RESEARCH

Knight Frank

AUTOMOTIVE

CAPITAL MARKETS **2015/16**

HIGHLIGHTS

The automotive sector has seen strong levels of occupier activity, supported by solid growth in the profitability of car dealer groups.

The increasing sophistication of the investment market is attracting a broader base of investors, with the prospect of strong covenants, secure long-term income and high returns.

As a result, the automotive property sector continues to see buoyant investment activity, and recent growth in capital values has comfortably exceeded that of All Property (IPD).

KEY FINDINGS

Automotive markets are becoming increasingly sophisticated and are attracting a new breed of investor. Our recent investor survey highlighted the main attractions to be long term index-linked income, diversification opportunities and strong returns.

2015 has seen the largest ever volume of automotive investment deals, with around £650m expected to transact by the end of the year. On average, capital values for automotive property have risen around 50% since 2010, compared with a 40% rise for All Property.

A record number of new vehicle registrations could be witnessed in 2015, with dealer group turnovers rising quickly. The top 100 dealer groups have reported sales growth of 36% since 2012 to £51.7bn (Source: Automotive Management). Greater consolidation is anticipated amongst second-tier groups, resulting in covenant windfalls for investors.

There has been an unprecedented level of occupational activity in the fuel and service area sectors, with high-profile consolidation activity, and multi-million pound corporate acquisitions taking place.

WHAT IS AUTOMOTIVE PROPERTY?

The sector is typically characterised by three asset types: car dealerships, petrol filling stations and services areas. Of these, car dealerships account for over 50% of the automotive investment market.

The term also covers other ‘roadside’ assets including, for example, convenience retailing, fast food and tyre and exhaust centres.

Key drivers

Automotive capital values have risen by around 50% since 2010, comfortably exceeding the 40% rise in All Property values over the same period (Figure 1). The star performer in 2016 is forecast to be dealerships let to major retailing groups, which will see capital growth of 90% against 2010.

The sector is increasingly on the radar of investors due to characteristically long 25-year plus leases, providing RPI-linked rental uplifts. Contrastingly, average lease lengths in the core UK commercial property sectors in 2014 stood at just 6.8 years, according to the Investment Property Databank’s Lease Events Review.

Additionally, benefits are gained from increased portfolio diversification, which has led investors to raise their allocations to the sector, evidenced by the number and value of automotive property transactions.

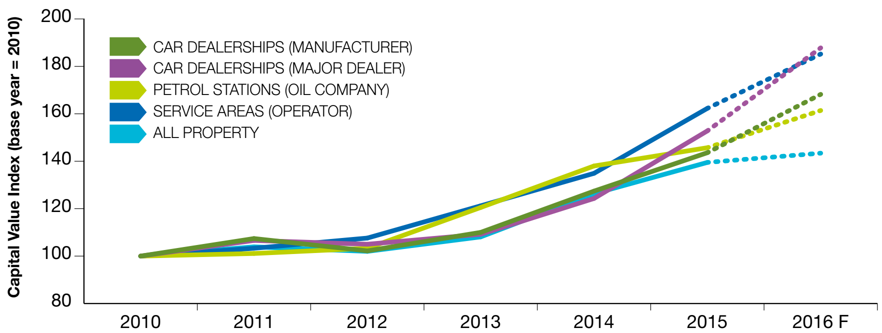
The South East and major UK cities are the most robust operational areas, and generate the strongest demand from investors. However, the competition for land, particularly from the residential development market, is reducing the number of opportunities in these high-density locations. The increasingly inflated cost of land suggests increased sale and leaseback activity will follow.

Manufacturer Corporate Identity requirements are a key consideration in the dealership sector and must be adhered to if dealers are to retain their franchises. The cost and frequency of refurbishment programmes, or requirements to relocate, will be determined by the manufacturers and the performance of the respective brands. The impact on investment value of the incumbent brands is often significant.

Currently, the best performing automotive sub-sector is premium-brand dealership investments. A key reason for this is that investors now fully appreciate that Corporate Identity standards require continual, and often substantial, tenant investment in their properties. This often results in significant asset management opportunities and properties that are regularly upgraded at the cost of the tenant, which has an extremely strong positive effect on maintaining investment appeal and maximising reversionary value.

