

Intelligent Investment

Grocery Market View 2023

VIEWPOINT

We consider the outlook for Grocery assets against the backdrop of the current macroeconomic headwinds.

CBRE RESEARCH
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Overview

- Consumers are changing the way they shop in response to the cost of living crisis, and grocers are investing heavily to retain market share
- All occupiers see opportunity for portfolio growth. While discounter duo Lidl and Aldi continue to report a sizeable pipeline, traditional grocers are focused on the selective roll-out of their convenience and mid-sized formats
- In-store sales remain well protected in the current economic climate, as consumers focus on value for money. Looking longer-term, while we anticipate online sales will grow, the store will remain a core feature of grocers' strategy – delivering an omnichannel service
- While investment stalled in 2022, following a period of swift repricing, the market has regained momentum this year. Sale and leasebacks are expected to deliver a stable supply of stock, and investors continue to seek secure income that can be delivered by this asset type

August 2023 ONS food and non-alcoholic beverage inflation

13.6%

August 2023 Kantar own-brand product spend (YoY)

9.7%

Consumer and occupier trends

In August 2023, inflation for food and non-alcoholic beverages was [13.6%](#). While this is lower than its peak in March of 19.2%, it is almost triple the five-year average of 4.8%. So, it is unsurprising that food inflation has been an increasing concern amongst UK consumers this year – in June 2023, nearly [70% of households](#) were either 'extremely' or 'very worried'.

Reflecting this, consumers are changing their shopping habits. According to Global Data, 49% of consumers are opting to save money by purchasing more of the store's own brand products. In August 2023, spending on own-brand had increased by [9.7%](#), versus [6.4%](#) for branded products. Further evidence of this trend can be seen in Asda's Q2 2023 reporting, where sales of their own brand range have grown 14.7% year-on-year. While this strategy is supportive from a customer retention point of view, it is expected to weigh on profit margins.

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As well as focusing on own brand ranges, grocers are heavily investing in loyalty schemes to retain consumers

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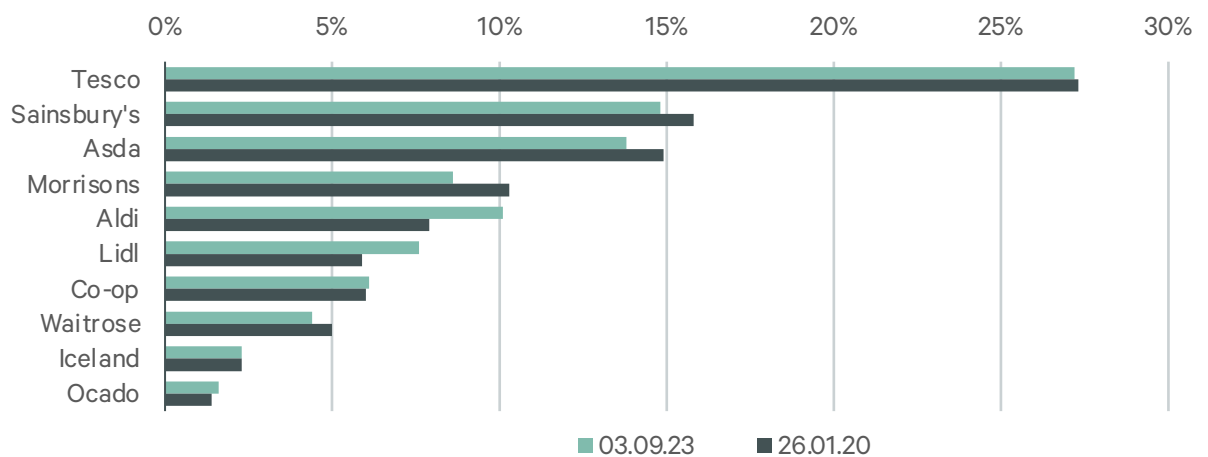
Grocers are heavily investing in loyalty schemes to retain consumers. While Tesco’s Clubcard pricing of 8,000 items maintains competitive advantage, other occupiers have sought to capitalise on this model. In April this year, Sainsbury’s revamped their Nectar loyalty scheme with Nectar Prices – as of June, the initiative included over 900 products. Meanwhile, Asda and Morrisons have also introduced their own versions, enabling consumers to exchange points for cash vouchers amongst other benefits.

Kantar Grocery Market Share –
Tesco 12 weeks ending 03.09.23

27.2%

However, savvy consumers continue to shop around. According to Global Data, 31% of consumers are choosing to switch stores or outlets to cope with rising prices. A review of market share changes in figure 1 highlights the increasing appeal of discounters. [In September last year, Aldi overtook Morrisons as the UK’s fourth-largest supermarket chain](#) when considering household spending. This market share gain can at least in part be attributed to the occupier’s strong expansion. Both discounters Aldi and Lidl have significantly expanded in recent years, focusing on medium-sized units – typically between 18 to 20,000 sq ft. Not only has portfolio expansion delivered access to an increasingly large shopper pool for the duo, but our analysis also shows that the newer stores within these occupiers’ portfolio have a more affluent catchment, reflecting their broadening appeal. This growth looks set to continue, with Lidl targeting to reach 1,100 stores by 2025, and Aldi’s recently announced plans for an additional 500 new stores after opening its 1,000th store in Woking.

