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BIRMINGHAM VOLVO – INVESTMENT ACQUISITION

# Car Dealership Market Review
# Spring 2022

## Market Overview

2021 saw consumer confidence briskly return to pre-pandemic levels and recovery drive a major bounce in spending on many services and consumer items, including cars. This surge in demand for cars has been so strong that supply bottlenecks have become apparent and is the key restraint to growth, which has been reflected by suppressed new car sales

The Society of Motor Manufacturers and Traders (SMMT) reported 2021 new car sales up 1% year on 2020 to 1.65m units with a 2022 prediction of 1.96m units (up nearly 20%) as supply constraints ease.

In response to this new demand led market many of the Original Equipment Manufacturers (OEMs – the car manufacturers) are reviewing their new car sales strategies and considering the opportunities for direct sales to customers using the dealer network as their delivery conduit. A number of manufacturers are considering introducing the *"agency"* model in respect of the sale of new vehicles. The process does offer benefits to dealers requiring lower investment in stock and increasing returns on capital employed. Several brands are now looking at online direct sales with the aim of simplifying the buying process and reducing the number of steps in buying a car.

There is also a lot of activity around EVs at the moment, but the charging infrastructure provision looks precariously balanced. According to the SMMT, EVs and hybrids made up 27.5% of the total new car registrations in 2021, up from 10.7% in 2020, and 3.1% in 2019. However, the market is influenced by insufficient charging infrastructure. A recent SMMT report stated that 1.7 million public charge points will be required by 2030 and 2.8 million by 2035, compared to around 20,000 public charging locations in the UK currently. A recent survey by CACI said that some 42% of the UK consumers believe their next car will be an EV. However, mass adoption of EVs is unlikely to happen by 2030 based on the current rate with rapid charger availability the biggest constraint.

New car sales remain impacted by the severe disruption caused by a shortage in semi-conductors. This is an increasingly important component in the electronic systems in vehicles. As a result, many OEM's have cut vehicle production, and this has pushed prices up for both new and used cars.

## Virtual Engagement Drives Growth

The restricted opening of dealerships throughout several lockdowns encouraged customers to do more of the car buying journey online. Covid-19 accelerated dealer development and use of the internet digital sales tools and now dealers are offering a more flexible omnichannel approach providing a full choice to consumers in how they wish to complete their sales journey. This comprehensive ***"bricks and clicks"*** strategy is expected to enhance dealer profitability over the coming years as whilst the pandemic has engendered an increase in digital selling, car buyers require the flexibility to mix online and in-person interactions.

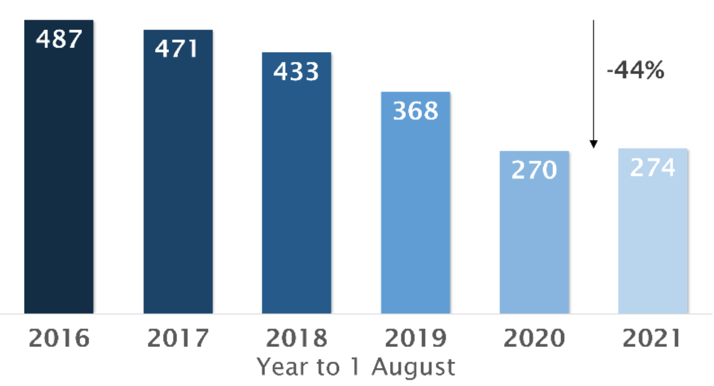
The last 18 months has seen a number of digital retailers enter the used car market with companies such as Cazoo, Cinch and Carzam aiming to capture a share of the c.8 million used vehicles sold each year in the UK. In reply incumbent UK motor dealers have adapted their online solutions and now offer a similar online customer proposition to that of the disruptor brands.

Used car demand and residual car values remain strong. Demand factors such as consumers buying used instead of new vehicles, combined with supply shortages, has driven up the prices for used cars by around a fifth. Aftersales continue to remain a lucrative area of business for car dealers and the most recent data from the DVLA shows that the average age of cars in the UK has crept up to 8.6 years at the end of 2020. This is bolstering dealers' profits and is offsetting the impact of volume reductions and as a result Dealers continue to report strong profits from ***"strong vehicle margins"***:

## The Real Estate Story

There are less new dealerships being built as evidenced by the 44% decline in planning applications for car dealership activities (2016-2020). This reaction is reflective of the wider industry's structural and geo-political background; and rising land and construction cost, balanced by the ability for the "***digital dealership"*** to provide the growth conduit.

**FIGURE 1 PLANNING APPLICATIONS SINCE 2016**
(Source:: EG Radius)



We have noticed a decline in OEMs new site search activity as they manage network consolidation and market area adjustments. This suggests that the car dealership property stock is starting to stabilise around current numbers and highlights the attractions to dealers of holding property to secure the best car franchising opportunities.

We are anticipating future changes in the size and shape of dealerships in response to these evolving car sales and aftersales developments. Showroom space is less likely to grow and may get smaller, and indeed more multi franchising and/or high ticket used cars coming inside showrooms beckons. Workshops will largely stay the same size and adjust to service EVs. We expect some reduction in the size of dealerships, particularly the built area. We expect a greater focus on used cars and their space and pre-delivery & inspection (PDI) requirements.

