Working paper on land holdings and use issues

Introduction

1. This paper examines land use issues associated with UK grocery retailers. It first examines the extent of the land holdings owned by six[1] grocery retailers and their potential impact on individual grocery retailers' national share of grocery sales, and second, examines the way in which land ownership and related transactions might be used as a strategic device to deter entry into local markets for the supply of groceries.

Grocery retailers' land holdings

2. The extent of grocery retailers' land holdings and the associated implications for individual grocery retailers' shares of national grocery sales has been the subject of a number of submissions (eg Association of Convenience Stores (ACS), Friends of the Earth (FoE), Sainsbury's, Tesco). In particular, ACS, FoE and Sainsbury's have argued that the size of Tesco's land holdings will result in significant growth in its national share of grocery sales. Tesco, however, has disputed these claims.

3. Current or future shares of national grocery sales are not of great significance in terms of grocery retailers' ability to exercise market power if we decide that the relevant geographic market is local. However, we are yet to reach a decision on the appropriate definition of the geographic market for the supply of groceries. As a result, we continue to be interested in the national share of grocery sales held by each grocery retailer. Further, to the extent that grocery retailers' land holdings provide information about future sales volumes, this may be of relevance when assessing possible changes in the degree of buyer power possessed by different grocery retailers.

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[1]The six include Asda, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose.

4. For the six grocery retailers we analysed, we sought to estimate the area of land owned or controlled by a grocery retailer and which, broadly speaking, is potentially available for development into retail stores or additional retail space. We estimated this by taking the total land interests[2] of these retailers and excluding land that is currently used for grocery retailing or related support operations as well as land that is leased to third parties.[3] For ease of reference, we have termed this measure of land holding the grocery retailer's 'land bank'.[4]

5. The land included in each grocery retailer's land bank, under this measure, will include land holdings at various stages of development. For example, some sites will be at a relatively advanced stage of development with planning permission already having been secured, while other land holdings may consist of a series of land parcels to which additional parcels will need to be added in the future in order to complete the site for development. Our measure of grocery retailers' land banks also includes any land that may be earmarked for disposal. As a result, our estimates of the size of individual grocery retailers' land banks may not be a precise measure of the land available for development by the grocery retailers. However, we consider that it provides a broad indication that is suitable, at this stage, for the purposes of this exercise.

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[2] Land interests include land owned outright by the grocery retailer, and also land owned by a third party either on behalf of the grocery retailer or with whom the retailer has an agreement to acquire an interest at a future date or on a future event.

[3] A number of parties pointed out that our land bank measurement is not exact. They noted that it includes some land that may not realistically be developed into retail stores, and excludes some land areas that may in fact be considered part of land banks. For example, we include some land areas that may be planned for disposal, or for non-grocery retail or mixed use developments. Similarly, we exclude land leased to third parties which in some cases might be used for retail development at some point in the future. These differences represent measurement errors and we will continue to explore the best means of minimizing these.

[4] One party (Tesco) preferred the term 'pipelines'. In our view, what matters is the definition rather than the term used. The definition that we have adopted for the purposes of identifying the extent of grocery retailers' land banks is not universally followed. One party ([✂]) in its submission defined its land bank as land for which planning permission has been granted, but where development has not begun. Another party ([✂]), however, suggested a much broader definition that would include 'all sites where the operator has made a public statement, or substantiated press statement, that they are connected with, but do not necessarily own, a site, where it would not be unreasonable to expect that this site would be developed as a retail store of greater than 15,000 sq feet at a later date'.

TABLE 1 **Land use by grocery retailers (m^2)**

[✄]

Source: CC analysis of data provided by parties.

6. Based on this definition, Figure 1 and Table 1 show the total land holdings, including the land banks, of six grocery retailers (Asda, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose). [✄] Our initial analysis shows, as is commonly supposed, that Tesco has the largest land bank both in absolute terms and as a proportion of existing retail space. Tesco's land bank is equivalent in size to about [✄] of its existing retail space.[5] This compares to [✄] per cent for Asda, [✄] per cent for Morrison's, [✄] per cent for Sainsbury's, [✄] per cent for Somerfield, and [✄] per cent for Waitrose.

FIGURE 1

Land holdings by selected grocery retailer

[✄]

Source: CC analysis.
Note: [✄].

