Savills Commercial Research
Retail 2017
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SPOT LIGHT

Retail Revolutions
The Evolution of the Outlet Centre

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Introduction

The sector's consumer and development trends

Outlets have been in the market place now for almost two decades. They range from large covered shopping centres that can draw in international shoppers, to small independent and more local catchment based schemes. Yet historically they were predominantly located out-of-centre, with large car parks and a drive-to appeal.

Two key changes have occurred in the last decade. First, the offer in most schemes are no longer factory seconds or end of line products, secondly the outlet proposition has become increasingly leisure orientated, with more schemes being developed in central and urban locations.

The outlet centre market is small with only a few key operators and investors specialising in the market. However, an increase in development and investment activity, as well as several new formats appearing, means that a comprehensive commentary on the property perspectives of the sector is long overdue.

This report draws together the past, present and future consumer and development trends in the sector, and considers how the close relationship between retailer and landlord is resulting in performance growth that makes this an increasingly compelling market to invest in.

The terms Factory Outlets and Designer Outlets are both used to describe different scheme formats and FOC is an outdated term given the significance the outlet market plays in today's retail space. For simplicity in this report we refer to all schemes as Outlet Centres (OCs).

"This report draws together the past, present and future consumer and market trends for a sector that has rarely seen such development and investment activity."

Contents

Key highlights

- The future of outlet centres (OCs) lies in a hybrid offer and more urban locations. With a multitude of new developments, extensions and investment transactions, there has arguably never been so much activity across the sector.

- This reflects solid performance in an otherwise challenging retail market; since 2012, OC footfall is up 10%, average spend is up from £51 to £72.50 and frequency of visit has also increased.

- The result is void rates of 3% and recent investment yields around 6.5%.

- The typical size of OCs is now 140-200K sq ft, up from 80K sq ft in late 1990s. This increase is largely due to an increased leisure offer, with F&B provision doubling since 2011 to circa 8% of units, but accounting for as much as 29%.

- Urbanisation is also a key opportunity for future growth of OCs, which have traditionally favoured out-of-town locations. Less than 33% of OC shoppers visit more than once a year but half of all shoppers make a local shopping trip every week. Several new developments are reaching new customers by locating closer to high population areas.

Outlook

The sector has an estimated market value of £2.8bn in 2016 and is expected to grow to £3.8bn (+35%) by 2020. Both average consumer spend and footfall have increased over the last decade.

Despite threats from the Value sector and ecommerce, OCs have continued to perform well in the last decade; both average transaction value and footfall are up 10% since 2012. The destination and experiential appeal of OCs is what will continue to provide a key point of difference against the threat of online retail.

Additionally, retail is now so diverse that it is no longer controversial to put discount next to full price. Both retailer and consumer accept outlets as part of the overall multichannel environment.

Discounted clothing dominates the outlet market accounting for 41% of sales, but schemes need to offer something more than price point alone, with browsing and leisure elements key drivers for the overall experience.

Outlet centres are continuing to evolve and there has been a trend for increasing the level of leisure offer; 42% of visitors make use of the F&B offer and more than half view a visit to outlet shops as a leisure trip. This is proven to increase the attractiveness of schemes to a wider range of visitors, thereby increasing dwell time, sales and footfall.

The occupational model of OCs provides flexibility for landlords and tenants, with turnover rents providing a transparent view on performance that encourages both parties to work together to optimise efficiencies. Additionally, the availability of regular performance data allows landlords to actively manage the scheme as a whole, customise marketing and maintain strategies to the benefit of all parties.

The advantages to landlords include affordability for occupants resulting in low void levels (3%), while being able to share in successes when retailers outperform expectations. Investors can closely and constantly monitor the performance of the asset and, subject to a retailer's performance, can see regular increases to rents above levels associated with conventional leases.

Recent investment yields average around 6.5%, which puts the sector in line with Town Centre Dominant shopping centres.

A cautionary spending mind-set of consumers will continue to play to the strengths of outlet centres while economic uncertainty persists. While there has been an impact on non-essential consumer purchases over the last decade, leisure experiences continue to perform well against a Value and Discount led consumer backdrop.

The challenge for operators is to get those people who already enjoy outlets and believe in them to come more often, while trying to attract more first time shoppers and win them over.

With a multitude of new developments, extensions and investment transactions, there has arguably never been so much activity across the sector, which is testament to the importance these schemes have in meeting UK shopper's desire for a bargain and a good day out.

Looking forward, the UK outlet centre industry is set for further growth. Despite the rhetoric that the market is losing favour and appeal from consumers, strong performance and evolution of the offer has maintained sales growth during a period when other shopping locations have struggled to remain relevant.

We see scope for further OC development in more urban settings, working in harmony with other forms of retail and leisure experiences.

Size and growth

The sector continues to grow significantly

There has been considerable activity in the outlet market of late. An average of one new scheme per year will be developed between 2013-2020, accounting for around 2 million sq ft of new retail and leisure space. To put this into context, during the same period shopping centres will have added 10 million sq ft to the UK market, which given the difference in scale of each sector represents a significant growth in outlet centres compared to the much larger shopping centre market.

