

EUROHYPO MARKETS

NEWSLETTER EUROHYPO RAC RESEARCH

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EXECUTIVE
SUMMARY

Retail warehouses/retail parks – the winners in the polarisation of German retail

- The polarisation of German retail between high and low-price segments continues. Among the winners of this crowding-out competition are retail warehouses and retail parks with their orientation towards the lower price segment.
- Legal regulations create protection from competition for existing properties in large-scale retail.
- In the area of retail warehouses/retail parks 6 sectors dominate around 50 % of the market; the consolidation in these sectors will continue. For investors this means focussing on sector analysis in order to make the best possible assessment of opportunities and risks.
- Retail warehouses, because of stable cash flows among other reasons, have become a favourite investment property of institutional investors. This has had the result that retail warehouses show a positive capital growth in contrast to the general trend of German properties in 2005. In 2006 this is continuing.
- The owner structure for retail warehouses and retail parks will in future shift in the direction of institutional portfolio holders.
- The focussing on core competencies is resulting in the fact that trading companies will increasingly place properties on the market, often in connection with sale and lease-back agreements.

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The polarisation of German retail continues

German retail has suffered for years from structural problems. This is clear not least in the continuous growth of sales space whilst at the same time productivity of space is declining sharply. A reversal of the trend cannot be expected in the coming years, since further retail space is being planned and built. At the same time the ratio of retail expenditure to total expenditure on consumption is dropping steadily. A loser in this development in many places is the classical owner-managed specialist retailer. It cannot compete on the one hand with the investments in new shop units and sales concepts of the international store chains and at the same time is coming under pressure through the “Aldi-isation” of the trading landscape. The retail market is becoming polarised between a high-price segment of quality products and a low-price segment.

With their orientation towards the lower-price segment, retail warehouses and retail parks are the winners of this predatory competition which is taking place throughout Germany and they have been gaining market share continuously for years. This development will continue, although with less momentum than before. ■

Retail warehouses/retail parks – the regulated niche

Retail warehouses, according to the range of goods sold or needs catered for, are specialist retail businesses with discounted pricing policy on usually more than 1,000 m² of ground floor sales space at a location easily accessible to transport and with a large supply of parking spaces. Because of the great need of presentation space for the products and the necessary parking spaces, retail warehouses are located as a rule on the edge of cities. Exceptions are retail drugstores and to a certain extent consumer electronics retail stores which also set up in city districts with good transport connections. The properties mostly have a simple visual functionality, an economical, single-storey construction and parking spaces at ground level.

Retail parks bundle different retail warehouses at a place conveniently accessible to transport. The aim is to increase the attractiveness of the location for consumers by putting together several retail warehouses and thus increasing the frequency of visitors. Therefore these concepts often also incorporate small-scale retail and retail-type services.

