor space
Comparison M: 30,000 – 60,000 m² retail floor space
Comparison S: 15,000 – 30,000 m² retail floor space
Comparison XS: 5,000 – 15,000 m² retail floor space

Convenience retail (Locatus):
The retail area is aimed at Run, Food and Daily. The retail floor space of the retail area is aimed at daily shopping for 30% or more and the supermarket sector is represented with more than 500 m².

Segments Convenience retail (MSCI / Locatus):
Convenience XL: > 15,000 m² retail floor space
Convenience L: 10,000 – 15,000 m² retail floor space
Convenience M: 5,000 – 10,000 m² retail floor space
Convenience S: 2,500 – 5,000 m² retail floor space
Convenience XS: 1,000 – 2,500 m² retail floor space

Alternative segmentation convenience retail for 'supportive centres' (Locatus):
District centre (large): 25-50 shops, supportive of a to town centre
District centre (small): 10-25 shops with generally 2 supermarkets
Neighborhood centre: 5-9 shops; generally sported by a supermarket
Mini convenience centre: 3-4 shops, including 1 supermarket measuring at least 500 m² lfa

Foot notes

Page 3:
1) Source: PMA.
2) Source: Locatus.
3) Growth 2023-2040 age group 15-55 year: NL +1% vs Top 20-municipalities +8%.

Page 4:
1) Source: https://locatus.com/blog/passantencijfers-voorjaar-2024/.
2) Source: CBS.
3) Source: Locatus.
4) The top 25 cities in the Netherlands relate to cities with at least 100,000 inhabitants.

Page 5:
1) Source: Locatus.
2) Source: CBS.
3) Concerns data from 1995-2023.
4) Especially in 2022, with inflation at 10.0%, this gap was extremely large.

Page 7:
1) This aim can be much broader and include elements such as the gathering of like-minded people, storytelling, collaboration, participation, making, playing and conviviality, learning and entertainment. Source: Future-Ready retail by I. Ibrahim.
2) Source: MSCI annual total returns; standing investments; 25th and 75th percentile.