7. The future size of each grocery retailer's land bank will be influenced by the size of any pending land acquisitions.[6] Figure 2 shows pending land acquisitions for each of the six grocery retailers that we have reviewed as a proportion of their existing land bank. On the basis of areas to be acquired, three retailers have a significant amount of pending acquisitions relative to existing land holdings. [✄]

[5]Tesco told us that its land bank (or pipeline) is larger than those of its competitors because it takes on the development role itself. Tesco pointed out that the development aspirations of some of its competitors would not be reflected in their pipelines, as Tesco was less likely than they were merely to be the recipient of the retail element of a developer's scheme. Moreover, not all of Tesco's pipeline will be used for grocery retail: Tesco explained that its land bank figure includes land which will be used for non-retail mixed-use developments, land which is to be disposed of, land which will be used for non-grocery, and land which will be used for replacement stores.
[6]Pending (or current) acquisitions reflect land for which the grocery retailer has made an offer to acquire an interest but where the outcome is still pending as at 1 July 2006.

FIGURE 2

Pending acquisitions relative to existing land bank

[✂]

Source: CC analysis.

8. Some pending acquisitions may be expected to fail, and the proportion of unsuccessful acquisitions may differ across retailers. However, if all pending acquisitions were to be completed, [✂] would have the largest proportional increase in its land bank among the six grocery retailers analysed, with its size more than [✂].[7] [✂] would have the largest absolute increase in the size of its land bank, adding over [✂] to its existing land bank. [✂] As seen in Table TABLE , Tesco's pending acquisitions represent [✂] per cent of its land currently used for retailing and provided to third parties, compared with [✂] per cent for Asda, and less than [✂] per cent for Morrisons, [✂] per cent for Sainsbury's, and [✂] per cent for Waitrose.

9. A number of parties put to us estimates of national share projections for Tesco arising from the building out of their land bank, including a Sainsbury's projection which predicted a 43 per cent national share for Tesco by 2010 and an FoE projection which predicted that this share would reach 45 per cent by 2010. We conducted our own analysis to assess these projections. Our preliminary results do not support either the 43 per cent or the 45 per cent share projection that was put to us; however, they do indicate that some increase in Tesco's national share arising from the building out of its land banks is likely in the future.

10. We projected national shares of grocery sales for the next five-year period up to 2011 for each of the four largest grocery retailers (Asda, Morrisons, Sainsbury's and

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[7]These projections of land bank sizes do not, however, account for land exiting from each grocery retailer's land bank in the form of land sales, new retail developments, or lettings to third parties. Some pending acquisitions may include existing developments which can be readily converted into operational stores.

Tesco) based on the development of each retailer's land bank and completion of some proportion of pending acquisitions. Details of the assumptions and methodology used to make these projections are included in Annex 1 of this paper. In making these projections, we have not, at this stage, sought to include estimates of growth in retail space from sources that may be unrelated to our measure of grocery retailers' land banks, such as store extensions and mezzanines.[8] We also have not incorporated the impact of possible land disposals, or economies from more efficient use of existing retail space.

11. Our first set of projections (see Table 2) assumes that the rate of pending land acquisition by each grocery retailer, scaled down by its success rate in acquiring land, is maintained throughout the forecast period at the rate achieved in the first year. The second set of projections (see Table 3) is more conservative in that it assumes that no further land acquisitions are made after those known to be planned for the first year.

12. For each set of projections we have assumed that the existing ratio of grocery sales to land area is maintained for each retailer in the forecast period. We have also assumed that sales from other grocery retailers remain at their 2006 level. We consider this to be a conservative assumption given that between 2005 and 2006 sales by other grocery retailers declined by almost 9 per cent.

TABLE 2 **National sales shares projections—Projection 1**

[✂]

Source: CC analysis.

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[8]We note that store extensions and mezzanines may, however, contribute substantial additional floor space. A recent report by Planet Retail estimated that nearly one-third of Tesco's 186,000 sq metres of new floor space in 2005 resulted from store extensions.

TABLE 3 **National sales shares projections—Projection 2**

[✄]

Source: CC analysis.

13. Under both sets of projections, Tesco's national share of grocery sales using TNS data[9] increases from 30 per cent to around [✄] to [✄] per cent. There were mixed results for the remaining three grocery retailers depending on the assumptions that are used. [✄]

14. We have also undertaken some sensitivity testing of this analysis by relaxing some of the underlying assumptions. In most cases, this results in a higher projected share of national sales for Tesco. For example:

- Assuming a complete build out by each grocery retailer of its land bank during the forecast period increases Tesco's share of national sales to [✄] per cent under the first projection and to [✄] per cent under the second projection.
- Holding overall growth in grocery sales to 3.1 per cent, the rate of growth in the most recent year for which data is available, results in Tesco's share of national sales increasing to [✄] per cent under the first projection and increasing to [✄] per cent under the second projection.
- Maintaining the decline in sales for grocery retailers other than Asda, Morrisons, Sainsbury's and Tesco at 8.8 per cent, consistent with last year, results in Tesco's share of national sales increasing to [✄] per cent under the first projection and to [✄] per cent under the second projection.
- Using a range of success rates in acquiring land (between [✄] and [✄] per cent) as well as differentiating Tesco's success rate with those of the other main retailers does not appear to yield noticeably different results. In all the different