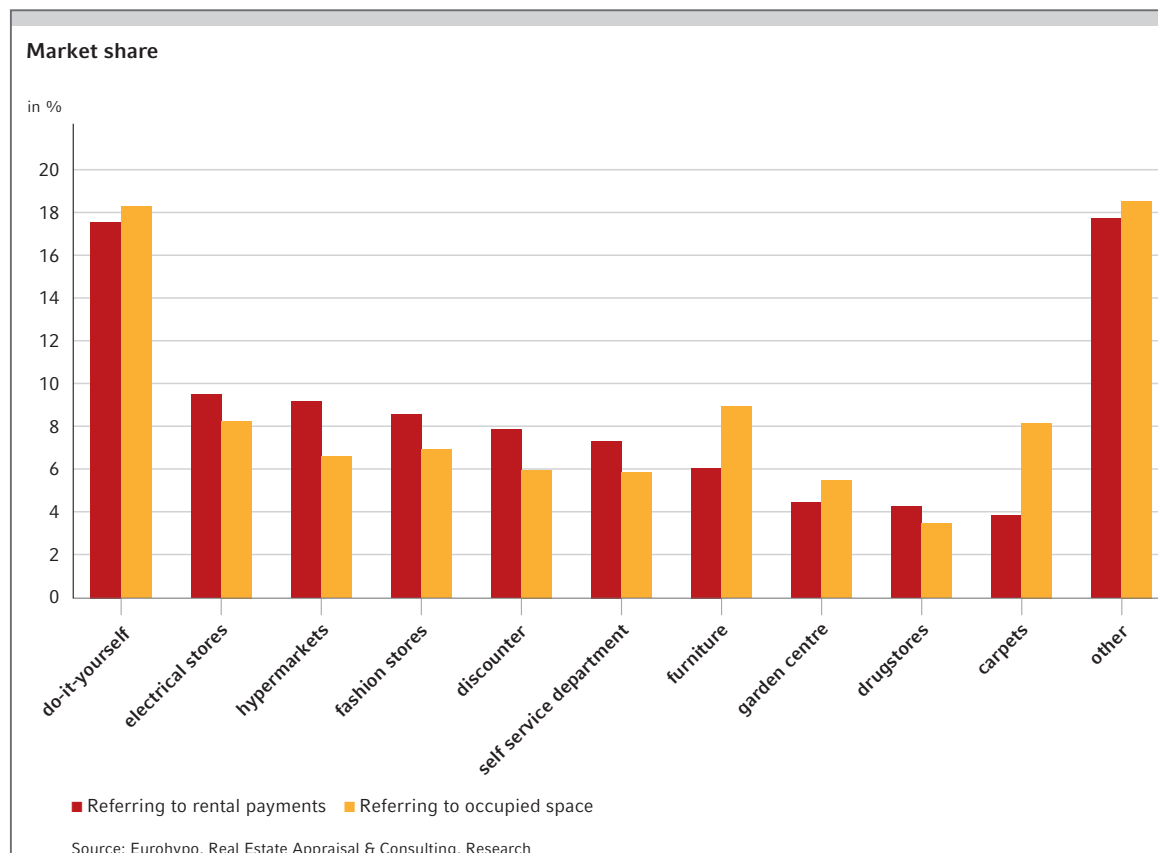
In the area of large-scale retail (sales area > 800 m²), which includes retail warehouses/retail parks, the pressure of competition increases and thus the competition for attractive locations. The reason is that as a result of the Building Use Regulations (German initials: BauNVO) the putting up of buildings outside city centre core areas has been rigidly controlled for the last two years. It is only permissible in special areas zoned for it (§11 BauNVO) and neighbouring communities have a right to be consulted in such zoning. In consequence the establishment of new, large scale retail projects is fraught with considerably difficulties and at the same time offers protection against competition for existing properties. For this reason the expansion of supply in the sub-segment retail parks could become increasingly difficult and lose momentum in the coming years.

This regulatory framework is forcing companies to rethink their branch structures and forms of organisations. Organic growth or growth through take-overs is an important success factor of these companies. In this way increases in efficiency are to be achieved in order to raise the low profit margins.

The first consolidation tendencies are being seen in the self-service department stores with the purchase of Wal-Mart through Metro (real,-) and in do-it-yourself stores with the take-over of Max Bahr by Praktiker. The continuous pressure from the capital and financial markets to increase profitability will have the result that further take-overs can be expected in the coming years. The consolidation in German retail will continue. ■

