Food retail **comes to the fore**

Johnnie Wilkinson, CEO of investment fund manager Greenman, describes how food retailers have coped during the pandemic

In January, I think it is fair to say that many of us in the sector were still trying to predict how online food retail would mesh together with bricks and mortar stores and click-and-collect models in an industry where operating margins are notoriously low, especially in Germany.

Several months into the Covid-19 pandemic and arguably the most severe test our investment model has seen, we are now much clearer on the future of the sector and the role that bricks and mortar will have within it.

Notwithstanding the significant challenges posed by Covid-19, the insight this crisis has provided is likely to prove invaluable in shaping our approach to the future.

As the operator of Greenman Open (GMO), one of the largest German food-retail focused real estate funds on the market, we found many of our tenants thrust into the eye of the storm, classed as providers of essential services that had to remain open throughout lockdown. After all, there are 83 million people in Germany and they all need to eat.

Essential retailers, which include both supermarkets and pharmacies, generate 83% of GMO's income. Food retailers experienced unprecedented demand as the pandemic took hold. Edeka, which sells 30% of all groceries in Germany and represents 30% of GMO's income, experienced a large increase in turnover.

To help Edeka and other supermarkets cope with the surge in demand, we were able to facilitate the transfer of staff from non-essential retailers to food retailers, as well as utilising unlet space as storage facilities to ensure supply chains remained open.

GMO PERFORMANCE

The fact that our GMO portfolio is significantly weighted towards essential retail meant that our performance was not as severely impacted as those with exposure to other retail sectors. At the height of the lockdown in Germany, GMO was still able to collect 86% of all its rental income, despite the German government allowing businesses to delay these payments. This figure bounced back to 94% in June and we expect to recover a sizeable portion of the unpaid rent over the next few months.

On the investor side, the fund's performance and the continued strength of the food retail market in Germany enabled us to collect €44.7m of investment inflows into GMO in Q2, making it one of our strongest quarters on record.

ACQUISITIONS AND DEAL PIPELINE

Despite having to adjust our working practices, we have continued to work on and execute deals, due in large part to the market knowledge and relationships we have been built up over several years. For example, GMO signed its first ever development framework agreement during lockdown. The deal to purchase three hybrid centres anchored by German supermarkets is a good example of how we intend to access better value for investors by taking advantage of off-market opportunities.

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> **Johnnie Wilkinson, CEO, Greenman**

What is clear from the pandemic, however, is that there will be changes to the way many of our retail centres operate in the future. The stress caused by the pandemic has served to accelerate the rate of evolution in the sector, highlighting significant opportunities for bricks and mortar assets and exposing some of the technical and infrastructure weaknesses in the online grocery model.

Rather than investing in online grocery services and the extra logistical infrastructure to support growth, we are seeing supermarket retailers allocate more space to click and collect services. These convey several advantages, including the potential to generate additional in-store revenue, while allowing supermarkets to economise in other areas, for example by using the same fulfilment areas, staff and inventory management systems.

What's more, rent for last-mile delivery fulfilment centres in Germany is now on a par with rent for food retail space, having moved from circa €3/sq m to €9/sq m, which is squeezing the margins available to online retailers further.

There have also been longer-term shifts in European planning regulations, with largescale food retail building permits harder to get. This has exacerbated the move towards mixed-use developments, often with food retail on ground floors and residential space above. We expect this trend to continue as Covid-19 makes social distancing on upper floors more difficult.

In a recent survey by Greenman, just 3% of our customers said they would consider shopping for groceries online, compared with 31% for clothes. We remain convinced that the bricks and mortar store is here to stay.

RETHINKING INCOME GENERATION

The pandemic has forced us to rethink how we generate income from our tenants and how we use the non-essential retail space in our portfolio. Whereas pre-Covid-19, changing the tenant focus to food and beverage was considered a good alternative strategy, we now believe a more fundamental approach is required.

As a result, we have set ourselves the target that by 2025, 5-10% of the income generated by the fund will come from non-rental items, such as data, sales to customers, additional fulfilment for the supermarkets, click and collect and return services.

In short, we believe it is time to look beyond rent as the sole income stream for the fund.

In the meantime, as the sector and our tenants continue to work through the pandemic, we intend to remain at the forefront of innovation, driving through change where it is needed and collaborating with our tenants to test and trial new technology and working practices along the way.

Even though our centres account for c€1bn of grocery sales in Germany, which is only 0.5% of the market, it is enough for us to continue to be part of the conversation about how our sector adapts to the future retail environment.

Above and below: Essential retailers, which include supermarkets, generate 83% of GMO's income