Several of the largest schemes have recently undergone (or are undertaking) significant extensions and seven schemes will have transacted in 2016/2017. Clearly, despite challenges from ecommerce and a booming Value sector, the outlet market remains a relevant and important asset class.

According to Geolytix there are 48 outlet malls in the UK. The top 15 Outlet schemes account for 4 million square feet of retail and leisure space, with an average scheme size of 270,000 sq ft; the next 15 schemes have an average size of 150,000 sq ft. Annual footfall averages 4.12 million in the top 15 schemes.

The majority of the larger prime centres are now owned by large institutions/ Propcos (eg Land Sec, THRE, Aviva, M&G etc), who tend to use specialist asset managers such as Realm and McArthur Glen who between them operate nearly 50% of the market.

In addition to being modest in scale, the outlet market is fragmented in terms of the primary concepts they offer. This ranges from small factory outlets selling seconds and last season's stock on an affordable basis, to designer outlets like Bicester Village where the goods on offer, although discounted, remain premium in terms of both brands offered and cost of product. Most UK schemes provide a middle ground, with a mix of aspirational and affordable retailers, but with price points that suit a wide range of demographic groups and brands that may also have a strong high street presence.

Traditionally, schemes were located in out-of-town locations, but increasingly developments are opening in more urban settings where they are closer to populations and can draw in new customers.

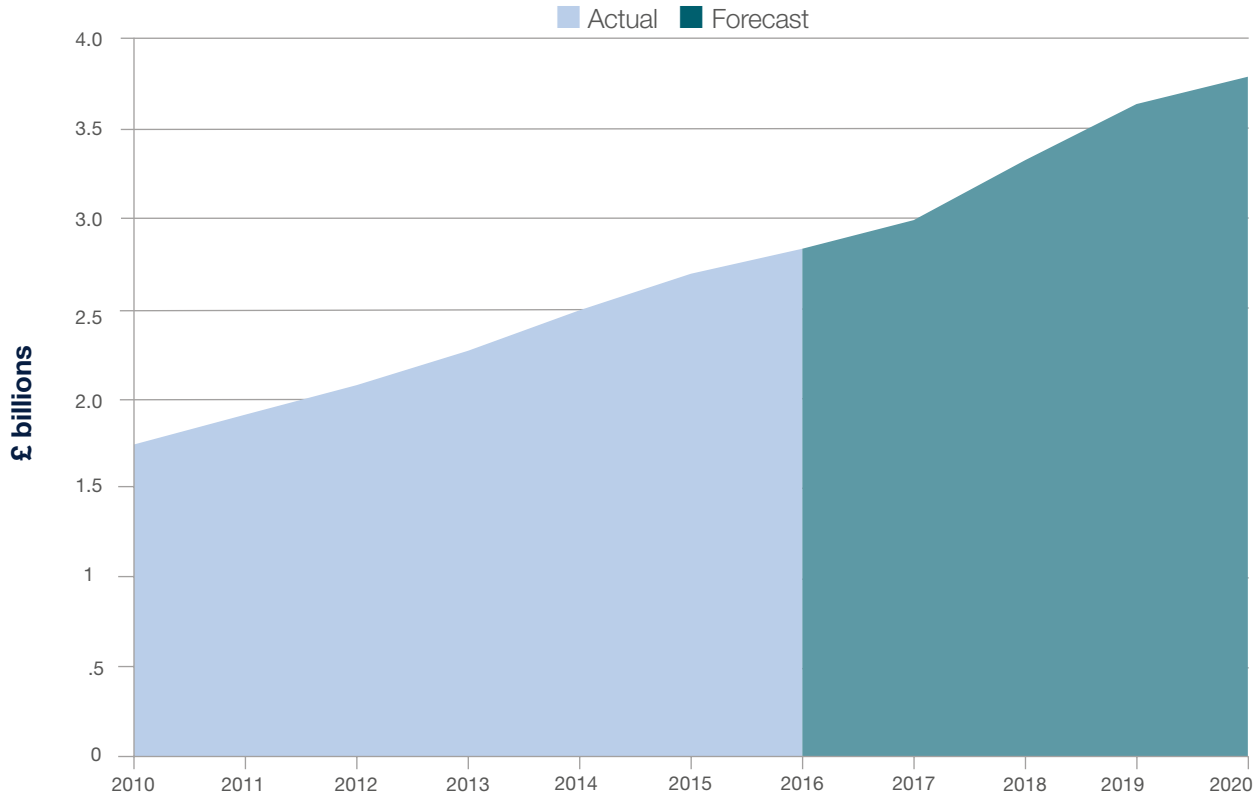
The UK Outlet Centre (OC) market has evolved considerably over the past few decades since the first factory outlet opened at Clarks Village, near Taunton, Somerset. Traditionally, manufacturers sold their surplus or seconds directly to the general public from factory shops adjoining their sites. Although there are still examples of these today, it is the concept of large out-of-town schemes selling end-of-line or last season's products from some of the UK's biggest brands that has seen phenomenal growth.

