

UK Commercial - February 2023


SPOTLIGHT
Savills Research

Motor Retail Market Commentary



Jaguar Land Rover Leeds – Investment Sale

● Occupational market trends

● Investment market trends

Market overview

After a strong start to the year, significant wider economic challenges emerged, and major economies around the world are now facing a downturn following higher inflation and interest rates. Across UK real estate, some sectors are experiencing the economic pressures, while others are showing resilience.

It was a fundamentally robust year for the car dealership industry amidst the obvious macroeconomic headwinds. Car mobility remains essential for the general population, and although trading volumes from vehicle customers were lower, demand remained strong. Dealers have reported months of orders backing up, despite the cost of living crisis which disproportionately impacted those in lower demographics less likely to own cars.

It would seem the principal challenge of the new car market remains a supply issue fuelled by the ongoing financial, energy and supply chain issues, likely to persist throughout 2023. The Society of Motor Manufacturers and Traders (SMMT) has, however, reported stabilising supply figures with car registrations in the green from August to November. Overall, 2022 registrations were 3.4% lower than 2021, but stabilisation towards the end of the year would suggest that the automotive sector is well poised for supply recovery.

Battery electric vehicles (BEVs) remain modish, with over half of motorists wishing their next car to be electric (MotorTrader), and the SMMT figures continue to show growth, with BEVs accounting for a 15.1% market share in 2022. To achieve zero emission growth, the government and various stakeholders must aid drivers in transitioning to go electric primarily through investing in nationwide charging infrastructure.

The market is also entering a transitional phase in the dealer and OEM (original equipment manufacturer) vehicle sales process. An option for OEMs is to introduce an 'agency model' whereby the dealer no longer inherits the profit margin risk of purchasing the vehicle product from the OEM, rather the customer places the order directly with the OEM and the dealer is the conduit for delivery of the product to the consumer. This will have a significant impact on dealership property. The dealer will display fewer new cars, reducing showroom space, which could lead to opportunities such as multi-franchising under one roof. Ultimately this will consolidate the dealer's property holdings, presenting an opportunity to reposition their property and potentially unlock alternative use value on surplus space. We have seen a number of dealers' balance sheets benefit from dealership sales for alternative uses such as care homes, data centres, convenience stores, self-storage and residential. Despite the potential consolidation which may come as a result of this model, the dealer will continue to maintain the

relationship with the customer, benefiting from the traditionally profitable aftersales portion of revenue. The dealer remains the focal point of the sale and distribution process of the vehicle.

The used car market has shown signs of correction in 2022 following a booming year in 2021, with sales 5.5% below the pre-pandemic five-year average (SMMT). Despite 72% of people now being open to buying online, half of all used vehicles are sold by franchised dealers (Car Dealer Magazine), with consumers staying loyal to the physical salesman as well using their online sales counterparts. As a result, franchised dealer balance sheets have remained healthy, with a number of groups posting record profits.

2022 was a year of major consolidation, with automotive giant Constellation incorporating Marshall Motor Group and substantial Lookers shares into its holdings. Additionally, the OEMs have begun a process of rationalisation of their dealer networks, most notably super-group Stellantis announced widespread closures and a drawback of representation across its network unlocking a number of opportunities for brands and dealers looking to expand. Toyota, KIA, Nissan and MG have been particularly active in increasing representation following a year of impressive vehicle sales statistics.

The property story

Generally, average prime yields across all commercial property sectors stabilised towards the end of 2022. Outward yield shifts are predicted amongst some sectors throughout 2023, particularly for offices and shopping centres. Yield hardening is expected in more resilient sectors, most notably Retail Warehousing, a sector often aligned with the car dealership market. As cross-sector property investment volumes tailed off towards the end of 2022, major investors are expected to come out of hibernation. There remains a sizeable amount of dry powder that investors will be keen to deploy, as holding large cash balances indefinitely is not a viable strategy in an inflationary environment. Institutions will continue to look favourably on real estate as an asset class. Inflation has peaked, interest rates are likely to stabilise as central banks approach the end of hiking cycles, and a longer-term economic outlook slowly becomes less opaque.

Car dealerships offer strong investment credentials amidst uncertainty, presenting an

arbitrage opportunity for the canny investor. For some investors, volatility and downward pricing trajectory has driven a momentum to dispose of car dealership assets to raise cash and liquidity. In our market, we have largely witnessed a shift in buyer profile towards occupiers, particularly Tenants buying in assets they occupy, with other tenants buying assets they feel they could either trade from or sit on the income, often adjoining landowners. Alternative users, such as self-storage and discount food retailers, have also been active, enjoying good returns with the anticipation of future redevelopment and occupation. Figures 1 and 2 outline the 2022 buyer and vendor profiles by investment transaction numbers.