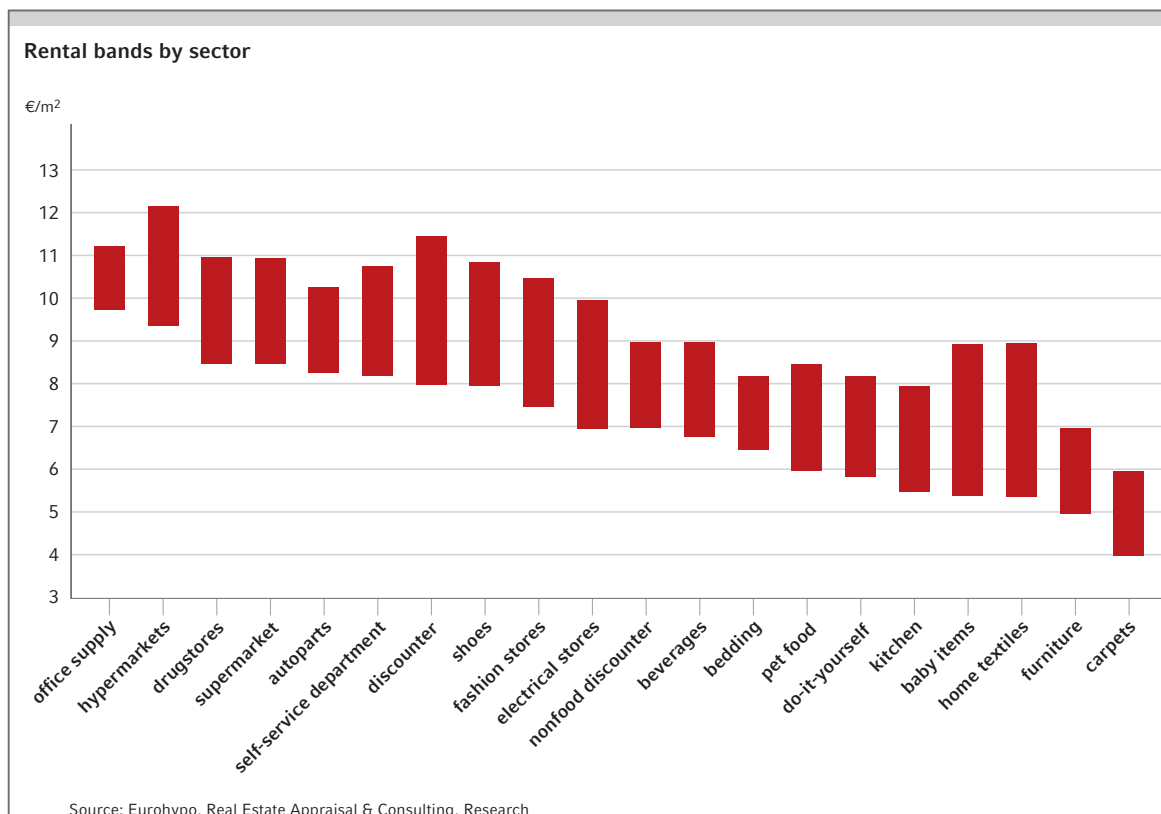
Investor as sector analyst

For investors in German retail warehouses and retail parks the regulatory framework means an increasing focus on sector analysis. Against the background of recognisable saturation tendencies in some sectors an analysis of the consolidation tendencies now occurring are of decisive importance before investment. According to estimates by Eurohypo RAC Research the most important sectors – measured by rental income – are particularly do-it-yourself stores (Obi, Praktiker), electrical stores (Media Markt, Saturn), hypermarkets (minimal, REWE), fashion stores (kik, Takko, Vögele), discounters (Aldi, Lidl, Norma) and self-service department stores (Kaufland, Wal-Mart [now taken over by Metro, is to be continued under the brand real,-], real,). These 6 sectors generate around 60 % of the total rental income and occupy around 50 % of the space. ■



The necessity of an increased focus on sectors should not however blind one to the fact that regional and location-specific influences have their importance for the assessment of each investment property. This is shown in the willingness to pay rent in retail parks and retail stores, which shows great differences depending upon location.

In general a range of rents between 6 and 12€/m² applies. An analysis shows both regional and location-specific differences and also clear variations depending on the sector in the level of rent. This is the result of the competition environment in each sector and shows the necessity for a careful analysis of the sectors. At the same time the rent level shows very low volatility over time, which makes it easier to forecast. ■



Retail properties in the spotlight of international investors

Despite or precisely because of the structural underlying conditions, German retail currently stands in the spotlight of international investors, even in front of residential property. The modest growth in value of retail properties compared with the rest of Europe, as illustrated by the DIX index, does not disconcert international investors. In particular large-scale retail, concentrated on retail warehouses and retail parks, is a favourite investment property, which is proved by the large number of transactions in the last 18 months. ■