£2.8bn

Outlet centre Sales were £2.8bn in 2016

Global Data

FIGURE 1: Retail sales in UK outlet centre market



Source: Global Data

FIGURE 2: : Top 15 UK Outlet centres by size sq ft (excluding pipeline)

Rank	Scheme	GLA(sq ft)	Manager/owner
1	Resorts World Birmingham	538,000	Genting/Realm
2	Gunwharf Quays	444,500	Landsec
3	Cheshire Oaks Designer Outlet	352,500	THRE/McArthurGlen
4	London Designer Outlet	350,000	Quintain/Realm
5	The Galleria Outlet Centre	330,000	Landsec
6	Gloucester Quays Designer Outlet	311,500	Lifestyle Outlets
7	Livingston Designer Outlet	291,000	Blackstone/Realm
8	Lowry Outlet	275,000	Lifestyle Outlets
9	Swindon Designer Outlet	250,000	THRE/McArthurGlen
10	York Designer Outlet	248,000	Aviva/McArthurGlen
11	Junction 32 Outlet Shopping Village	246,000	Landsec
12	Bridgend Designer Outlet	241,000	M&G/McArthurGlen
13	Freeport Braintree Outlet Shopping Village	200,000	Landsec
14	Bicester Village	200,000	Value Retail
15	Clarks Village	195,000	Landsec

Source: Savills

The sector has an estimated consumer value of £2.8bn in 2016, expected to grow to £3.8bn by 2020 (Global Data). A cautious spending mind-set of consumers will play to the strengths of OCs, while economic uncertainty persists. However, Discount Retail has come a long way since the Global Financial Crisis and is now pursued across the demographic spectrum.

The pace of development since 2000 resulted in an increase in the size of schemes from about 80,000 sq ft prior to 1995 to around 100,000 sq ft in 1996-97, with more recent schemes accommodating 140,000-200,000 sq ft, and typically including an increasing leisure component.

It is possible that outlet schemes with more open planning consents could, in the future, become mainstream shopping centres. Furthermore it is likely that outlets may increasingly take on the physical appearance of shopping centres, with roofs installed to provide an environment that complements what many already do to attract shoppers with regards to entertainment, food courts and crèches. This environment is already familiar to outlet shoppers in the US and Middle East.

While the wider retail market has been exposed to a shift to Value and Discount goods, the visitation to OCs remains strong, which has prompted several new developments in extensions in the pipeline.

In the last two years, there have been two major new outlet scheme openings in the UK. The first was Resorts World Birmingham, a traditional 'out-of-town' OC that opened in September 2015. The second was Hackney Walk in July 2016. Hackney Walk, an outlet 'district' in East London, is a major urban development with historical links to the fashion industry.

In summer 2017, Princes Quay in Hull, became the first hybrid outlet scheme to include both full price high street retail and traditional OC offer under one roof as well as providing a city centre scheme. In 2018, Greenwich Designer Outlet Village, which will form part of the O2's existing and extensive leisure offer will see the opening of a new 205,000 sq ft designer outlet targeting premium and high street retailers.

Three schemes with planning consents include Mill Green Designer Outlet Village, Cannock (Development Securities c. 130 units - expected 2019), Scotch Corner - c.80 units, and Tewkesbury; each awaiting full development plans and confirmed delivery dates. Lifestyle Outlets Glasgow is proposed at Glasgow Harbourside, but is yet to go into planning.

In addition, current or recent extensions and refurbishments are being made to Swindon, Dalton Park, Bicester Village, Ashford Designer Outlet and Lowry Outlet, Salford Quays.

With a multitude of new developments, extensions and investment transactions, there has arguably never been so much activity across the sector, which is testament to the importance these schemes have in meeting UK shopper's wants and needs.

Visitation and spend

Frequency of visit and average spend have increased in the last five years

Frequency of visit

Around 30% of UK consumers visit an outlet centre once every six months, but for those that do visit the average frequency is closer to once a month.

Despite threats from the Value sector and ecommerce, outlets have continued to perform well since the downturn. Realm data shows that since 2012, during a period when footfall on traditional high streets and shopping centres has fallen, outlet centre footfall has increased on average 10%. If we include visitation on new schemes opened since 2012, footfall has increased by almost 50%, indicating that the market has a long way to go in reaching new markets.

First-time domestic visitors to outlets have seen modest growth of 5% per year over the last four years and this has been driven by the rise in retail park style shopping and younger families moving out of cities into the suburbs and changing their shopping habits accordingly.

This can be explained by the general acceptance that outlet shopping is now more than a trawl through clearance stores and the bar has been raised in terms of the overall offer and experience. Increased investment in events and entertainment are also helping to convert more footfall, with consumers increasingly likely to consider visiting outlet schemes when choosing where to shop.

