Automotive & roadside

Surge in investor appetite as automotive sector motors on

Burgeoning asset class: Automotive is now seen as shifting from an alternative to a mainstream investment class

Consolidation of dealerships and a growth in UK funds and foreign investors have generated a surge in investor demand. **Simon Creasey** reports

Few property investment sectors have motored along at as rapid a rate of knots as automotive over the past few years. Investor appetite for car dealership lots is booming, with the sector offering the enticing combination of long leases, strong covenants, inflation-linked rents and regular tenant investment to ensure buildings match the aspirations of the car manufacturing giants.

The average lot size has also increased significantly in recent years, according to new research from Knight Frank. Its Automotive Capital Markets 2016-17 report shows that whereas a decade ago the typical investment lot size was approximately £2m to £5m, today the £7m to £10m bracket is well populated and assets and portfolios in excess of £10m are becoming increasingly commonplace.

Rise in registrations

These larger assets are expected to become more common in the future as car brands demand larger facilities off the back of four years of rising new-car registrations.

But has the market still got plenty of fuel left in the tank or are there threats on the horizon that will slam the brakes on autmotive investments?

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>
> **Adam Chapman, Knight Frank**

Since the millennium, there has been significant consolidation in the car dealership sector and the trend continued in the last year, with more than £500m of corporate acquisition activity registered making it one of the busiest 12 months for a decade, says Adam Chapman, partner and national head of automotive at Knight Frank.

“Merger and acquisition [M&A] activity has been prolific, which is a huge sign »

« of the health of the sector not purely from the investor perspective but also from the occupational perspective," he says. "We've seen more companies doing business-to-business transactions in the past 10 years and we've seen huge amounts of consolidation, with the bigger groups getting bigger and buying in brands. That's resulting in a significant windfall for a lot of investors."

In addition to car dealership businesses snapping up rival operators, the market has been buoyed by the arrival of more UK funds - propcos set up to specifically target automotive investment stock and foreign investors drawn by the cheap pound.

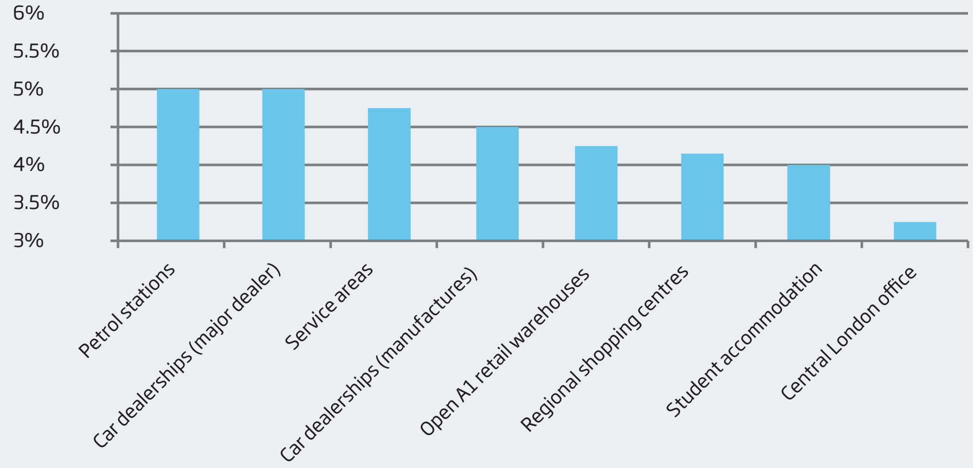
Their arrival has coincided with the perception of automotive as an investment class shifting from something considered alternative to something seen as more mainstream, and this reappraisal hasn't been adversely affected by the outcome of the EU referendum, according to Chapman, who says deals have still gone through post vote.

"We've seen other sectors where prices have been reduced or purchasers have tried to take advantage [of the vote], but in our sector values have held up extremely well and I can't think of too many examples where prices have been chipped," he says.

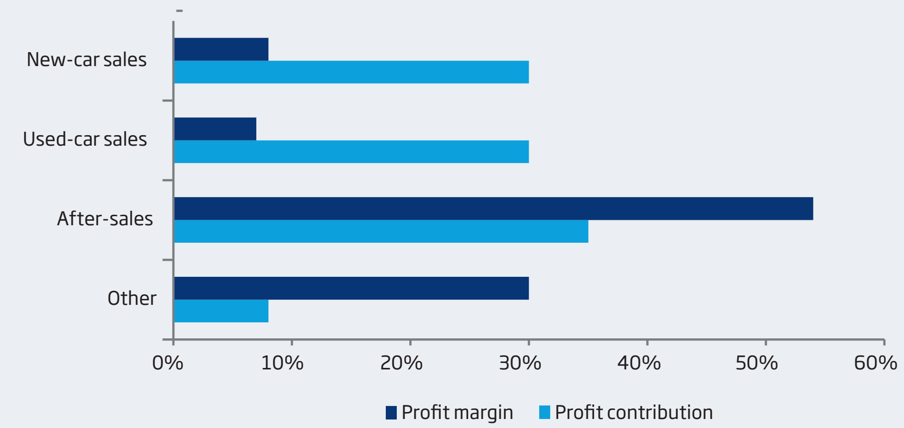
It comes back to the scarcity of stock and strong fundamentals, he adds. "We're selling a portfolio at the moment and a party tried to come and make an adjustment to the price to reflect the uncertainty and we said that nothing has changed – the product is solid and it's a great sector. Ultimately they agreed."