FIGURE 1: Grocery market share



Source: Kantar

Meanwhile, the more mature, traditional grocers have seen less change in their established portfolios during this period. All currently have requirements for stores up to GIA of 70,000 sq ft, although these remain highly selective and annually new openings are unlikely to amount to more than a handful in aggregate.

One continuing area for growth will be the rollout of the convenience format of c.3,000 sq ft. This format is complementary to existing portfolios, generating synergies for distribution and delivering greater flexibility to the consumer.

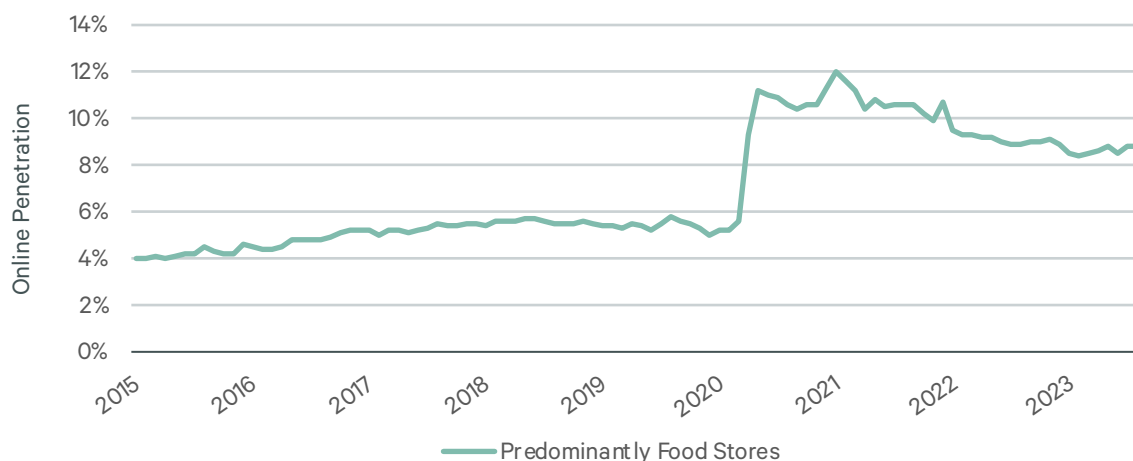
Further to their recent expansion into forecourts, Asda now have three trading standalone convenience stores, Asda Express, with plans to open a further 300 by the end of 2026. Following their successful integration of the Argos business into the larger stores in their estate, Sainsbury’s is also now primarily focused on convenience store expansion, opening three new stores last month in East Horsley, Ketley and Wapping. At the same time, the grocer is selectively considering locations offering a net sales area of 8,000 to 20,000 sq ft, such as their recent opening in Hook, with Alsagar and Talbot Green to follow.

Meanwhile, Morrisons' recent acquisition of McColl's has enabled the grocer to significantly expand their convenience presence. Plans to renovate the majority of the 1,164 stores to the Morrisons Daily format is expected to boost performance, with every new conversion delivering an immediate, substantial sales uplift, often more than 20%. The grocer is also continuing to expand its mid-size store format with new store openings in Newcastle Great Park and Chelmsford.

Considering the premium grocers, Marks & Spencer continues to deliver its full-line store rotation programme – focusing on the right stores, in the right place, with the right space. At the same time, the occupier plans to open over 100 food stores, reaching 420 by FY 25/26 in the coming years. Meanwhile, Waitrose remains focused on revamping their existing portfolio of 332 stores, with £250m of investment announced earlier this year.

Looking ahead, we expect the discount sector will continue to see the strongest performance. Euromonitor's consumer spend forecasts that on average, the grocery market size is expected to increase 0.8% year-on-year in 2023, while discounters are expected to see much stronger performance at +6.5%. Warehouse clubs are also anticipated to see good performance as consumers opt to buy in bulk to make savings. Meanwhile, local grocers are likely to be impacted the most as they struggle to compete with larger rivals' own brand lines and greater margin flexibility.

FIGURE 2: Predominantly food stores online penetration



Source: ONS

Amidst increasing cost sensitivities, we anticipate the physical store will become even more important to the consumer in the short-term. [53% of consumers believe they can get the best deals shopping for groceries in-store, as opposed to 13% for online.](#) Above, figure 2 highlights that while grocery online penetrations peaked at 12% during the pandemic, they have since moderated and now stand at 8.8%.