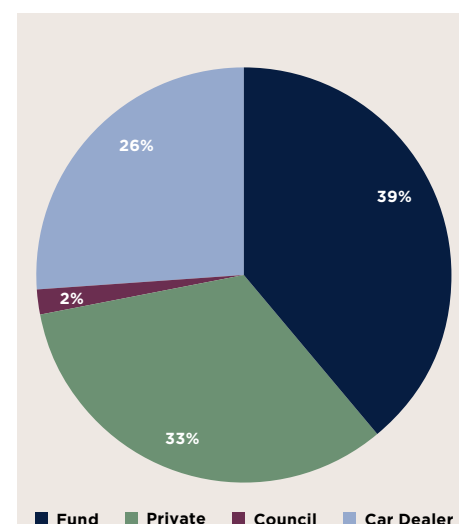


Figure 1: Investment buyer profile

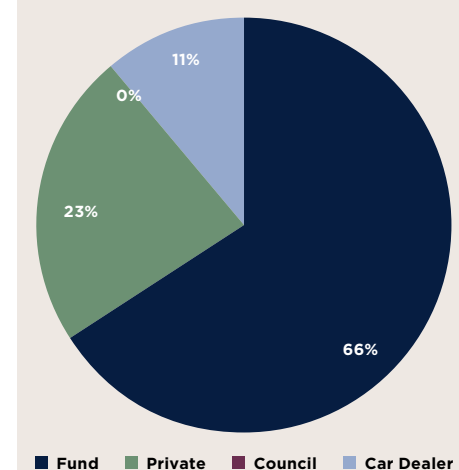
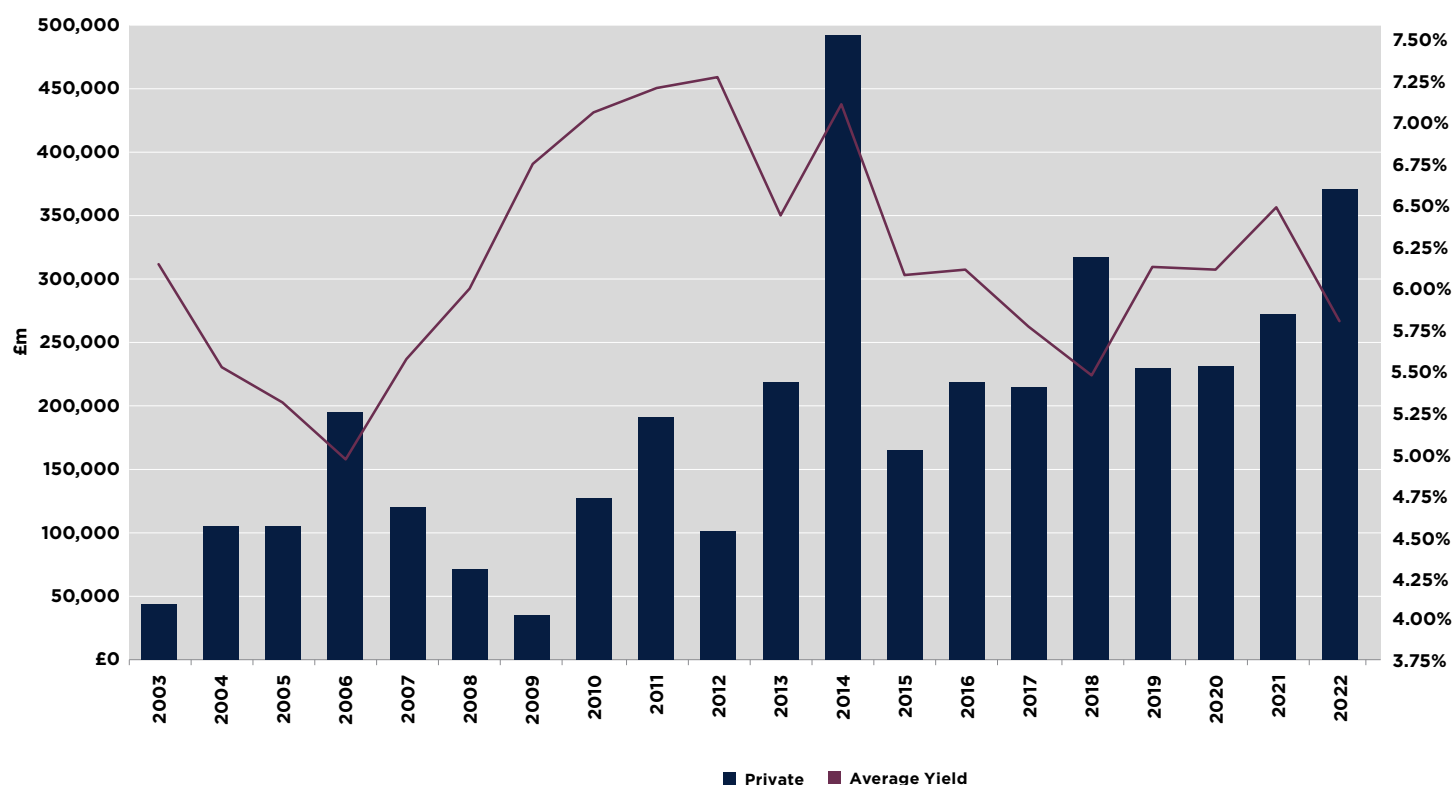


