Savills Commercial Research
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EXPAND INTO EUROPE: RETAIL DESTINATION INDEX 2016

Examining the strengths of Europe's key retail cities and identifying the best opportunities for expanding international brands.

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The Retail Destination Index

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Retail brands, particularly luxury fashion brands, are no longer confined to their domestic markets but increasingly expanding across geographies to access new markets and consumers, ultimately driving sales and their global reach.

Within Europe, it has been the global gateway cities of London and Paris that have been the key target markets due to their sheer size and international visitor appeal.

The draw of the retail markets of both these global cities is assured. However, by examining a wider range of features related to retail sales, demographic drivers, tourist flows and spend, total occupational costs and appeal to international shoppers, we hope to identify other retail cities that may also offer more immediate opportunities.

All the cities included in this analysis are the prime retail destinations in their respective countries. As such they would be key target markets for expanding retailers.

London topped the Index, closely followed by Paris in second place. Across the 'smaller' European cities Barcelona and Amsterdam both performed well (Figure 2).

The various drivers behind the Index are explored in the following pages but one key element to note is that the 'opportunity' for retailers is not solely determined by the cost of operating a store.

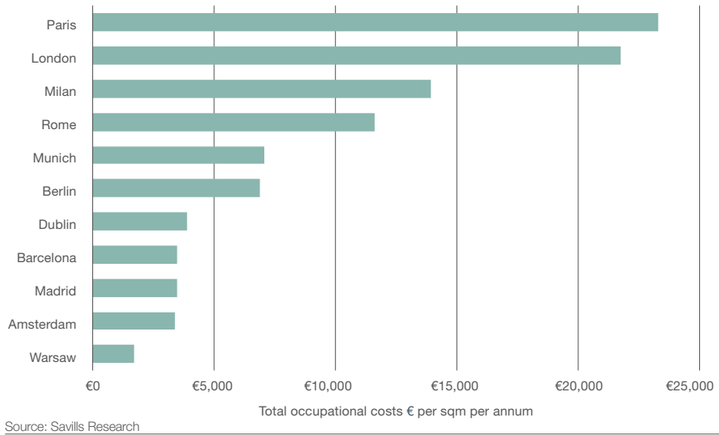
Total occupational costs provides some insight into the sales opportunity and demand associated with different markets. The traditional thinking dictates that the higher the occupational cost, the greater the sales revenue associated with that particular market and in turn the demand for space.

This is reflected in the fact that Paris and London are the most expensive cities in regard to total retailer occupational costs (based on prime/luxury retail areas excluding staff costs, Figure 1).

Yet, where a disconnect has developed between retail sales potential and store costs, these markets could prove more attractive to expanding retailers as it suggests the profitability of these locations could be greater.

It is this disconnect, amongst other features, that helped place London above Paris in the Index and it also explains why Amsterdam ranked third, despite having relatively small retail and visitor markets compared to its peers.

FIGURE 1: Total occupational costs for prime retail areas
(€ per sqm per annum as of Q3 2016)



Source: Savills Research

FIGURE 2:
2016 European Retail City Index

Source: Savills Research; Mastercard; Oxford Economics

The Global European cities

'Opportunity' and lower occupational costs enhancing London's appeal

London and Paris have jostled to be the top European destination, if not global destination, for international visitors for some years.

London has overtaken Paris according to Mastercard's latest Global Destination Cities report seeing a record 19.8m international tourists spending a total of €17.8bn in 2015/16. This level of spend is 53.5% above that recorded for Paris and is even more pronounced when looking at the proportion dedicated to shopping. Visitors to London tend to allocate 46.7% of their total spend to shopping according to Mastercard. On Paris it is 16.7% (Figure 4).

More recently, spending by overseas visitors in London received an added boost from the Brexit vote due to its impact on the value of the Pound. Based on a 'basket of goods' the average price of goods in London are now approximately 13% lower than those in Paris. As a result London's West End saw a 3.0% annual increase in retail sales in July, the month immediately following Brexit. While this measure did not feed into the Retail Destination Index it does highlight the importance of visitor appeal in determining the appeal of a location to new international brands.

Paris's international visitor numbers, and their spending, has been impacted by the recent terror attacks, which also led to softening in some other European city markets over the early part of 2016. Yet, the city remains a major destination with total retail sales, for the wider Paris region, far in excess of that seen for Greater London (Figure 3) ensuring the city's attraction to prospective retailer entrants.

Despite the very apparent appeal of Paris to expanding retail brands, London scored better overall on our Retail Destination Index.