While discounters maintain a store-first strategy – with Aldi only offering a limited click and collect service and trialling home deliveries in Germany – all the other major grocers are investing heavily in this channel. Tying in with an increasing focus on convenience, several partnerships with external rapid delivery providers have been announced since the pandemic. Therefore, as purchasing power begins to improve, we anticipate online penetration growth within the sector will resume. Albeit growth is expected to be moderate as the profit margin challenges associated with this sales channel remain. Moreover, given that stores continue to be the most efficient route to servicing online orders – in our experience 25% of sales from strongly performing omnichannel stores can be delivered by the online channel – we do not anticipate penetration growth will impact grocers' store requirement plans.

Looking ahead, given the sector's resilience, and with many operators continuing to plan expansion, we forecast moderate all grocery rental growth of 1% in 2024, and 1.3% in 2025.

Investment trends

Prior to last year, investment into the sub-sector had been stable – between 2019 and 2021, volumes totalled to approximately £1.4bn per annum. However, the combined effects of the progressive Bank of England interest rate hikes and record low prime yields (3.5%) stalled investment, and in 2022, volumes fell to almost 60% below the levels seen in preceding years.

Yet, conditions are improving. Following a period of swift repricing in the final quarter of 2022, prime yields for supermarkets have now stabilised at 5.25%. At a 10-year high, this price point has re-engaged many investors who are seeing significant relative value in the sub-sector.

Reflecting the improving sentiment, investment volumes totalled to £928m in the first quarter of 2023 – 60% above the total transacted volumes in 2022. Driving the strongest quarterly performance seen in over a decade were three portfolio transactions; two relating to the Sainsbury’s Reversion Portfolio, and one relating to a portfolio of Morrisons assets acquired by Pimco for M&G. Aside from significant portfolio activity, the first quarter of the year also delivered the first institutional fund acquisition seen in the sub-sector since Q4 2020. Aviva’s acquisition of Asda located in Hayes, is indicative of the flight to secure income assets that many investors are expected to follow during this turbulent economic period.

H1 2023 supermarket investment volumes

£1.1bn

September 2023 prime supermarket equivalent yield

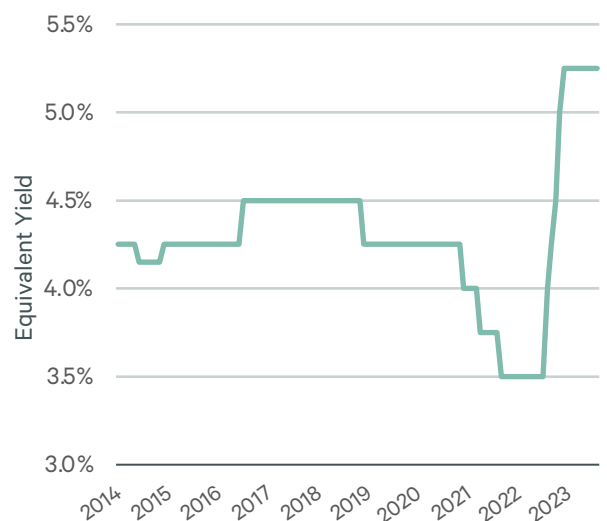
5.25%

FIGURE 3: Supermarket Investment Volumes



Source: CBRE Research

FIGURE 4: Supermarket Prime Equivalent Yield



While the second quarter of the year delivered more modest investment totalling £159m, a diverse investor pool remained. During the quarter, we advised institutional investor Federated Hermes on the acquisition of Sainsbury’s in Darnley for £48.3m (NIY 5.7%), as well as British Steel Pension Fund’s sale of Tesco in Worcester to Supermarket Income REIT for £38.3m (NIY 6.0%). Looking to this quarter’s results – Q3 started strongly, driven by Realty’s £645M acquisition of an Asda 25-asset sale and leaseback portfolio, and LCN Capital Partners’ £100M purchase of Tesco, Cardiff and Sainsbury’s Wigan from M&G. We understand there is a further c.£175M currently under offer or exchanged.

While consumer spending continues to be challenged, non-discretionary retail such as food and groceries will be prioritised. Moreover, with index linked rent review clauses common place – providing the fundamentals of stores are robust – the asset class will continue to offer compelling returns on a risk adjusted basis for direct real estate. Additionally, while other sectors may be challenged by stock availability in the next 12 to 18 months, the volumes in the supermarket sector are likely to be driven by the grocers themselves. In an era of increasing debt costs, sale and leasebacks will continue to offer occupiers an efficient way to raise capital. We anticipate that for grocers with large freehold estates, the strategy will remain attractive provided that initial rents are based off sensible levels and are protected by suitable caps.

Given the current lack of stock from other real estate sectors competing for attention, the strong fundamentals of the sub-sector will continue to appeal to the investor community.

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