Auto capital markets

Prime yields by sector (as at Q3 2016)



Profit contribution and margin



Source: Knight Frank

Investment opportunities

The scarcity of stock remains a major challenge, but Chapman believes there is an opportunity for occupiers to take advantage of the pent-up investor demand for automotive property.

"The fact that nearly 80% of the automotive market is freehold sounds like an enormous amount to me and that clearly provides a finite amount of leasehold and therefore investment opportunities," he explains. "As investment appetite continues to gather pace, I think the dealer groups will start to question whether it is financially sensible to hold those very impressive, bespoke, retail-led dealerships or whether their business is about selling cars. If it is then sale and leaseback in some form could release a huge amount of money for them to invest in other [dealership] groups."

> **The prime dealerships are about as attractive an investment product as it gets**
> **Adam Chapman, Knight Frank**

While the opportunity to do sale-and-leaseback deals might appeal to some occupiers, others may be put off by past experience of the funding mechanism, believes David Chittenden, head of automotive and roadside at Colliers International.

"The dealership groups can do these types of deal at the moment, but the problem is that when they do the deal with the original landlord it's happy days, but when the existing landlord sells on to a third party the relationship can break down, so a lot are saying they don't want to do sale and leaseback anymore," he says.

A handful of new dealership developments are taking place at the moment, which would help to bring much-needed new stock to the market, Alisdair James, partner in the automotive and roadside team at Rapleys.

However, finding appropriate sites can be difficult because dealers are looking for spaces that bear the same characteristics that appeal to the likes of care home operators and residential developers.

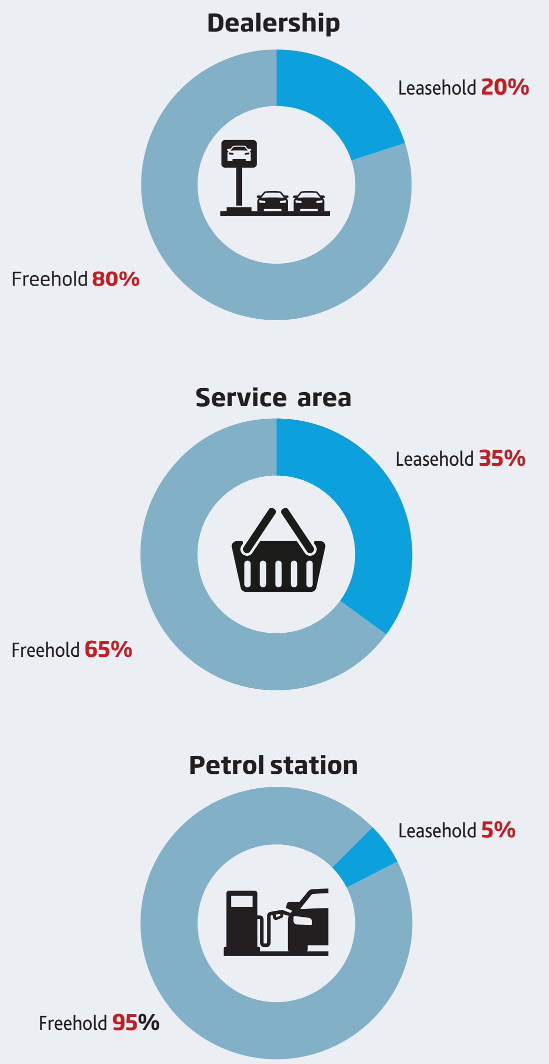
"Jaguar Land Rover wants the same dealer partner to represent both brands in the same territory and that's created a bit of musical chairs," says James. "But in some towns it's increasingly difficult to find a four-acre site that can satisfy both brands in one location, so it becomes quite a challenge."

Other prestige car manufacturers are also putting pressure on their dealers to ensure their premises are kept up to scratch. If they aren't, the manufacturer may choose to relocate to another location. But many dealership groups, especially the smaller ones, can't afford the high cost associated with building bespoke dealership property, notes Chittenden.