FIGURE 1

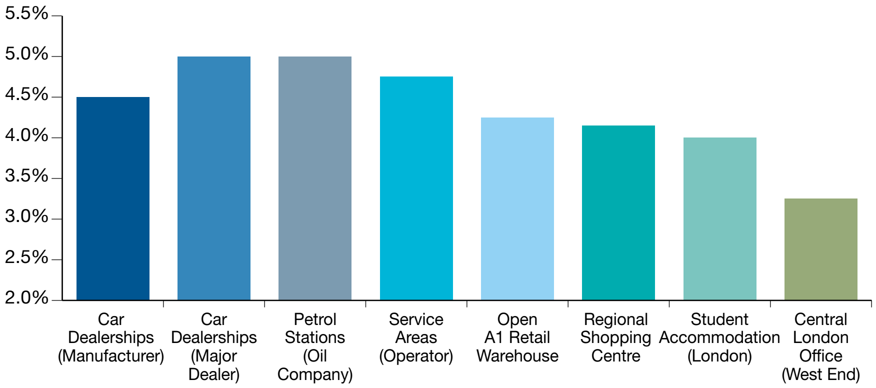
Automotive property capital values



Source: Knight Frank Automotive / IPD

FIGURE 2

Prime yields by asset class (Q3 2015)



Source: Knight Frank Automotive

INVESTMENT PERFORMANCE AND YIELDS

H1 2015 saw a flurry of major investment transactions, with over £300m of automotive property changing hands. This represents a considerable level of activity when the relatively small lot sizes are considered.

Yields have hardened, with prime dealerships let to manufacturers selling for yields of 4.5% (Figure 2), predominantly to UK institutional buyers. Yields on assets in the major dealer market have also moved in so that they are only marginally above those of manufacturer covenants, despite a marked difference in financial standing. However, automotive yields continue to offer genuine value compared with other specialist sectors, and significant value against the keenest yields in the market (Central London Offices).

Our research has identified that over 80% of automotive investments (by value) have been acquired by UK funds since 2010. The remaining 20% have been acquired in roughly equal proportions by private investors, property companies and overseas buyers. We expect the dominance of UK funds to ease slightly in 2016 and beyond, with overseas private equity firms and REITs becoming increasingly active in the automotive sector, particularly for large-scale portfolios.

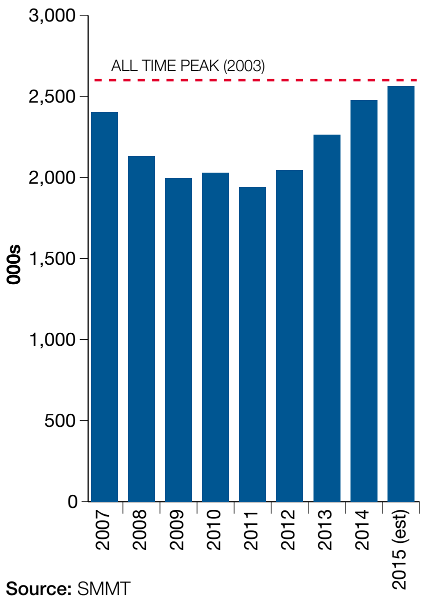
Car dealerships continue to provide the bulk of investment opportunities for investors, accounting for around 50% of the automotive investment market. However, despite the small number of sites, motorway service areas have attracted a significant share of investment capital (by volume) due to their large individual lot-sizes.

“Automotive yields continue to offer genuine value compared with other specialist sectors, and significant value against the keenest yields in the market.”

Porsche East London acquired by F&C UK Property Fund for £9.5m in Q2 2015

Norton Canes Services acquired by Antin Infrastructure Fund in Q4 2014

FIGURE 3
New car registrations



Source: SMMT

UNDERSTANDING THE BUSINESS

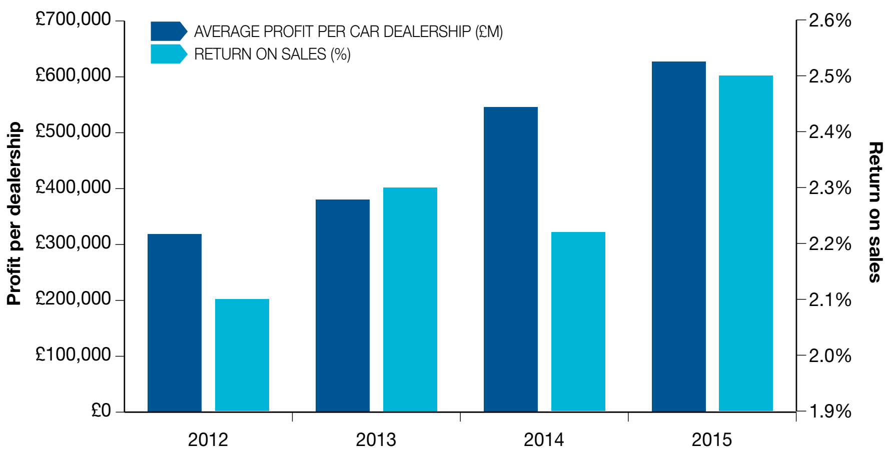
The car dealership industry operates on a franchise model, with manufacturers rarely retailing directly, but rather through a dealer partner. However, manufacturers appreciate the value of their balance sheet, and therefore can use their blue-chip covenant by taking headleases and then sub-leasing to dealers to recoup the considerable cost of acquiring land and developing facilities. This is particularly the case in important territories where manufacturers seek to retain an element of control, and in higher value parts of the country where the financials simply may not stack up for a dealer.