London's higher score, while largely determined by its underlying operational fundamentals related to retail spend and tourist flows, was enhanced by its 'opportunity' potential and lower total occupational costs.

Savills has devised a relatively simple measure of retailer 'opportunity'. This is based on the total number of stand-alone stores the top 10 global fashion brands/groups (based on global turnover) have in the city relative to population and visitor numbers.

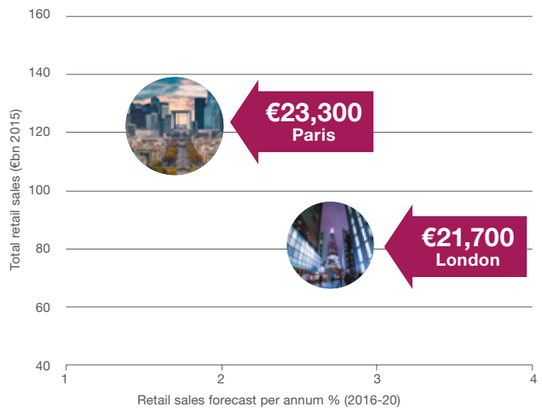
Based on this measure London would appear relatively under supplied compared to Paris with 13.1 stores per 1 million of population and 3.9 per 1 million of international tourists. This compares to 17.3 and 5.9 respectively in Paris. For international brands looking to expand, this suggests the level of competition may be less pronounced in London, albeit this will be largely dependent on the nature of their product offer and existing competition.

London also outperformed Paris in terms of prime total occupational costs, with an indicative cost of €21,700 per sqm per annum, 6.7% lower than Paris. The revenue potential of London and its lower occupational costs suggests the profit margin offered by a London store may be greater than that of a similar store in Paris. This will enhance its appeal to new international entrants, hence its place at the top of our Retail Destination Index.

13%
Cheaper in London than Paris for the same 'luxury' products

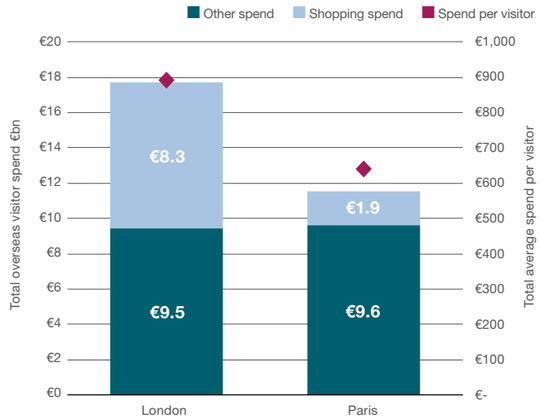
€21,700
Prime total occupational cost per sqm per annum in London

FIGURE 3: Retail sales and total occupational costs (€ per sqm)



Source: Savills Research, Oxford Economics

FIGURE 4: Overseas visitor spend



Source: Savills Research, Mastercard Destination Index 2016

Looking beyond London and Paris

Operational fundamentals are the key to determining retailer appeal

While London and Paris are the top destinations for expanding international brands, all of the other major gateway cities included in our Retail Destination Index offer attractive opportunities.

By their very nature, these markets are considered the key retail cities for their respective countries, typically being the first point of call for new international brands before a potential national rollout.

Our methodology, which takes into account a range of measures related to retail spend, tourist flows and occupational costs, suggest Amsterdam and Barcelona may present the most attractive and immediate opportunities to prospective international brands after London and Paris.

However, each European gateway city has individual strengths which may enhance its appeal above other locations, dependent on the particular requirements of the retailer.

Margin potential

The performance of a given store will be based on a number of very specific features related to location, store size, staffing, product offer and appeal to consumers both local and international, amongst others. At a very macro level, however, examining retail sales at a city level, total occupational costs and level of competition/supply (opportunity score) can provide a loose indication of 'profitability' and how this may compare across the various European gateway cities.

Figure 5 details total annual retail sales benchmarked against the Savills retailer 'opportunity' score across the other nine European gateway cities. Those markets placed higher on the y-axis and further to the left on the x-axis could be considered as high revenue/opportunity markets, with the size of the bubble reflecting total occupational costs.

Based on this approach, while Milan performs very strongly in terms of sales potential, the city's relatively high occupational costs (€13,900 per sqm per annum) may impact operational margins, although this may be offset by sales volumes.

Munich and Barcelona, who have similar retailer 'opportunity' scores to Milan, could offer an attractive alternative. Both lag behind Milan in terms of total retail sales. However, they have significantly lower prime total occupational costs, with Munich being 49.0% cheaper than Milan and Barcelona (75.0%).