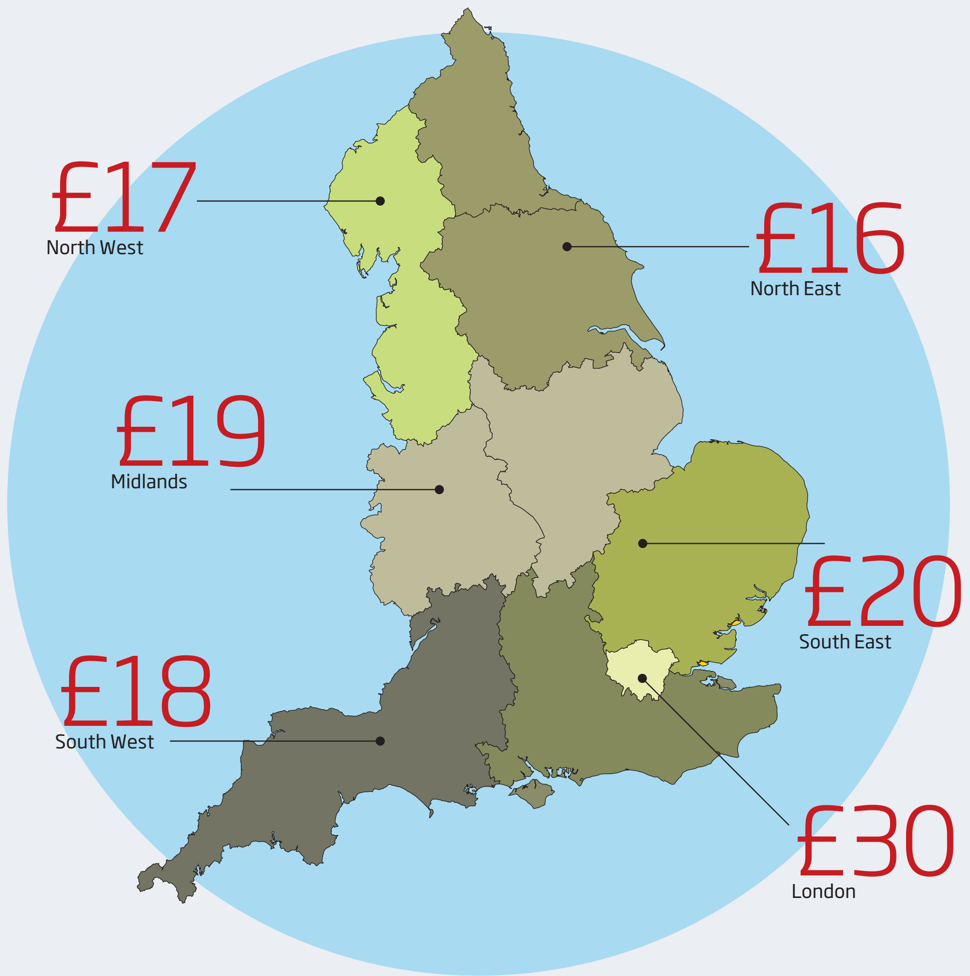
A model for the big boys

"I do a lot of work with the retailers and it's tough out there," he says. "We're seeing a lot of smaller groups exiting who can't afford to

Leasehold vs freehold ownership



Automotive rents (£ per sq ft)



survive because it's become a model for the big boys. It's a good time for them to sell because money is cheap and the investment market is still strong for this product."

The big question is how much longer the appetite for investment opportunities will continue. Over the next few years the automotive sector could experience a seismic shift. We are already seeing showrooms get bigger because the model ranges of manufacturers are rapidly expanding and at the same time, many experts expect that in the future there will be fewer dealerships around. That is partly due to the further consolidation and M&A activity expected among the larger dealer groups, but it is also down to the growing importance of the internet and the next generation of car purchasers.

Chittenden thinks that for millennials and the generations that come after that car ownership will become less important as the sharing economy and short-term car hire businesses such as Zipcar gain a greater foothold.

High-footfall locations

The industry is responding to the changing demands of modern consumers head-on by establishing a greater presence in high-footfall locations such as shopping centres.

"These sites have become more prevalent over the last few years and I can see more and more manufacturers opening sites in shopping centres," says Chittenden.

However, these locations aren't without their problems, as Rapleys' James points out. "If you want to offer test-drives it's a lot harder to do from shopping centre sites," he explains.

So investors need to be aware of the changing dynamics in the automotive sector to ensure the investments they buy today are future-proofed for the duration of the lease.

That said, while the automotive sector faces a number of challenges, with new-car sales showing little sign of slowing, Chapman is bullish about the prospects of this burgeoning asset class.

"Pricing is robust, certainly for the absolute prime assets, and we're seeing a real surge in investor demand, with this flight to quality that you see in uncertain times," he explains. "The prime automotive dealerships, which are typically 20-year plus terms to solid covenants with fixed RPI-linked rents, are about as attractive an investment product as it gets."

In short, there is little sign that the brakes will be applied on investment in the automotive sector any time soon. ■