[9]We note that this data represents a smaller overall 2006 market value than the IGD, UK Grocery retailing, 2006 data.

scenarios the projection of Tesco's national share is between [✂] and [✂] per cent.[10]

15. Although Tesco's share of national grocery sales rose under each of these scenarios, we did not observe this share rising as high as the 43 or 45 per cent levels put to us by Sainsbury's and FoE. Tesco objected to our projections, [11] stating that a retailer's pipeline of land interests cannot be used to predict future market shares. Nor did it consider that previous performance is any guarantee of future success; if any retailer underperforms for customers, the resultant switching away could have a much more material effect on market share than the impact of introducing new space.

Land transactions as a strategic means of impeding entry

16. A number of parties have told us that because land is not readily available for retail developments in many local areas, some grocery retailers strategically acquire land or carry out other land transactions to deter entry by competitors and thus protect their position. To assess whether this might be taking place, we have undertaken some preliminary analysis of:

    (a) the extent to which grocery retailers have land holdings on which they have not sought planning permission or land holdings on which planning permission has been granted but construction has not commenced (see paragraphs 17 to 23);

    (b) the extent to which grocery retailers use restrictive covenants when disposing of land (see paragraphs 24 to 26); and

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[10]We ran one scenario using a uniform success rate of [✂] per cent for all retailers, instead of [✂] per cent; we ran an additional scenario using a rate of [✂] per cent for Tesco while the remaining retailers have a rate of [✂] per cent; and we ran a further scenario using a rate of [✂] per cent for Tesco with the remaining retailers having a rate of [✂] per cent.

[11]Tesco told us that it believed that our model overstates its national share for a number of reasons: first, it disagreed with our measurement of its land bank, which it consider to be overstated; second, it considered the success rate we have applied to its acquisitions to be too high; third, the model does not take account of land disposals; fourth, it considered that holding constant the ratio of grocery sales to land used creates a bias against Tesco, whose future developments include more mixed use than its competitors, and because it is expanding its non-food offer; and fifth, it considered that the 'other' category of grocery retailers is likely to grow while our model holds these sales constant. We are not, at this stage, convinced of the validity of these points but are considering them further.

(c) the financial incentives for grocery retailers to buy land but not develop it for retailing purposes (see paragraphs 27 to 29).

Duration of grocery retailers' land holdings

17. Holding land banks for an extended period without developing a store entails an opportunity cost, which may suggest that a grocery retailer is holding the land to prevent entry into a particular local area by a competitor. Measurement of this type of strategic land holding can be difficult to differentiate from land held for site assembly purposes, and must be interpreted with caution. We have looked at two measures of land-holding times for grocery retailers:

   (a) *post-assembly holding time:* the time between assembling a site and applying for planning permission;[12] and

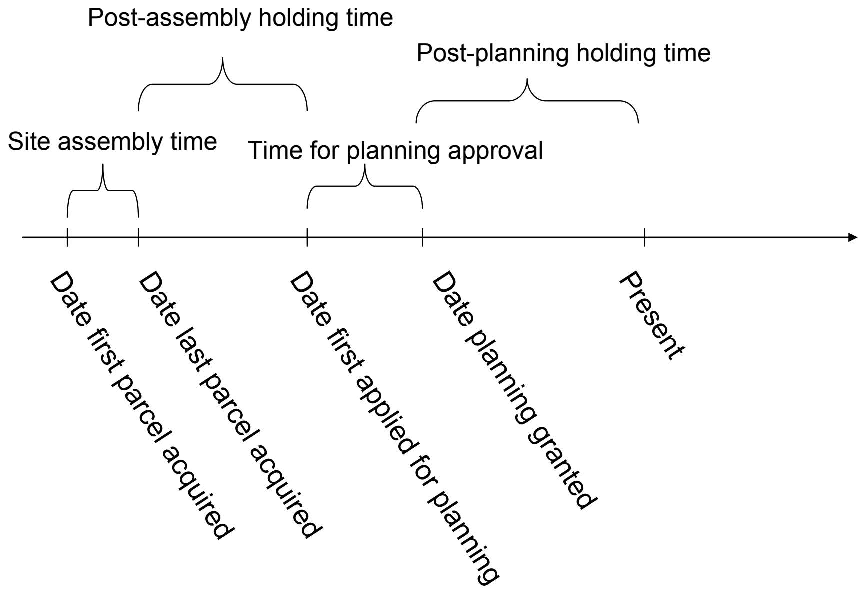
   (b) *post-planning holding time:* the time since planning approval has been obtained on applications where development has not commenced.