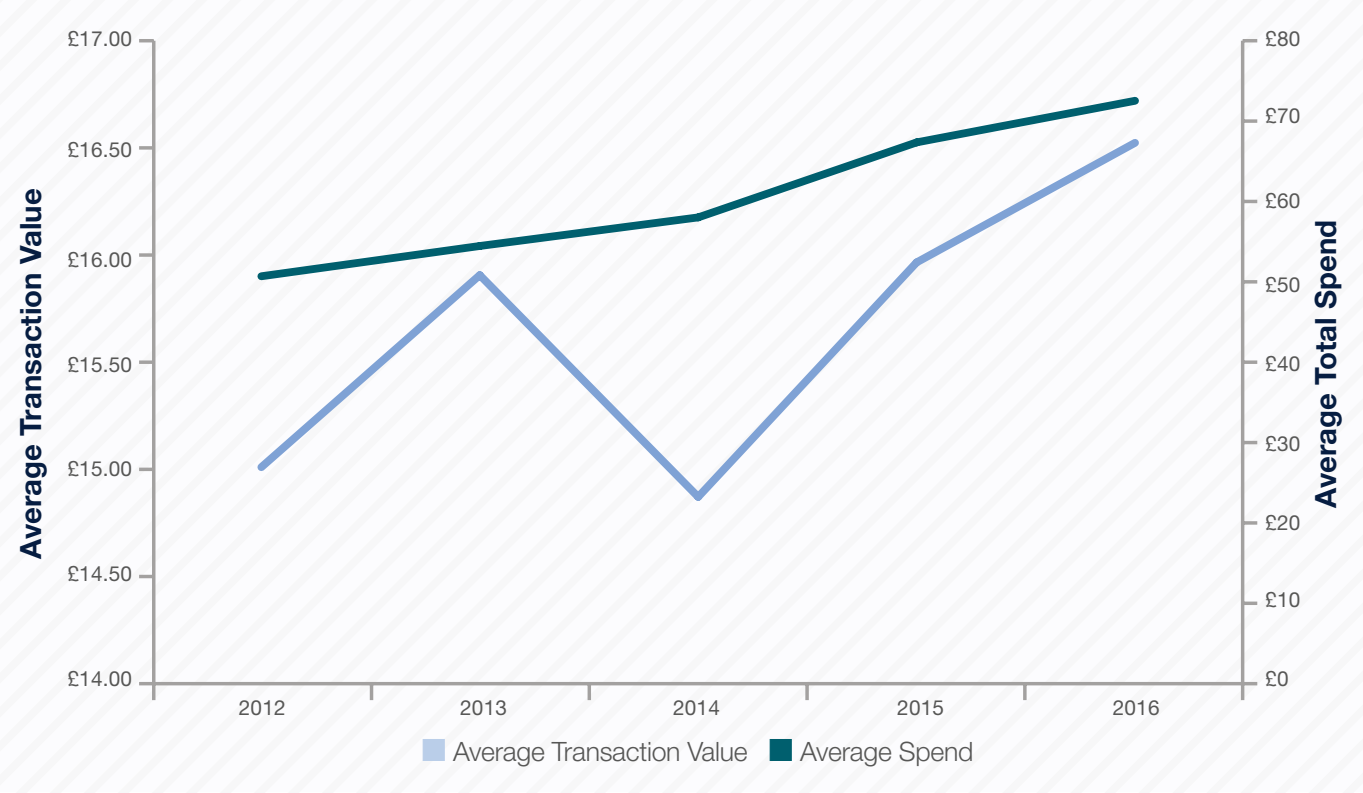
At the other end of the scale the most frequent visitors are what Realm calls Uber Shoppers, who visit at least twice a month. There were swathes of people who adopted a post-recession shift in their shopping habits in search of Value. These were dominated by visits from people within the immediate catchment at the less affluent end of the demographic scale. Recently this group has reduced visitation by as much as 15% as their circumstances have improved, however, future economic challenges that restrict available household spend are likely to see consumers readopt these shopping characteristics.

The most promising sign of visitation growth in the last few years is a 10% increase in the Infrequent Shopper turning into an Occasional Shopper. The Occasional Shopper typically visits 3 to 11 times per year. These shoppers see a blurring of the lines between an outlet and a full price shopping centre and as outlet centre products, shop fit and ambience have improved the appeal, this core group appear to be increasingly satisfied by their visits.

Increased satisfaction is driving repeat visits and this broad group of shoppers typically account for 45% of total footfall to a scheme. Even if people are unsuccessful in their shopping trips and only able to buy a few of the things they wanted, the environment and expectation combine to provide a sense of fulfilment.

This is a quirk of leisure and destination shopping, the prime motivation is not necessarily to tick off ten things on a shopping list, but it is less functional and a more holistic experience.

FIGURE 3: Change in average transaction and total visitor spend



Source: Realm

Spend has increased

Realm have recorded significant growth in shopper spend in the schemes they manage during the last five years. Average Transaction Value (ATV) has increased 10% since 2012 and in 2016 was £16.52. However, with ATV recorded between £15-£25 it is clear that spend levels fluctuate quite significantly by location.

Average total trip spend has also increased. Spend is up 42% since 2012, a rise from £51 to £72.50, but has increased by as much as 50%. Several schemes are now reaching £90-£100 average total spend. Spend levels are anticipated to be even higher in the most premium schemes, such as Bicester Village, which has a considerable draw to affluent foreign visitors.

However, while the affluence of the visitor clearly holds sway with average spend levels on outlet schemes, even the least affluent demographic groups spend on average £51 per visit when visiting a Realm scheme. By contrast the most affluent groups spend closer to £73 on average.