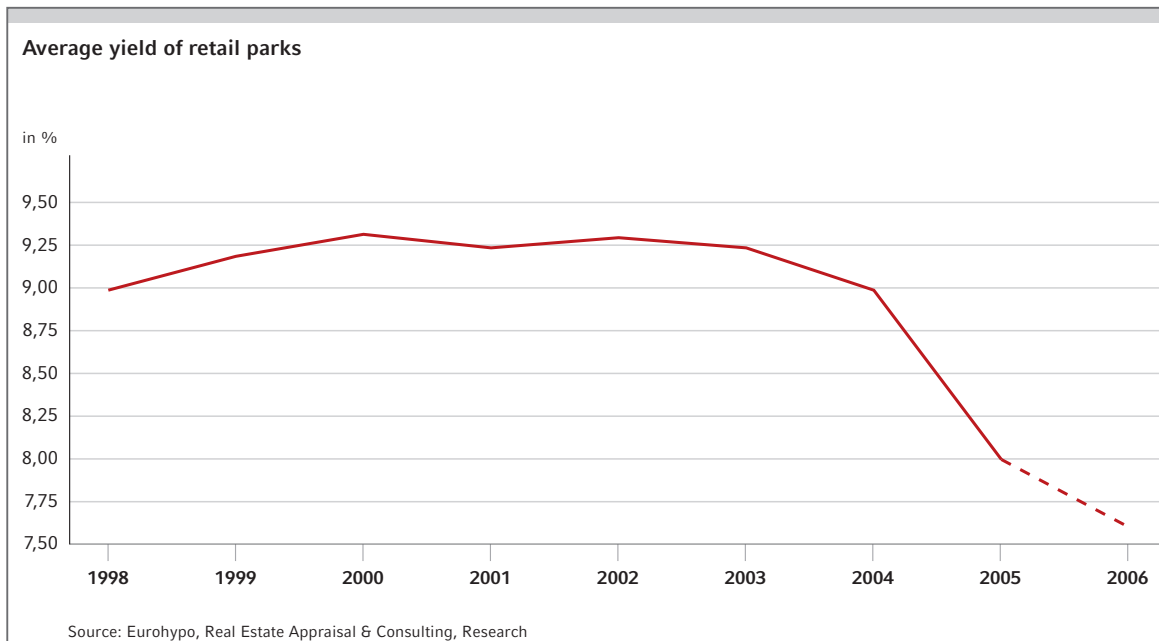
Selected transactions in 2005/2006

Investor	Property(ies)	Comments
Capital & Regional	Portfolio of 10 properties will do the asset management	Price 150 m€, the seller Hahn AG
ACL Property One SARL	3 retail parks (Bad Staffelstein, Schwalmstadt-Treysa and Mühltdorf am Inn)	Price 17 m€
LaSalle Investment Management	5 retail parks the project phase	Price 55 m€, 2 properties still in
Curzon/IXIS AEW Europe	35 Praktiker stores in Germany	Included in a portfolio of 53 Praktiker properties – in Germany (35), Greece(8) and Hungary (10) and the HQ in Kirkel, portfolio price ca. 480 m€
MEAG	2 retail warehouses (Weil am Rhein and Bremen-Blumental)	Price ca. 55 m€, Weil am Rhein still under construction
Edinburgh House	Furniture retail warehouse in Wesel	
Warburg Henderson KAG	Retail park in Bedburg near cologne	
LB ImmoInvest	Furniture retail warehouse in Braunschweig	Price 7.5 m€
Edinburgh House	Retail park in Meiningen	Price 11 m€
German Retail Reit AG (80% Cargill, 20% Sontowski & Partner GmbH)	7 discounter and retail parks (Maxhütte, Nabburg, Pödelsdorf Schlieben, Rudolstadt, Dresden and Weißwasser)	Price 18 m€
Edinburgh House	Retail park Rostock	
BGP Investment Sarl (Joint Venture von Babcock & Brown und The GTP Group)	Retail park Gäubodenpark in Straubing	
Capital & Regional (Joint Venture with Hahn AG (10%-share))	22 retail warehouses	Included in a portfolio deal of 214 m€
Moor Park Holdings Luxembourg Sarl (European Funds Group of Nomura International plc)	Max Bahr do-it-yourself stores	Simultaneously the operational business of Max Bahr was sold to Praktiker

