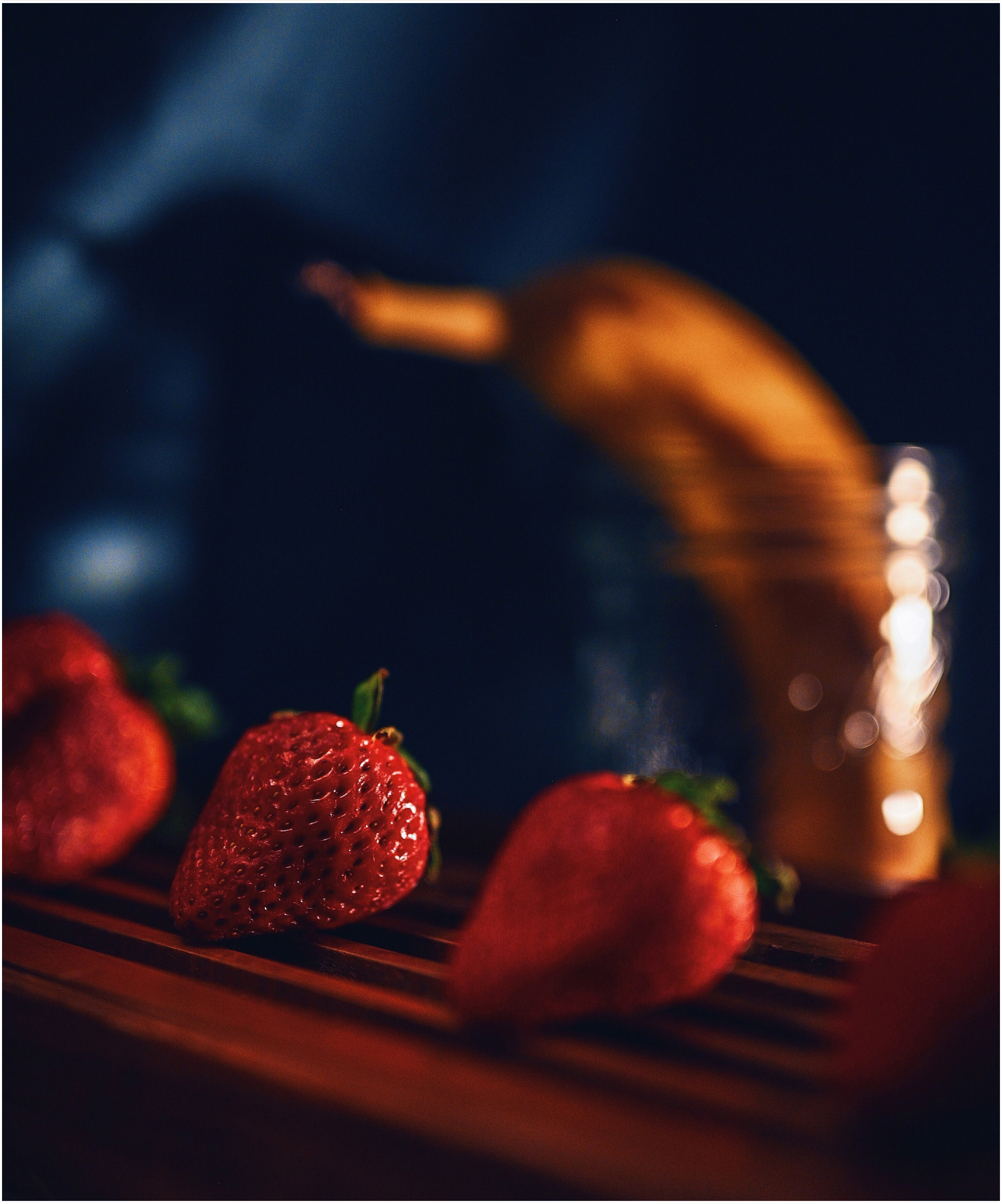
Retail in France at the time of Covid-19 - September 2020

SPOTLIGHT

Savills Research

9 ½ weeks (and 15 days) since lockdown



Return to normal for household spending in June 2020 ● Change in the structure of consumption ● The health crisis as a trend accelerator ● Priority to dialogue between landlords and tenants

Retail in France: **Twelve weeks and counting**

On 11 May 2020, the French government began easing the lockdown imposed to fight the spread of Covid-19. Gradually, and with certain measures in place, most retailers forced to shut up shop have been able to reopen. Twelve weeks later,[1] how is French retail faring, and how have consumers, brands and landlords responded??