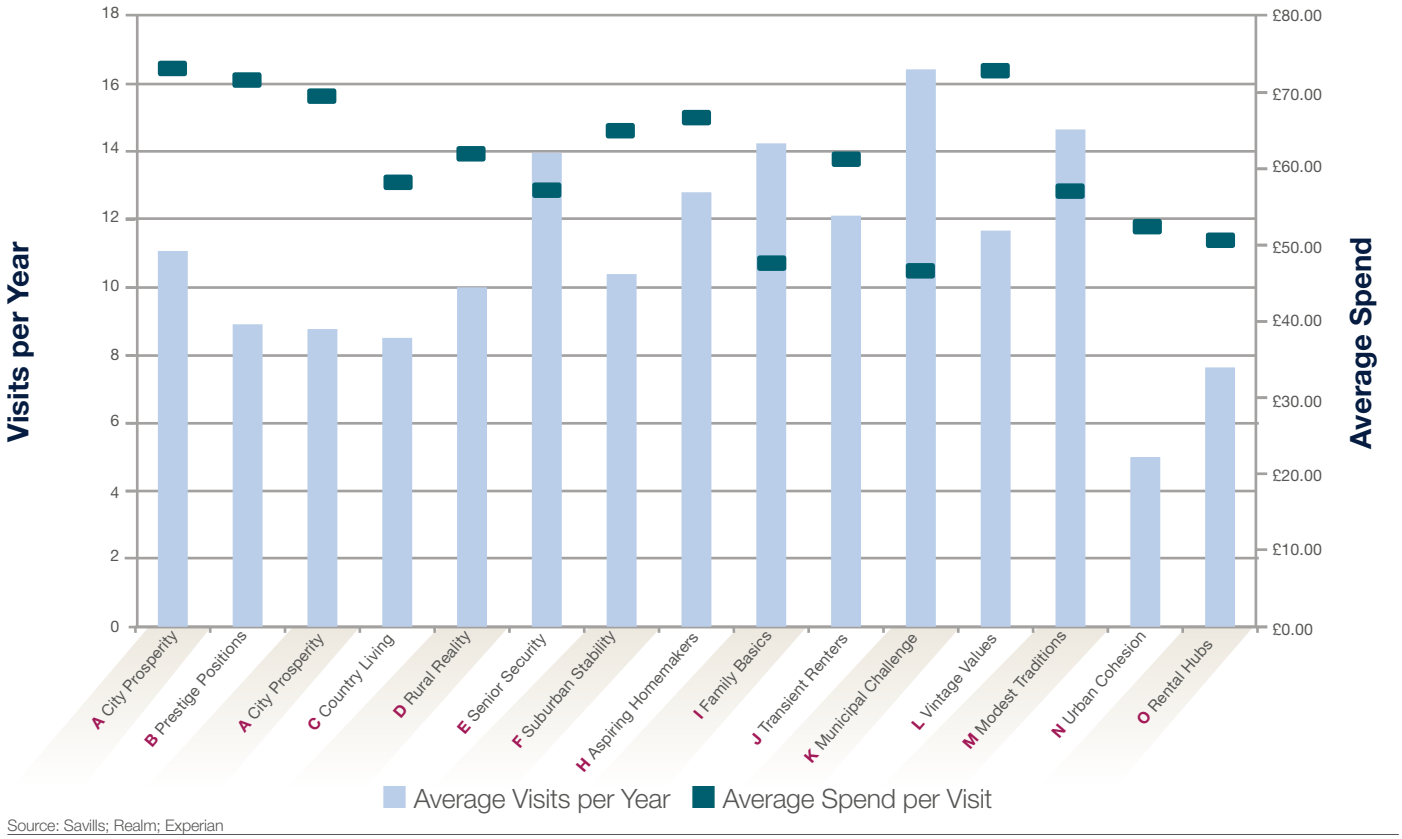
Furthermore, the visitation of below average-affluent shoppers often exceeds that of more affluent visitors and these are therefore a fundamental customer base that should not be overlooked. Yet we have found that this customer base is often underserved; an issue we explore further, later in this report.

> "Shoppers tend to spend more visiting an outlet centre than other shopping destinations"
>
> **Mintel**

23.4%
of Outlet shoppers anticipate increasing visitation in next five years
Global Data

64m
Footfall in the top 15 schemes

FIGURE 4: Visitation frequency and average spend by demographic group



Source: Savills; Realm; Experian

Motivation and reason for visit

Outlets accommodate a variety of consumer needs

Motivation of visit

Gone are the days when an outlet centres' offer was one-dimensional. The range of goods and experiences means that outlets provide different purposes for different visitors. Realm has identified four consumer profiles in terms of reasons for visitation:

Cherry Pickers

Those who have been drawn to specific stores (often just one or two). Over time this has increased slightly and these shoppers are often from more affluent groups. They are not the most frequent or loyal shoppers but they do have high average spends.

Day Trippers

Shoppers intent on a more thorough expedition type, visiting for in excess of three hours. These are closest to the original outlet shoppers when the concept was imported from America.

Spending is often high but frequency has its limits and this group has remained pretty stable depending upon reach of marketing and targeted efforts to attract specific areas within the extended catchment.

Proximity Shoppers

People who now shop at an outlet just because it is convenient and the fact that it is an outlet is actually of little consequence. This group increased in line with frequency of visit four years ago, but has now tailed off slightly.