Expansion opportunities

As previously noted, the gateway positioning of all these European cities means that they will all be attractive markets to prospective retailer entrants. However, examining the retailer 'opportunity' measure in isolation highlights the relative strength of some markets.

Warsaw would appear to be the most constrained market with an overall 'opportunity' score of 2.2 stand-alone stores (based on top 10 global fashion brands/groups). This equates to 3.2 stores per 1 million of the population and 7.2 per 1 million overseas visitors. Likewise, Amsterdam also scores well against this measure with an overall score of 2.5.

Clearly the quantum of retail sales in both these markets, which lags behind some others, has, to a certain extent, restricted previous retailer expansion into these cities.

However, with both cities forecast to see strong retail sales growth over the next five years of 3.8% and 1.8% per annum respectively, with Warsaw forecast to be the fastest growth market of the 11 European cities, these could become increasingly attractive to expanding international brands.

The positive growth in retail sales of both these cities is also supported by strong operational fundamentals. The unemployment rate in Amsterdam and Warsaw is 6.1% and 6.4% respectively, the lowest after Munich (Figure 6). With low levels of unemployment often correlating with stable retail spend levels by the resident population, this suggests that from a revenue security perspective both markets should prove attractive.

Overseas visitor spend enhancing market appeal

Part of the growing appeal of certain European retail markets is based on the number of international tourists they attract and how much they spend. According to the United Nations World Tourism Organisation (UNWTO) Europe saw 60.7m international arrivals in 2015 with a total spend of €406.2bn, having increased by an average of 3.8% per annum since 2012.

Excluding London and Paris, the largest city destinations for this international tourism spend are the Spanish cities of Barcelona and Madrid, with total visitor expenditure of €8.3bn and €7.2bn respectively. On a per-visitor spend basis, Madrid leads with an average of approximately €1,800 per visitor based on the latest data from Mastercard, closely followed by Barcelona with €1,000. The level of expenditure by international visitors in both these cities and level of historical growth, averaging 6.2% per annum since 2012, has enhanced both cities' attractiveness to expanding international retailers.

The next tier of gateway cities, including Munich, Berlin, Milan, Rome and Amsterdam, all share similar levels of international visitor spend (Figure 7) meaning that on this basis alone there is little to differentiate them. Examining average spend per visitor suggests that Munich and Berlin may prove slightly more attractive.

Naturally, the attractiveness of a given city to international retailers will be determined by the specific requirements of the brand. For certain brands, particularly within the luxury space, those markets with a relatively affluent population and large number of high spending international tourists, are likely to have a stronger appeal.

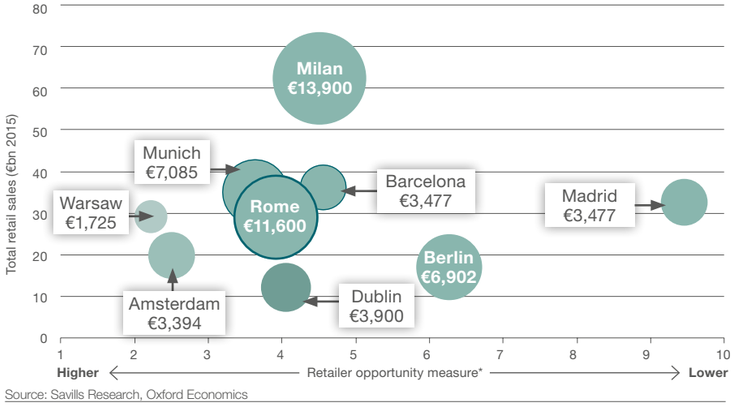
This explains the draw of London and Paris to luxury brands, and why both markets have seen an influx of new luxury brands over the last three years. For example, London has seen 53 new luxury entrants since 2013, accounting for 35.8% of all new international openings over this period. Paris has seen 21 new luxury entrants, representing 23% of the total, over the same period.

While the smaller European 'gateway' cities will prove attractive to some international luxury brands, particularly those where high spending international tourist arrivals are increasing, the real appeal of these markets is likely to be within the mid-market and 'aspirational' tier.

Considering that these types of brands account for the majority of the retail market, the appeal of the gateway European cities looks set to continue.