1: At the end of July 2020

Consumers:

I spend, therefore I am

The French economy continued to dust itself off as June progressed. In fact, the recovery has even gone better than recent forecasts anticipated. That said, market activity is still far more subdued than in a "normal" year. Assuming that Covid-19 continues to circulate but remains well controlled in the coming months (still thought to be the most likely scenario, despite the rise in new cases over the summer), the economy should have a chance to adapt gradually. In this scenario, the Bank of France forecasts a contraction in French GDP of just 10% for 2020 as a whole.

France's economy appears to be one of the most severely affected by the current public health crisis. However, the country is now well poised to make a vigorous recovery in 2021. In its latest forecasts, the Bank of France predicts growth to approach 7% in 2021 and hold at almost 4% in 2022. That would put France ahead of most surrounding economies and the Eurozone average.

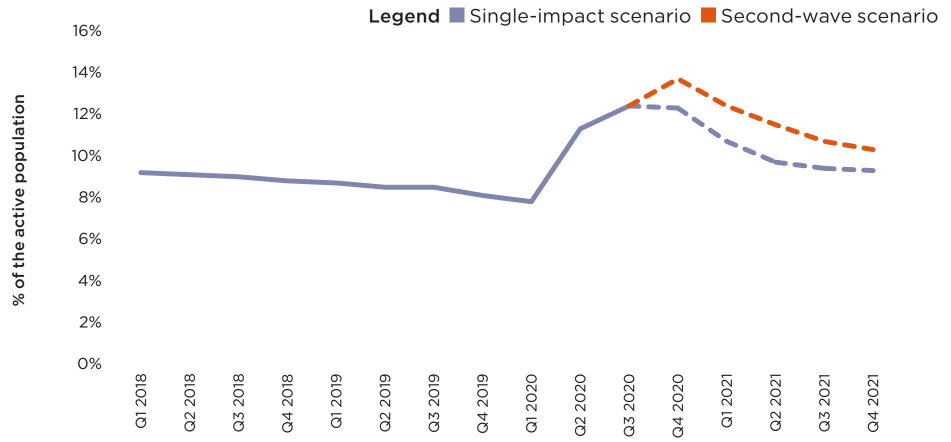
This rebound, still just a ripple in the trendline, will not be enough to avert heavy job losses. In May, a little over 4.42 million people were out of work in France. Before the lockdown, the four-million threshold had never been breached. The OECD predicts that the unemployment rate will jump from 7.8% in Q1 to 11.3% by mid-2020. Provided that there is no second wave, it should start to come down quite quickly by the end of the year.

If this projection bears out and employment bounces back, household spending should not be hit too hard. Consumer confidence, which recouped four points in June (back within touching distance of the long-term average), could continue to grow. This may encourage households to dip into savings stacked up during the lockdown — an estimated national nest egg of €75,000 million. Already, it seems that French consumers are falling back into normal spending habits. INSEE has just announced that retail sales in June were higher than in February, before the Covid-19 crisis began in earnest.

The lockdown was an incontrovertible boon to e-commerce, particularly online food sales. Deliveries through platforms like Uber Eats or Deliveroo, which mainly cater to hungry urbanites, remained stable throughout. This is despite the fact that many city-dwellers left to sit out the hiatus elsewhere. Meanwhile, there was a marked growth in online grocery sales. Stuck at home, many in France rediscovered the joys of home cooking, turning to online platforms to fill their shelves. Online sales of non-food products, too, went through the roof — sometimes resulting in lengthy delays to delivery.