Value Shoppers

This is now a major source of the increased visitors to outlets as the shift in shopping habits in the grocery sector is now mirrored for consumer goods. They may not necessarily go as far as to describe themselves as typical outlet shoppers but they are keen on brands and are interested in being frugal with their spending.

This could mean taking advantage of the increased price promotion in the full price sector, or dipping into the outlets every now and again. This group is a growth area and often contains younger families who may not have been brought up with the concept of outlet shopping when they were younger, but it has now become relevant to their lifestyles.

Hierarchy of needs whilst visiting

Realm have gained valuable insights into the reasons people visit their centres by undertaking frequent exit surveys on their assets.

Outlet shoppers put environment above retail mix, though there are signs that demand for fashion and footwear is increasing. Yet the two factors are closely linked in meeting consumer need. Realm indicate that it is almost as though non-shopping reasons are responsible for attracting people but brands and discounts are responsible for keeping them interested.

However, 48% of visitors are drawn for a specific store; akin to a destination visit. The opportunity to browse motivates the visitation of 52% of outlet shoppers, which highlights the leisure/ non-essential purpose of the visit.

Additionally, 42% of shoppers eat at an outlet centre, demonstrating the importance of a mixed proposition and the leisure orientated retail trip.

48%
visit for specific store
Realm

52%
visit to browse
Realm

42%
use the F&B on offer
Realm

Top outlet brands

The Value and Premium retail offer is less significant than you may think

The strategy for an outlet centre is a finely balanced mix of retailers. Although dominated by fashion; there will be a wide variety of offers, ranging from men, women's and children's clothes, accessories and shoes. The fashion units will be complemented by lifestyle offers including homeware, furnishings, china, and luggage.

The types of retailers occupying outlet units divides between national brands that also trade from the high street and specialist retailers only found in the discount world.

The national multiples use outlet as part of their multi-channel business model, together with full price stores and ecommerce. The outlet units are used to sell surplus stock and increase brand awareness. This includes household names such as M&S, GAP, Next, Jaeger and Hobbs.

The specialists have an alternative business model, often selling branded ranges of goods acting as a clearing house for surplus stock, or in some cases selling goods specifically manufactured for this market. These retailers are less well known but include Scopes, Bench, Roman, Ben Sherman and Graham&Brown.

While all brands in OCs sell discounted goods, the market tends to be associated with Aspirational and designer brands. However, the market is dominated by Mass and Value retailers, brands whose non outlet stores provide mass market or affordable products.

The Works, has the highest representation with 30 outlet stores and are also well represented on the high street having increased their total portfolio by a third since 2009. Savills categorise the retailer as a Value brand.

Pavers, M&S and Claire's are the most represented Fashion Goods, with 27/24/24 stores, respectively.

Denby, The Body Shop and Pro Cook (24/18/18 stores) are the only Aspirational retailers to list in the top 20 brands. Holland & Barrett, Costa, The Body Shop, Suit Direct and The Gift Company have the most significant growth in the sector; each having increased portfolios in outlet locations by 14-18 stores since 2011.

FIGURE 5: Top 20 Outlet centres brands

Brand	VAMP	Category	2017	Growth 2011-2017
The Works	Value	Comparison Goods	30	-1
Pavers	Value	Fashion Goods	27	2
Holland & Barrett	Mass	Convenience Goods	25	16
Costa	Mass	Cafe/Takeaway	25	14
Mountain Warehouse	Mass	Comparison Goods	25	-2
Denby	Aspirational	Comparison Goods	24	2
Trespass	Value	Comparison Goods	24	0
Marks & Spencer Outlet	Mass	Fashion Goods	24	0
Claire's	Value	Fashion Goods	24	-1
Clarks Factory Shops	Mass	Fashion Goods	23	3
GAP	Mass	Fashion Goods	23	0
Roman Originals	Value	Fashion Goods	21	-4
Cotton Traders	Mass	Fashion Goods	21	-6
Chapelle Jewellery	Value	Fashion Goods	19	0
Thorntons	Mass	Comparison Goods	19	-2
The Body Shop	Aspirational	Convenience Goods	18	14
Bench	Mass	Fashion Goods	18	6
Procook	Aspirtional	Comparison Goods	18	3
Suit Direct	Value	Fashion Goods	18	18
The Gift Company	Mass	Comparison Goods	17	16
Nike	Mass	Comparison Goods	17	3

Source: Savills; Geolytix

The future is hybrid

Significance of the relationship between retail and leisure trips in the outlet market

Destination trips

In previous reports we have discussed the polarisation of shopping trips between 'destination' and 'local' retail journeys. Local shopping trips represent a 'needs' based retail journey, while destination trips represent a 'want' based journey.

For destination retail trips the overall experience is paramount in order to draw people from distance for long dwell times. This allows for browsing and comparison of goods or services. Visitation is less frequent and consumers are typically prepared to spend more.

However, an increase in both the significance of local shopping trips and the growth of ecommerce means that destination retail has to work harder to compete for a reduced share of consumer spend. Where destination schemes have combined with other retail and leisure offers, or another consumer draw such as an arena or tourist attraction, footfall has remained high. The challenge is providing a point of difference in a market flooded with choice, value and experience.

Like regional malls and major city centres, visitation to outlet centres is typically destination driven and an evolution of the offer has been on the agenda of many operators and developers in the sector in order to remain in-tune with current consumer demand.