18. Figure 3 shows the measurement of these two land-holding times.

[12]Where a site is assembled through acquisition of a number of parcels, this is the time from purchasing the last parcel in a site. It is not possible to assess from our data whether a site is fully assembled. For the purposes of this preliminary analysis, we assume the last parcel acquired completes each site in question, and interpret the results with caution.

FIGURE 3

Land-holding times for grocery retailers' land banks



Source: CC analysis.

19. Figure Figure 5FIGURE shows our preliminary analysis of post-assembly holding times, measuring the time elapsed between the date of acquisition of the last parcel in the site to the date planning was first applied for.[13] As can be seen, in many cases planning applications are submitted before a development site has been fully acquired although the extent to which this occurs varies between the four largest grocery retailers. It has been put to us that some grocery retailers become involved in site assembly at an earlier stage than others, and this must be considered in interpreting the results.

[13]This is based on land bank sites acquired since 1 January 1996 (including sites where the last parcel was purchased after this date), for which a planning grant for retail development was obtained by 1 July 2006 but for which no retail development was completed by 1 July 2006. Each observation represents a land bank site for which we had information on a planning grant relating to that site, a date for the first planning application made for that site, and an acquisition date for the site or for the last parcel acquired in the site, and where no retail development had been completed.

FIGURE 4

Land bank holding times between final site assembly and first planning application, by grocery retailer

[✂]

Source: CC analysis.

20. For three of the four largest grocery retailers ([✂]), the data shows that planning permission is sought within one year of the assembly of nearly all development sites. A fourth retailer ([✂]) submitted planning applications for almost a third of its sites over a year after the last parcel was acquired. It is not clear, however, that this delay is indicative of this retailer ([✂]) engaging in strategic land acquisition as a means of deterring entry by competitors, or whether it reflects a larger proportion of in-completely assembled sites in its data.

21. In consultation with the parties, a number of issues were raised with respect to our methodology and measurement of holding times, which we will be considering further as we take this analysis forward. In particular, we were told that there are significant variations between sites in terms of whether a site is acquired from a developer already assembled and with planning permission having been granted, or whether a series of land parcels needs to be acquired to assemble an entire development site on which planning must subsequently be obtained. As such, any comparison of the time for which sites are held must be interpreted with care.

22. Figure 5 shows preliminary estimates of post-planning holding times of land bank sites for the four largest grocery retailers, measuring the time elapsed between the granting of planning and the present.[14,15] This shows that each of the four have some

[14]The unit of analysis is planning grants, and not sites. Where a site has more than one planning application granted it will be counted more than once.

planning grants that have not resulted in retail developments up to three years after the granting of planning permission. One retailer ([✄]) appears to be somewhat slower than its competitors in developing a site once planning permission has been obtained. This data, however, may reflect factors other than attempts by the grocery retailers to impede entry by a competitor into a local market.

FIGURE 5

Land bank holding times since grant of planning permission, by grocery retailer

[✄]

Source: CC analysis.

23. Any conclusion on the extent to which land-holding times are indicative of strategic behaviour by a grocer retailer aimed at deterring entry by competitors into a local market requires an analysis of land-holding times for those sites that are in areas where a grocery retailer may wish to protect its position. Our analysis to this point has looked at this issue in terms of grocery retailers' development sites in aggregate. Going forward, however, we anticipate undertaking a more localized analysis that relates land-holding times to local market concentrations for individual grocery retailers.

Use of restrictive covenants

24. Grocery retailers may choose to attach restrictive covenants to the sale of freehold land, for example, to prevent its use for grocery retailing.[16] This may represent another way in which a grocery retailer seeks to prevent entry by a competitor into a local market for the supply of groceries.

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[15]This is based on land bank sites acquired since 1 January 1996 (including sites where the last parcel was purchased after this date), for which a planning grant for retail development was obtained by 1 July 2006 but for which development was not completed by 1 July 2006. Each observation represents a planning grant relating to a land bank site for which we had information on the date planning was granted, and where no retail development had been completed.

[16]In some cases restrictive covenants may be included because they were put in place by previous owners. Where we have been notified of these, we have omitted these instances.

FIGURE 6

Land disposals with restrictive covenants since 2000, by grocery retailer

[✂]

Notes: [✂].
Source: CC analysis.