It would appear that the online shopping bug has well and truly bitten: post-lockdown, e-commerce sales are still going strong. It remains too early to draw conclusions, but year-on-year growth seems particularly steep for services, IT equipment, sporting goods, office supplies, automotive equipment, entertainment and toys. E-commerce accounted for 9.8% of all French retail sales in 2019 (2% for non click-and-collect food sales) and should push past the symbolic 10% mark in 2020.

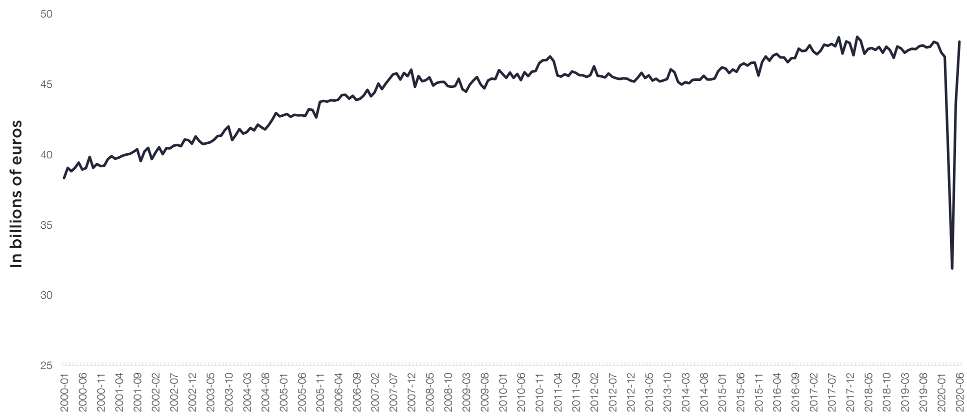
Projected change in unemployment rate in France



Source OECD, June 2020

Monthly household spending in France

Chainlinked volumes at previous year's prices - data adjusted for seasonal and working-day variations



Source Insee

Brands and retailers: Reshuffling the deck

Since the lockdown was lifted, household spending has largely recovered. This is particularly true of clothing and footwear sales, already back to normal levels. There's even better news: sales of food and drink, sporting goods, household appliances and electronics have actually risen in comparison with the pre-lockdown period, while bookstores are also doing a brisk trade. Less cheerfully, the service sector (hotels and F&B in particular) are still lagging behind, having borne the brunt of a drastic reduction in international tourism on top of the switch to remote working, which has meant more meals being prepared at home. Many F&B operators bought themselves some breathing space by launching takeaway and delivery services.

Although sales picked up to some extent, the notion that these offerings could make up for vanished custom is a pipe dream. Retailers have lost revenue that they will never get back, and the rest of 2020 will be tough. Not every business is experiencing the same challenges. The impact on high-street retail in Paris and other major tourist cities, and in the south of France, is plain to see. Like hotels and F&B, many of these stores are heavily dependent on international tourists. Numbers of (typically high-spending) visitors from the UK, US, Russia and Asia have plummeted. More modest tourist flows, from Belgium, the Netherlands, Germany, Switzerland and Italy, remain more or less intact. Also feeling the effects of this sudden tourist vacuum are Paris' iconic department stores. For both designer labels and high-street brands, the answer is probably to double down on online retail and cultivate their sales networks in the US and Asia, both key target markets. This should ensure that they have sufficient resources to keep their Paris flagships open for at least a few more years — and to bank the fat haul of investor cash put up in expectation of more prosperous times ahead. Still, we can expect them to ease off on expanding their store networks and, especially, to be much more circumspect when it comes to signing lease agreements.