> "Each gateway city has its own specific features and appeal to different types of retailers"

FIGURE 5: Retail sales, 'opportunity' score and total occupational costs (€ per sqm pa)



Source: Savills Research, Oxford Economics

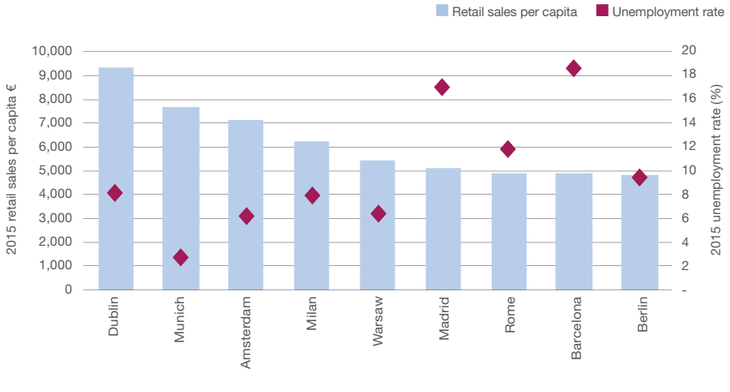
2.8%

Average growth per annum in total retail sales forecast for Dublin to 2020

20.5 stores

Madrid scores first in number of top 10 fashion brands stores per 1m of overseas visitors

FIGURE 6: Retail sales per capita and unemployment rate



Source: Oxford Economics

FIGURE 7: Overseas visitor spend

KEY: Other spend, Shopping spend, Total spend per visit

	Other spend	Shopping spend	Total spend per visit
BARCELONA	€6.9bn	€1.4bn	€1,000
MADRID	€6.0bn	€1.2bn	€1,800
MUNICH	€3.9bn	€0.8bn	€980
BERLIN	€3.7bn	€0.8bn	€900
MILAN	€3.3bn	€0.8bn	€540
ROME	€3.2bn	€0.8bn	€570
AMSTERDAM	€3.3bn	€0.4bn	€470
DUBLIN	€1.5bn	€0.2bn	€390
WARSAW	€0.4bn	€0.05bn	€330

Source: Savills Research, Mastercard Destination Index 2016

Property perspectives

What does this mean for the European property markets?

Over the next five years, retail sales will grow by 2% per year on average across the 11 gateway cities. Against this background, we expect retailer demand for prime retail areas to remain robust in all cities, especially in premier luxury, international flagship or premier domestic locations.

London and Paris's appeal to expanding international brands is unrivalled in Europe. However, the other gateway cities examined in this report will all appeal to different types of retailers, some more than others. So, what makes these cities retail 'gateways' to expanding brands?

'FLAGSHIP' GATEWAYS

London and Paris are obvious destinations due to their large populations, high level of retail spending and their strong appeal to international tourists. In Paris, the general slowdown in luxury spending, on the back of the of the recent terrorist attacks, is resulting in short-term headwinds. This partially explains why Savills does not expect rental growth in 2017, notably on the Champs Elysées. The very high total occupational cost is also restraining demand and, in turn, rental growth. On the other hand, the positive Brexit knock-on effect on tourist-focused retail sales in London should translate into sustained retailer demand, albeit focused on prime retail locations.

Barcelona and Madrid will also increasingly appear on international retailer's radar. Both Spanish cities attract a high and fast growing number of international tourists with high propensity to spend on shopping. Since luxury brands already have a strong presence in both cities compared to other European gateways, there is perhaps more room for mid-market and aspirational retailer expansion. In both cities Savills expects the annual prime rental growth to be at circa 3% next year.

'OPPORTUNITY' GATEWAYS

Warsaw and Amsterdam, where Savills retailer 'opportunity' measure highlighted the greatest prospect for expanding retailers, we expect international expansion to pick up pace going forward. Demand will come from a wide spectrum of retailers, from luxury to the value-market tier. This is particularly the case in Warsaw, since retail sales expectations for the next five years are high. Additionally, Warsaw is considered by many retailers as the gateway market to the other CEE countries. Nonetheless, prime rental growth in the Polish capital is forecast to remain flat next year. This can be explained by the high proportion of transactions signed in recent years on a turnover-base rent. In Amsterdam, we expect the prime rent to rise by 3% next year backed by the 'opportunity' gateway evidence coupled with the high and fast growing number of international tourists (7.6% pa over the past two years).

'MARGIN' GATEWAYS

Mid-market and aspirational retailers should regard Madrid, Barcelona and Warsaw as good gateways, where the total occupational cost is relatively low compared to retail sales volumes. In Warsaw, the profit margin potential is expected to improve next year since retail sales are expected to grow by 5.3% whereas rents will remain stable.

