Supermarket Sweep: Investing in Food Retail Property

Richard Curry, Partner, Retail & Leisure Group at Rapleys, comments

The UK's food retail sector has seen a significant shake-up in recent years. Challenges caused by e-commerce, changing consumer habits and the rise of challengers such as Lidl and Aldi has seen many operators reassess their property portfolios and requirements.

Meanwhile, factors such as Brexit continue to cause uncertainty and in some cases patchy financial performance. For example, J Sainsbury citing the referendum as a factor, announced an 8.2% fall in its annual profits for the year ending April 2017.

However with operators such as Morrison's and others posting healthy results, the market is becoming more confident. This has translated into a relative level of stability in terms of property strategy which has brought food retail property firmly onto the radar.

Investors however, may need to reassess their own strategies and there are several key factors to consider to optimise and manage food retail property assets.

A selective approach

For many years, as the 'Big 4' looked at increasingly diversified product ranges, bigger was often seen as better in terms of occupational requirements. Competition from online platforms and discount clothing retailers has seen supermarkets reassess this strategy and operators are now getting back to their core market purpose of food retailing. This has seen a general downsizing across portfolios and/or a targeting of sub-lettings or merchandising arrangements.

At the other end of the spectrum some retailers are offloading smaller stores. For example, Co-op sold almost 300 stores to convenience chain McColls, primarily because the stores were considered too small for the format that the Co-op are aiming at throughout its trading portfolio, which is 4,500 sq ft GIA (Gross Internal Area).

All this adds up to an environment where food retailers are being far more selective in terms of their store requirements as they streamline product offering. Investors must therefore be similarly selective over their acquisition strategy.

Very broadly the optimum property asset will fall into one of three categories, with close attention paid to the differences between the gross square footage and the square footage operationalised for sales.

1. The 3,000 sales/4,500 sq ft convenience store which is located within a major city, neighbourhood parade or proximity to a significant transport hub. This sector's operators have been actively pushing for expansion and this sector of the market is likely to continue to be in demand. The capital expenditure and running costs of convenience stores and competitive price pressures has resulted in a greater level of threshold required for sites. Careful selection is now being undertaken by the operators. Investors should do likewise.
2. The 7,000 sales/15,000 sq ft expanded convenience store, generally located in commuter hotspots or just out of town. These don't need to be 24/7 stores, with consumers peaking generally in the early evening but they require more diverse product ranges to the classic convenience stores. This is shown by Waitrose and M&S, albeit both Aldi and Morrisons are becoming more active within the format class, especially in city locations.
3. The optimum size for the 'superstore' is regarded now as 25,000 sales/40,000 sq ft (Tesco Extra stores, for example, historically have been up to 100,000 sq ft gross). This size enables operators to carry a sufficient range of products including non-food, while limiting excess.

Optimisation

The retail sector as a whole has seen a significant move towards shorter, more flexible leases and occupiers of larger properties will continue to explore space efficiencies. These larger sites must then be approached holistically.

Many investors will be attracted by the covenant strength of Big 4 leaseholders, particularly, but in a store of circa 100,000 sq ft, it is unlikely going forwards that a leaseholder of this size is likely to be the sole, or even principal, occupier. Over recent years there have been a number of development sites where the 'Big 4' occupiers have renegotiated the agreed space usage or pulled out altogether, as space requirements change. For owners and investors this requires active management of leases and rent review processes, while, where sites are pre-development, collaborating early with tenants to ensure the occupancy reflects the scheme plans is essential.

The future

Supply continues to be the key challenge for both investors and occupiers in the sector, with commercial property developments in general facing continued significant competition from the residential market. Meanwhile, the success of e-commerce operators and the launch of new challengers like Amazon Fresh may, in the long run, impact on bricks-and-mortar food retail and increase the prominence of logistics and warehouse facilities as property assets.

The impact on the market of these disruptors has, though, been slower than predicted and food retail property remains a core market need both for occupiers and investor alike.

Fundamentally investors should, like food retail occupiers, prepare to take affirmative action to ensure efficient and profitable portfolio performance in what is an increasingly dynamic and changing market.