Paradoxically, the current crisis might just be the saving of high-street retail, as certain less prominent locations are given a leg up by the "shop local" trend. Indeed, many centrally located food retailers and supermarkets have emerged relatively unscathed. These stores have the advantage of a business model that meets a clear need for local goods and/or those requiring minimal handling. As a result, we can detect a spike in interest in retail units suitable for this kind of use. This trend can be seen across primary, secondary and tertiary locations in towns and neighbourhoods with a large and dynamic catchment area.

Out on the urban fringe, hypermarkets and warehouse stores are having a very different experience. Although sales leapt at first as customers stocked up on non-perishable goods, footfall in supermarkets and hypermarkets has since tailed off. Amid restrictions on travel, an aversion to crowds and hygiene concerns around self-service products, this format has been shaken to its very foundations. For these very large units, click-and-collect and home delivery services have been a godsend.

The situation does seem to have been improving since the end of lockdown, but it will be a long, hard road back to normality for these retailers. Shopping centres are in much the same boat, as they tend to rely on a large-format anchor. Visitor numbers confirm that, while more consumers ventured into shopping centres in May and June, footfall remains far below the pre-pandemic norm.

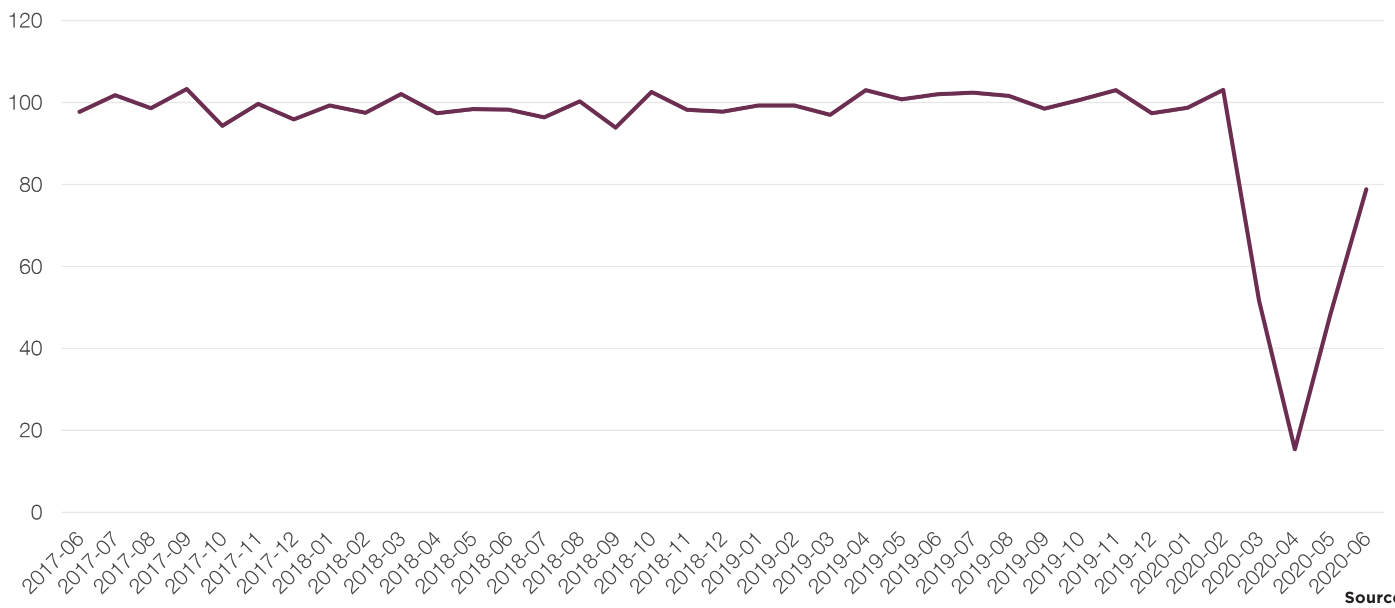
Retail parks and peripheral mid-sized stores are proving somewhat more resilient, thanks to their "open-air" layouts with individual units and their tendency to attract low-cost and/or specialist retailers of personal and household goods and garden supplies.