On the business-to-business front, the major dealer groups continue to have a strong appetite for acquiring smaller owner-driver groups. The occupational markets will continue to strengthen which will, in turn, have a positive influence on both rental and capital values. Consolidation will continue to result in covenant windfalls for investors, as regional dealers trading with sought-after franchises are acquired by UK majors, quoted companies and foreign dealer groups.

Low inflation and interest rates are prompting investors to seek opportunities with good rental growth prospects and the automotive sector in particular is benefitting from exceptional car sales and dealer profit margins. Rents are only now starting to respond to this sharp upturn, following a pronounced lag. New car registrations have risen by more than 30% since 2011 and are forecast to reach a near record breaking 2,565,000 registrations in 2015 (Figure 3).

Figure 4 shows that dealer average return on sales have increased by around 20% since 2012, and are currently at 2.5%. Alongside significant increases in turnover this has led to exponential growth in dealer returns. The average profit per outlet in 2015 was £627,513, nearly double that of 2012.

FIGURE 4
Average profit per dealership & return on sales



Source: Automotive Management

We have closely monitored manufacturer and dealer requirements in recent years. Figure 5 shows that activity was (naturally) depressed during the recession, as manufacturers eased pressure on dealers to relocate amidst poor profitability and difficult trading conditions.

However, new requirements in 2014 were nearly three times more than in 2013. The number of new requirements for 2015 looks to have slowed, but many of the requirements from 2014 are yet to be satisfied and therefore, in aggregate terms, there is still very strong demand for prime locations across the UK, putting further upward pressure on values.

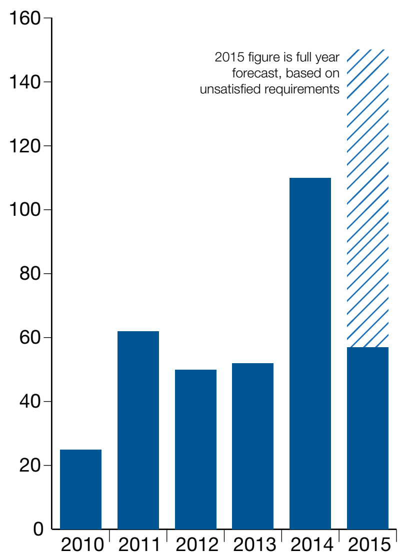
THE ROAD AHEAD

- Investors are now fully aware of the strong investment credentials of automotive property and this is leading to record transaction volumes. With greater consolidation across the sector, which will ultimately lead to high-quality modern networks of sites, and significant improvement in rental values, we anticipate that demand will continue and will extend increasingly to buyers from outside the UK.
- Our research identifies that operators are increasingly considering alternative ways to raise capital for expansion, by unlocking it from their real estate assets. As private equity partnerships and sale and leasebacks return to the agenda, there will be increased opportunities for investors.
- We forecast that 2016 will see further records broken in terms of automotive investment transaction volumes, on the back of a strong-performing automotive market, with foreign investors in particular showing increased appetite alongside UK institutions. There are also likely to be a number of high profile corporate acquisitions, which will potentially change the landscape of several automotive sub-sectors.

"Investors are now fully aware of the strong investment credentials of automotive property and this is leading to record transaction volumes."

BMW Cambridge sold as part of the Elms BMW business in Q4 2014

FIGURE 5
Dealership site requirements



Source: Knight Frank Automotive

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AUTOMOTIVE

Adam Chapman
Partner, Head of Automotive
+44 121 233 6426
adam.chapman@knightfrank.com

Tom Poynton
Partner
+44 121 233 6428
tom.poynton@knightfrank.com

COMMERCIAL RESEARCH

Lee Elliott
Partner, Head of Commercial Research
+44 20 7861 5008
lee.elliott@knightfrank.com

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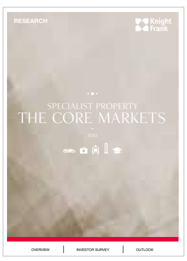

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