Figure 2: Investment vendor profile

Figure 3: Transaction volumes against average yields



Source: Savills Research

It has been a bumper year for investment sales of car dealership property. 2022 was the best year in investment sales volumes since 2014 (which was somewhat skewed by a single portfolio sale), with £371m transacted, well above the ten-year annual average of £258m, as highlighted in Figure 3.

The general car dealership investment market has been ebbing and flowing in recent years with the uncertainty of Brexit and Covid-19 lockdowns, resulting in a see-sawing pricing movement. Figure 4 shows car dealership prime investment yields within the car dealership market from March 2020 to November 2022, with yield movements moving outwards.

The car dealership market is not being impacted as definitively as other sectors, as

underlying occupational activity is resilient, with dealerships continuing to report strong returns and trading conditions, albeit profitability is being tempered by rising interest and energy cost and inflation.

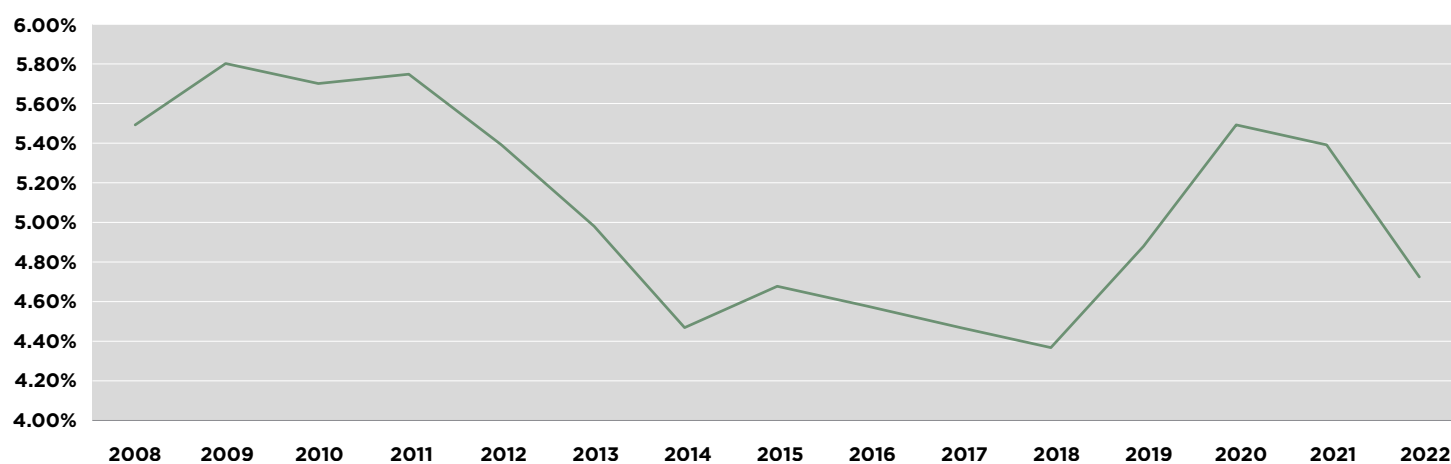
In tandem with the wider economy, was a different narrative between the first and second halves of 2022 for the car dealership investment market. The period from autumn 2021 to May 2022 saw a very active market, with average yield movements pushed down to levels last seen prior to Brexit. Subsequently, there has been a distinct change in direction, reflecting the impact of inflation. Stock has continued to come to the market, causing yields to recede as the market corrects, which led to the withdrawal

of some opportunities, a lot of which will almost certainly return to the market in 2023 as exciting investment stock.