What continues to drive consumer visits to large retail schemes, is the notion that non-essential shopping trips are essentially a leisure pastime. Shopping has evolved from being considered an activity in its own right to part of a wider leisure experience. As such, many retail led schemes have become more of a hybrid between the retail and leisure offer.

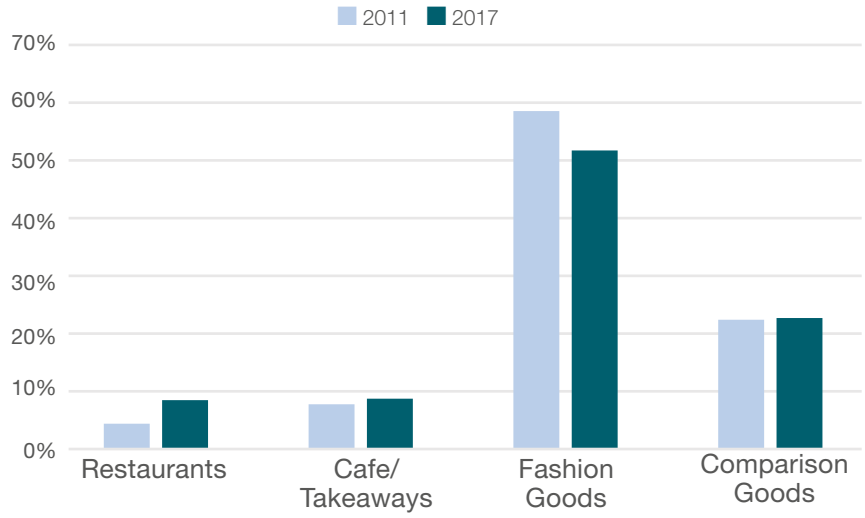
Role of leisure in OCs

Clothing dominates the outlet market accounting for 41% of sales, but Mintel suggest that, discounting on the high street has eroded OCs unique proposition. Therefore schemes need to offer something more than price point alone, with browsing and leisure elements key drivers for the overall experience.

The most significant link between retail and leisure is with regards to food and beverage. F&B is increasingly heralded by retail landlords as an essential means to increasing footfall and extending dwell times. In outlet shopping the provision of F&B is increasingly important too, not least because for most visitors this kind of shopping predominantly constitutes a leisure activity.

Realm data indicates that half of visitors to OCs are interested in a combined retail and leisure offer. The rationale is to increase the attractiveness of schemes to a wider range of visitors, thereby increasing sales and footfall, as well as increasing the dwell time which should, in turn, drive turnover.

FIGURE 6: Change in provision 2011-2017



Source: Savills

48.7%
of outlet shoppers consider dining options an important factor for visitation
Global Data

33.6%
consider leisure facilities are more important at outlet centres than other shopping locations
Global Data

105%
Restaurant provision has doubled in outlet centres since 2011
Savills

37%
Quick F&B has increased by 37% since 2011
Savills

This not a new trend within large regional shopping centres, which have been evolving their leisure offer for some time. Consider any of the large retail developments in the pipeline, or delivered over the last decade and there is a significant leisure component to each of them. Eating out in particular is now an essential part of the retail experience. The outlet market has also been driving the growth of F&B forward in recent years.

The importance of these trends to the outlet market can be demonstrated in how the tenant mix has evolved over time on many schemes. Savills analysis has found that restaurant provision in OCs has doubled since 2011, while cafes/takeaways have increased by over a third. Restaurants now account for

8% of units on outlet schemes across the country, but increasingly account for more than 10% of provision. Total F&B provision on new or redeveloped schemes typically occupied 20-30% of units on new schemes.

This phenomenon shows that the UK outlet market is ahead of European countries, with typically twice as much space allocated to F&B as outlet centres on the continent.

This increase in provision is driven by consumer demand. Global Data report that for consumers visiting OCs, 34% state that leisure facilities are more important on outlet schemes than other shopping locations, while 49% consider dining options an important factor for visitation. Realm have recorded from exit surveys that 42% of visitors ate while at the centre.

Other forms of hybrid

While the concept of an outlet being located within a 'full price' shopping mall is new, hybrid models themselves are not new and there are various schemes that work in harmony with adjacent retail schemes. In fact, a blended retail offer is already prevalent in the majority of shopping centres. The retail and leisure offer appeals as a draw to consumers seeking essential goods, or for leisure shopping trips.

Several OCs have taken other approaches to providing a point of difference. Princes Quay in Hull takes 'hybrid' in an innovative direction that comprises four levels providing a different type of offer on each. The Lower and upper floor are leisure and F&B focussed, with the middle floors split between an outlet offer and a full price high street line up.

Examples of F&B growth

The increase in food & beverage in outlet centres comes as a result of a decrease in the proportion of space given to Fashion goods 2011-2017. Comparison goods have grown marginally in the period. However, as many schemes have increased their F&B provision through extensions, the net decrease in Fashion units is actually less significant.