**TABLE 1 AVERAGES**
Source: APC

| | 2016 | 2021 |
|---|---|---|
| Average Rent psf | £13.58 | £13.28 |
| Average Rent overall | £305,000 | £400,000 |
| Average Yield | 6.16% | 6.45% |
| Prime Yield | 4.50% | 4.10% |
| Average Unexpired Lease Term | 12.6 years | 10.7 years |
| Average Lot Size | £5,380,000 | £6,600,000 |
| Average Building Size (sq.ft.) | 23,452 | 30,200 |
| Average Site Density | 30% | 24% |

## The Digital Dealership

During Autumn 2021 we conducted a survey of senior industry players seeking their thoughts on the impact of digitalisation on the number of dealerships in the UK through to 2025 and the key takeaways were:

- Digital adoption has advanced 12 years in 12 months as Covid lockdowns have prompted consumers and dealerships to embrace technology.
- Less showroom space will probably be required and will be configured to provide an improved and inspiring customer experience.
- Multi-franchising of sites will increase.
- The dealership remains key to the sales process and is valued highly as a means of demonstrating the increasing technology in vehicles an\d educating consumers on the relative merits of new EV / hybrid vehicle types.
- The introduction of EVs is beginning to impact on how dealership sites are used.
- Only modest dealership rationalisation through to 2025 is anticipated, with a decline in numbers of between 6 and 15 per cent.

## Tightening Supply of Property

Based on National Franchised Dealer Association (NFDA) data the actual decline in the number of dealerships since 2010 has been 13.2%, the previous 10 years 19.5%, and the 10 years before that 21.8%, and so the data suggests the rate of decline is slowing rather than increasing.

In all distribution functions physical provision is required and information gleaned from our database (recording circa 15,000 car dealership property transactions since 1995 covering nearly 10,000 properties) identifies only 2% out of an estimated stock of 4,345 dealerships (NFDA) are currently available (January 2022).

Activity from growth brands and new entrants; e.g., Kia, MG, Volvo, Cazoo, Tesla, CarShop, and Motorpoint have quickly been absorbing surplus stock, together with some adjustment to existing franchise representation i.e., adoption of authorised repairer status, and interest in disaggregation (i.e., aftersales and used car sales sites only).

## Market Pricing

This is engendering rental growth particularly in dealership properties containing an Industrial functionality (such as Vehicle Workshops) or stand-alone workshops and vehicle compounds.

**TABLE 2 CAR DEALERSHIP PROPERTY RENTAL GROWTH**
Source: APC

| | Average Market Rent Review Increase Over 5 Years* | Annual Equivalent |
|---|---|---|
| All Car Dealership Property | 17.24% | 3.45% |
| Composite Car Dealership | 9.25% | 1.85% |
| Freestanding Workshops | 27.43% | 5.49% |
| Vehicle Compounds | 38.06% | 7.61% |

*Excludes inflation linked rent review increases.

**FIGURE 2 TOTAL MARKET VALUE OF SOLD PROPERTIES**
(Source: APC)

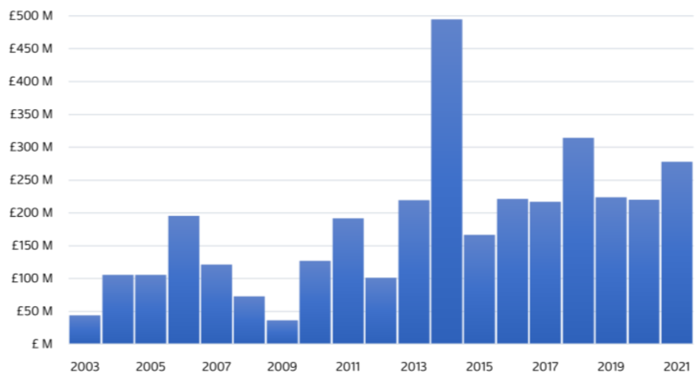
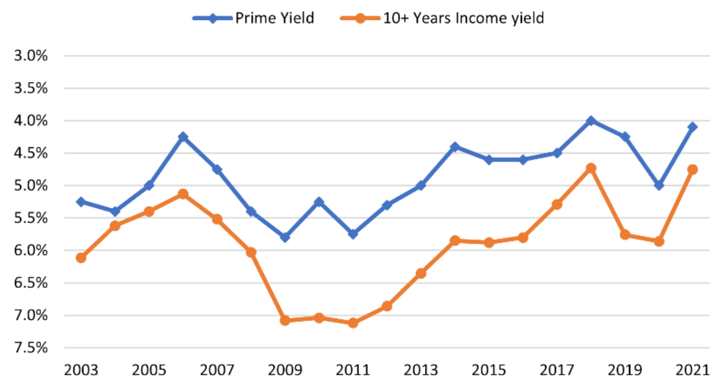


**FIGURE 3 PRIME YIELD VERSUS 10+ YEARS INCOME YIELD**
(Source: APC)




Looking over the last 15 years we can see car dealership pricing behaviour has tracked the general peaks and troughs of the wider commercial property market. Current performance suggests that previous market pricing peaks will shortly be matched, and likely bettered. Many investment assets in the sector offer inflation hedges and long leases, and structural changes position the car dealership genre as a beneficiary of technological and behavioural change.

Property is key to Dealers with dealerships providing the ***"last mile solution"*** in the unfolding distribution functionality of dealerships, which the direct new car sales model being explored by some OEM's will serve to enhance. Property underpins many dealers' balance sheets performing well during recent times and remains set to continue this trend.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