'YOUTH' GATEWAYS

Beyond Paris and London, Madrid, Berlin and Warsaw are all cities with a sizeable young and relatively affluent shopper population. This is where brands targeting this demographic should consider locating, but this may also be where consumer expectations in terms of shopping experience will be the most demanding. In this battle, creative and innovative store concepts will win. However, the high costs involved in delivering and regularly refreshing shopfits and fascias could be a challenge for some retailers' margins in these locations.

Each gateway city will hold an appeal to international retailer brands, some more than others, based on the specific expansion requirements of the brand in question. Some cities will strengthen their position as international tourist retail destinations, enhancing their appeal to those expanding brands keen to tap into a 'new' international audience. Others will benefit from improving domestic conditions, as will some of the international tourist cities. While London and Paris have previously dominated new entrant expansion in Europe, we expect the improving appeal of other European cities will help lure expanding brands into a wider range of gateway cities going forward.

FIGURE 8: Annual rental growth forecast for 2017 (Growth in average prime rents)

Source: Savills Research

▼ Dublin has a low unemployment rate

Where are the millennial and Gen Z consumers?

Affluence of the 'youth' population as important as scale in determining a city's appeal

Our recent analysis of UK shopping habits highlighted a number of differences in the way different generations shop for fashion. While the research focused on UK consumers some of the demographic trends, we suspect, could be universal across Europe.

The research found that the physical store still holds the aces when it comes to the customer experience and engagement, particularly for the younger age groups of millennials (those aged 25-34 years) and Gen Z consumers (aged 16-24 years). In those markets where online retailing only forms a small part of the shopping experience, this preference for an in-store experience is likely to be even more pronounced.

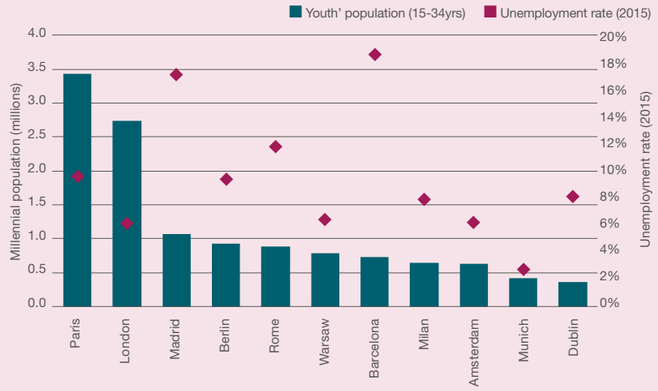
For those expanding international retail brands targeting this demographic the need to have a physical presence as part of their expansion strategy, in order to drive sales, becomes vital. The question is then, which of our gateway European cities offer the greatest opportunity to these types of retailers?

A very simplistic approach is to identify those cities that have the largest youth population. London and Paris, based purely on their overall scale, lead with a population aged between 15 and 34 years above 2.5 million. The remaining gateway cities have relatively similar sized populations aged between 15 to 34 years ranging from approximately 1 million in Madrid to 400,000 in Dublin.

From a retailer perspective, the markets with the larger youth populations are likely to have a stronger appeal, meaning that beyond Paris and London, Madrid and Berlin stand out. However, with youth unemployment still a major issue in a number of European countries those cities with low levels of unemployment, pointing to a greater propensity to spend, could hold a greater appeal dependent on brand positioning and their specific requirements. For example, while Warsaw, Milan, Amsterdam, Munich and Dublin all have relatively small 'youth' populations, they have some of the lowest unemployment rates of the smaller gateway cities (Figure 8).

> "The need to have a physical presence as part of an expansion strategy is vital"

FIGURE 9: 'Youth' population count and unemployment rate



Source: Oxford Economics, Local Statistical Offices

METHODOLOGY

The analysis used to develop the Retail Destination Index draws on various indicators of retail spend, demographic drivers, tourist flows & spend, total occupational costs, international visitor appeal and existing retail provision.

Depending on the indicators in question, the data used for the Index was collected at national, city or street level. In order to represent a wide range of both retailers and consumers in each market, we chose three streets per gateway, which are the "premier luxury location", the "premier international flagship location" and the "premier domestic retail location".

Where possible these indicators use the latest annual data available (predominately 2015 data) and five-year forecasts to ensure the Index incorporates a forward looking view.

The various indicators have been ranked and weighted across the 11 gateway cities included in this report allowing us to develop the Index. The results of the Index does not determine the exclusive attractiveness of a given city to prospective international retail entrants, it purely provides a macro guide for retail brands to incorporate as part of their specific brand/market requirements.

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▼ Paris no longer dominates new entrant expansion in Europe