Source: Eurohypo, Real Estate Appraisal & Consulting, Research

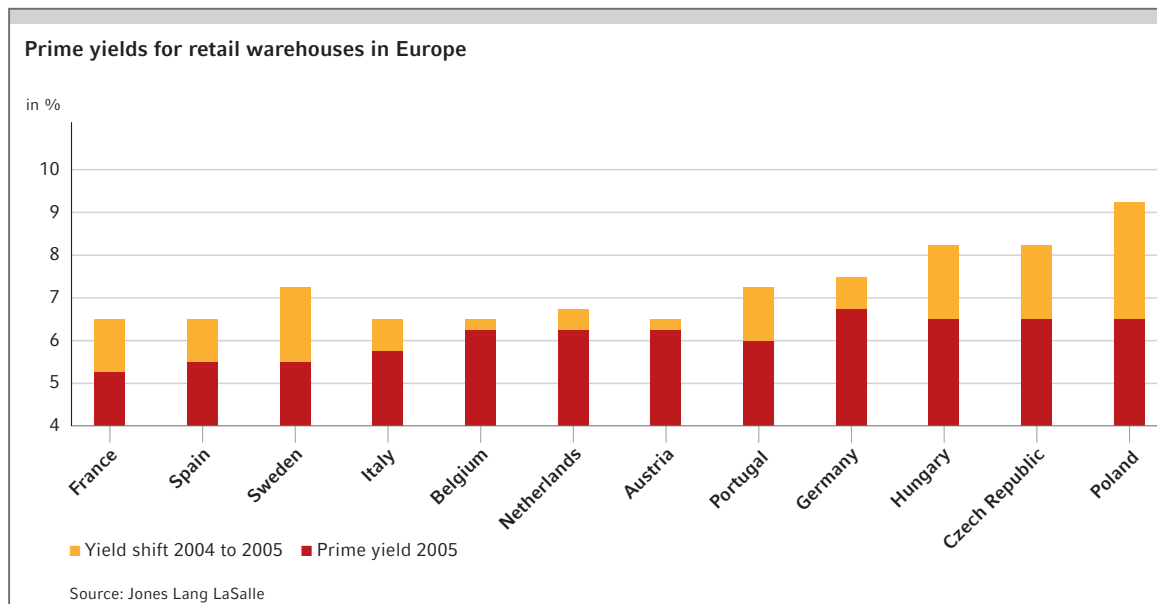
Positive change in value of yield against the trend

If one analyses the development of average yields of retail parks it is shown that movement has come into the market with the increasing interest of international investors. Since 2003 a clear drop in yields has been evident, around 100 basis points in 2005 alone. This development is due not least to the above-described scarcity on the supply side. Accompanying this is a considerable increase in value of the properties, since on the rental side no great changes have been recorded. The sector was thus able to uncouple itself from the negative capital growth of retail properties of institutional investors in Germany. ■



Yields – further decline probable despite possible rise in interest

Compared with other European countries the level of yields for retail warehouses in Germany is still however assessed as very attractive. The continuing great interest of institutional investors in properties and their increasing orientation to current earnings has guaranteed consistently high demand for retail warehouses and retail parks. In consequence a further decline in prime and average yields in Germany is to be expected, even if more increases in interest rates are decided upon by the European Central Bank. ■



Expansion of supply through focussing of trading companies

The structural changes appearing in the individual sectors will make themselves evident on the supply side in the investment market. The focussing on core competencies results in the fact that ever more retailers recognise the potential which lies in their properties. Not least the transaction of the Praktiker properties has shown that the attempt is increasingly being made to exploit this potential, in order to use the resources released to increase returns in the core business. It can therefore be expected that in future more portfolios will come onto the market.

For investors the focussing of the trading companies on their core competencies means the opportunity of acquiring further properties. In many cases such portfolio sales are combined with sale-and-lease-back agreements so that the cash-flow of the investment is also calculable. But investors must above all pay heed to the following factors. Are the locations attractive in the long term for the present tenants or for potential other tenants? How does it look with the duration of the leases? What is the size of the properties? Are they large enough for the current requirements of the trading companies? Is there a risk of closing of retail branches as part of consolidation tendencies? ■

Transformation of the owner structure

In the medium term it can be expected that the owner structure for retail warehouses and retail parks will change in favour of institutional portfolio holders. At present this process is being driven above all by foreign investors. It can be expected however that institutional investors from Germany will also play an important part, particularly because of their local know-how. In the long term further consolidation will take place with retail warehouses and retail parks both on the demand and also on the supply side. ■

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