25. Since 2000, around 13 per cent of all land sales by the six grocery retailers for which we have analysed data involved the inclusion of a restrictive covenant. This figure was 12 per cent for the four largest grocery retailers. Figure 6 shows the proportion of freehold land disposals since 2000 with restrictive covenants by grocery retailer. It can be seen that the practice of including restrictive covenants varies widely. [✂] reported very low inclusion of restrictive covenants. [✂] included restrictive covenants on more than half of the land which it disposed of since 2000. [✂],[✂] and [✂] followed with the next largest proportions of disposals with restrictive covenants.

26. As with our analysis of land-holding times, any conclusion on the extent to which restrictive covenants are being used by a grocer retailer to protect a strong position in a local market requires an analysis of the geographic distribution of these restrictive covenants in relation to existing stores. We intend to conduct this analysis in the period leading up to provisional findings.

Financial incentives for strategic land acquisitions

27. In addition to looking at specific land-holding patterns and other transactions, we will be looking at the financial incentives for a grocery retailer to buy land as a means of impeding the entry of a competitor into a local market.

28. To this end, we will be conducting some modelling to assess the incentives for retailers to *(a)* buy and hold land; *(b)* buy and build land; *(c)* buy and lease land to a

non-grocery retailer; and *(d)* buy and sell land with a restrictive covenant. The parameters from the model include store contribution margins, construction costs, rental yields and differentials in land values between retail and non-retail uses.

29. The objective of the modelling is to determine the circumstances where an incumbent grocery retailer in an area would have an incentive to outbid a potential entrant. The modelling will allow us to assess the likely maximum bids each party will be willing to make for the land in question. The incumbent must assess, in considering whether to build a new store on a piece of land, the ‘cannibalization’ effect of that new store on its existing store(s). Against this must be balanced the value of retaining profits that would otherwise be lost if entry occurs. The potential entrant makes a simpler calculation balancing cash inflows (store profits) against outflows (acquisition and development costs).

Methodology, data and calculations for projections of grocery retailers' national sales shares

1. As a starting point the national shares projection model uses groceries sales at grocers based on the TNS data for the 52-week period ending 18 June 2006. Using this base we forecast future sales based on land bank development and pending acquisition.

2. To determine how much land is turned into future groceries sales, we compute for each retailer the proportion of annualized number of sites with proposed developments relative to number of land bank sites.[17] This ratio is then used as the annual build-out rate of land banks in the forecast period.

3. Next we include pending acquisitions submitted by the parties to reflect future additions to the land banks. We assume that 70 per cent of these pending acquisitions will be successful. This rate is held to be the same for all retailers.[18] In Projection 1, the level of land acquisition is maintained throughout the forecast period, which implies that land banks increase, while in Projection 2, pending acquisitions are a one-off addition to land banks in the first year. We do not attempt to model disposals.

4. For each retailer we calculate the proportion of national grocery spending to total land area used for retailing and retail support as a measure of the intensity with which grocery sales can be generated from their land in the forecast period. This ratio will reflect differences in format mixes, efficiency of distribution, scale

[17]We assume that all proposed developments submitted to us will go forward over the first five quarters of the forecast period. We have annualized these by taking four-fifths of the overall value.
[18]We initially attempted to estimate success rates based on data submitted by the parties, but in most cases successful acquisitions were at parcel level while unsuccessful acquisitions were reported at site level, rendering this exercise ineffectual. The parties provided a wide range of estimates of success rates in acquisitions that ranged from about [✂] to [✂] per cent.

economies, and other retailer-specific attributes which are held constant in the forecast period.

5. In each year of the forecast period, the retailer is assumed to build out its unique build-out proportion of its land bank, after expected acquisitions for the projection in question have been added in. This built-out land is then taken out of the next year's land bank area, and considered land used for retail and retail support. The built-out land is assumed to generate incremental sales based on that retailer's unique ratio of grocery sales to land bank. These sales are then added to the retailer's previous existing sales to arrive at the total sales for the retailer in the forecast period. Sales by other retailers not modelled directly are held constant in the forecast period, and the market is allowed to grow by the full amount of incremental sales. This assumes there is no cannibalization of the retailer's own or its rival's existing sales arising from the retail expansion.

6. The assumptions of the model for each retailer are shown in Table 1. The full model results for Projection 1 and Projection 2 are shown in Tables 2 and 3.

TABLE 1 **Model assumptions**

[✂]

Source: CC analysis.

TABLE 2 **Projection 1—full calculations**

[✂]

Source: CC analysis.

TABLE 3 **Projection 2—full calculations**

[✂]

Source: CC analysis.