In today's harsh economic climate, brands are exercising caution. LVMH, for example, has just released its mid-year figures. While the titan of luxe is still in the black, its net profit has dropped by 84%, with turnover down 27% at the end of Q2 2020. Two other big designer names, Kering and Hermès, have also seen profits evaporate without actually making a loss. In response to the current economic climate, LVMH has embarked on a cost-cutting mission, which includes renegotiating lease terms. No numbers have been confirmed as of yet, but the group's top brands are thought to have secured a reduction in rental costs of around 10%.

Outside of the luxury segment, the Inditex group recently announced a 44% contraction in global sales between February and April, shouldering a loss of over €400 million. A 50% boost to online sales could not compensate for the closure of so many of its outlets. Inditex has resolved to bring forward its transition to an omnichannel model combining in-store and online sales. For France, this will mean relatively little change. The group is set to close 1,200 stores worldwide (16% of its outlets) in a bid to streamline its network of brick-and-mortar stores around a smaller number of larger units.

Some retailers are in deeper financial trouble. This is particularly true for brands that were already struggling before the pandemic hit. Prior to Covid-19, Conforama (home furnishings) had already triggered plans to close 32 stores and cut 1,900 jobs, and is now on the verge of being sold off to its rival But to avoid bankruptcy. Alinéa, another homeware brand, has gone into administration — as have André (footwear) and Orchestra-Prémaman (baby care). Meanwhile, La Halle (footwear and clothing) is poised for a takeover. For some brands, then, the Covid-19 crisis has amplified pre-existing challenges.

Shopping centre footfall in France



Source CNCC

Owners:

All eyes on the horizon

Generally speaking, most Covid-19 business support measures are aimed at brands and retailers. Many have taken advantage of temporary unemployment schemes (the French state is covering wage costs for almost two million workers, until the end of the year for certain sectors, such as hotels and F&B), a €740 million solidarity fund for small businesses, state-backed business loans amounting to more than €10,000 million, the option to defer social security and tax payments and, finally, support for the digital transition.

However, some of the measures introduced could benefit landlords. The government has announced plans for around a hundred new real estate companies, partnering local authorities with the Banque des Territoires. Its ambition is to acquire and refurbish at least 6,000 French retail units within five years. Ultimately, this initiative is designed to breathe new life into the small business economy in France's town centres.

In March, landlords' associations issued new guidelines to the effect that rent payments should be moved to a monthly schedule for Q2, and that rent for April and May should be waived. The government has stepped in to prolong these measures through a mediation exercise, culminating in June 2020 with a new charter signed by various organisations representing traders and landlords. Based on the principle of mutual agreement between parties, the charter provides for rent deferrals extending to the post-lockdown phase and the possibility of rent-free periods. Rent waivers could be traded off against other concessions — such as a longer term certains or lease terms, early renewals or new lease agreements. Negotiations on rental costs are outside the scope of the charter.

As a result of this initiative, we could see certain provisions applicable to commercial lettings changing over time. However, the text leaves a lot of room for negotiation in each individual case. The duration of the agreement, for instance, is left up to the parties, provided that it covers a minimum of nine years; a typical lease term for a shopping centre retail unit would be 10 or 12 years.

Tenants have the right to terminate the lease at the end of every three-year period. They may agree to give up that right when negotiating the lease, but will generally gain something in return, such as a rent deduction or the owner taking charge of maintenance works.
The parties are also free to agree the applicable rent, the review schedule (annual or triennial) and the payment method. Indexation calculations are to be based on INSEE's Commercial Rent Index.

The financial scope of negotiations under the charter (which does not address rent renegotiations, to be pursued through other channels) is tricky to quantify. Every agreement will be different, depending on the particular challenges facing tenants and landlords and the location of the property concerned.

However, the objective of these and other negotiations instigated by the Covid-19 crisis is clear enough: to ensure the survival and sustainability of retail occupancies while avoiding the need for legal action. Anything to make the future a little more secure.

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