Overall, yields for long-term prime income have been affected more than shorter-term income yields, with “All” average dealership yield across all transactions for the past ten years at 6.27% and the last five years at 5.98%.

In the context of the current market, the best guide to pricing is by reference to the 5, 10 and 15 years long-term trends as markets, as a rule, tend to revert to their long-term trend lines. For investors, security of income, income growth potential, and its ability to combat inflation to sustain real value will be paramount.

Figure 4: Car dealership prime yield trends



Source: Savills Research

Less critical to buyers currently is short to medium alternative use potential, unless the asset has attractions either to the occupier themselves or an alternative owner occupier, and developers are largely out of the market, albeit falling land and construction prices will tempt them back. It is also important to recognise the uncorrelated nature of the car dealership market; its performance is not a mirror image of the broader economic picture – it has particularly resilient revenue security credentials that should appeal to investors looking for a safe haven for their money in turbulent times. Some of these points of difference are:

Table 1: Five-year comparison of the car dealership market KPIs

	2017	2022 H1	2022 H2	2022 FY
Average Rent Epsf	£12.57	£10.37	£13.26	£11.77
Average Rent Overall	£345,000	£407,000	£297,000	£350,000
Average Yield	5.96%	5.63%	6.07%	5.87%
Prime Yield	4.50%	4.00%	5.25%	4.75%
Average Unexpired Lease Term	10.6 yrs	11.7 yrs	9.9 yrs	10.8 yrs
Average Lot Size	£5,870,000	£7,480,000	£4,700,000	£6,000,000
Average Building Size	28,228 sq ft	31,989 sq ft	23,374 sq ft	27,648 sq ft
Average Capital Value Epsf	£208	£234	£201	£217
Average Site Density	31%	26%	29%	27%

Source: Savills Research



Automotive industry pressures are generally supply side rather than demand side. Seven out of ten people require a car for work (Autotrader), and whilst there might be fewer car journeys, this does not impact on the demand for cars.



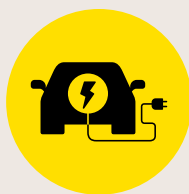
This supply shortage has led to burgeoning order books for dealers and car manufacturers/OEMs, often up to 12 months and even beyond, all at full retail price. This renewal cycle then feeds stock into the used car market.



Over 90% of new cars are held on private contract/lease plans, which tie customers into the brand. At the end of the contract, they either have to buy the car or renew the contract. This secures the customer base, particularly when tied into vehicle servicing plans.



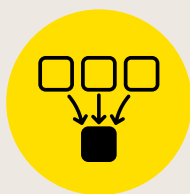
The industry trade body (SMMT) publicly lobbies government for industry support and reports new car sales numbers. This commentary is generally focused on car production numbers and consequent new car sales; it does not necessarily highlight the fact that used car prices have been generally rising due to the shortage of new cars, which is good news for dealers.



There is a distinctive sea-change towards EVs, OEMs have shifted production to deliver this, and there are now well over 100 EV options in the UK. Alongside the accompanying need for car charging infrastructure, this is a whole new world of opportunity brought about through structural change rather than economic conditions.



Car dealers are a crucial conduit for OEMs – for their goods and services, even as they move towards more direct online new car sales. In hard times the ‘good’ brands will support their dealers – in this respect, there is an implied ‘guarantee’ from the OEM if the dealership is considered a key operating asset for their market representation strategy.



The market is continuing its march toward greater consolidation both amongst OEMs and dealers. M&A activity is continuing and delivers economies of scale.



Dealers are tackling rising costs by consolidating staffing numbers, technology adaption (it is colloquially said that in the first 12 months of the pandemic, the dealer cohort advanced 12 years in technology and internet adoption), and “greening” their dealerships to comply with the their OEMs standards and to address energy costs.



Rising interest rates are impacting car stocking costs, but the OEM move towards the “agency” model means that many dealers no longer need to fund new car purchases; they will be sold straight to the customer by the OEM. Overall, the result is that dealers are making greater profits (both % and £) from lower turnover.



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