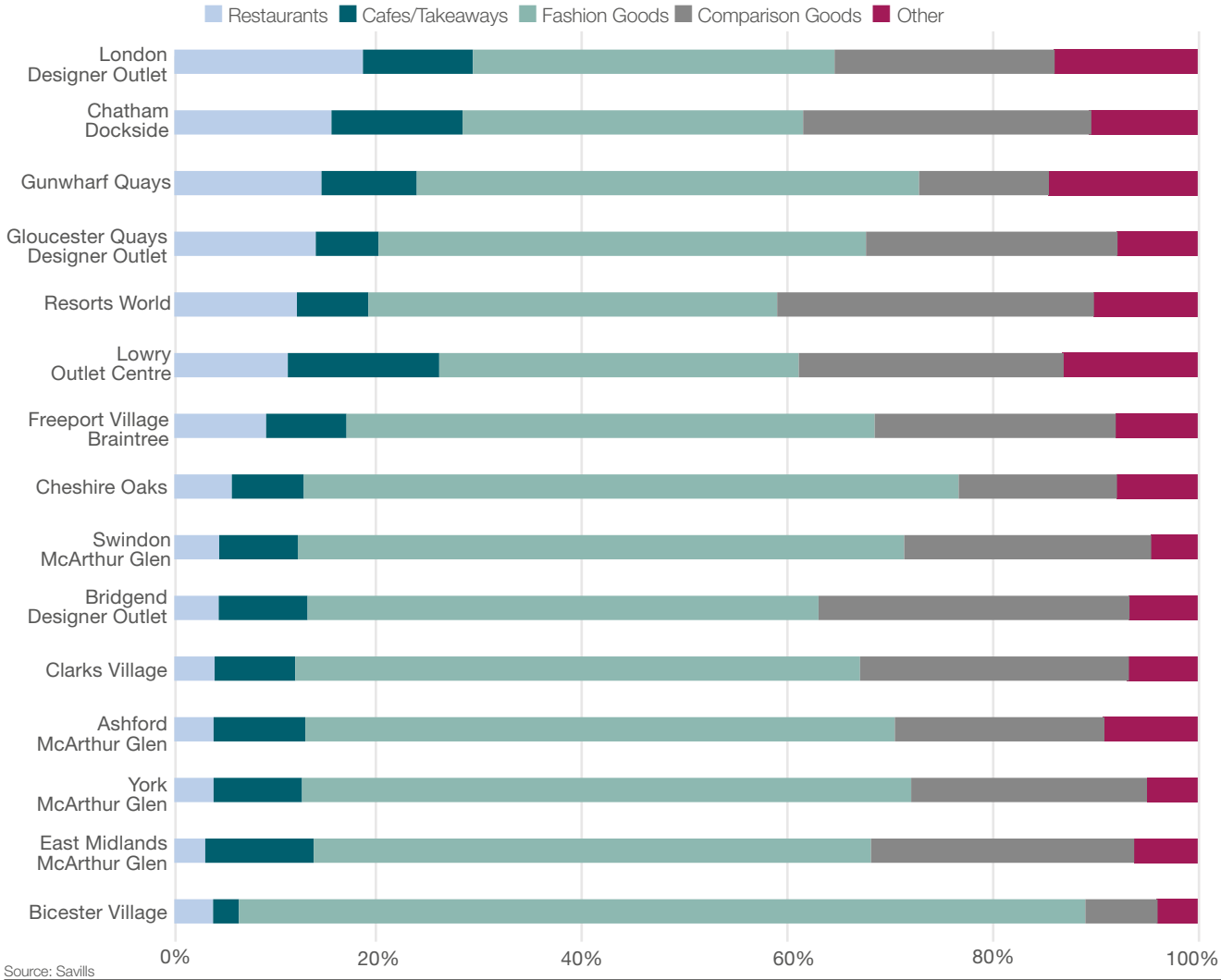
Recent examples of this include Dalton Park in the North East of England, which recently unveiled its Phase 2 with an extended leisure and dining offer that includes Cineworld, Prezzo, Frankie & Benny's and Pizza Express.

Gloucester Quays reportedly had a rocky start to trading prior to increasing the ratio of F&B (now at 20%), resulting in a 70% increase in visitation over the following year. Ashford Designer Outlet's expansion will add 30 new brands, including some international luxury designers, as well as six new cafes and restaurants to its offer to meet the growing demand for a strong F&B offering.

Greenwich's O2 scheme is going in the other direction, by taking an existing leisure and F&B offer and supplementing the consumer experience by adding in outlet retail.

London Designer Outlet has embraced the need for F&B more than any other scheme, with 29% of units taken by cafes/restaurants. The scheme also benefits from being adjacent to Wembley Stadium and Arena.

FIGURE 7: Provision of top UK Outlet centre schemes



Source: Savills

Urbanising the concept

Why are more outlet schemes seeking more central locations?

A more 'central' destination

Another consequence of polarised shopping trips has been the increased significance of local retail journeys since the GFC. This means that destination centres have to compete for a reduced share of consumer spend, particularly in the face of ecommerce. In order to maximise exposure to shoppers, many destination schemes now combine with another retail and leisure offer, or capitalise on more locally generated shopping trips.

Furthermore, despite strong performance growth in the sector, frequency of OC visitation for most consumers remains low, due to the 'destination' nature of the proposition. This means that these schemes are competing with regional shopping centres in terms of the destination visit, even though the offer is quite different.

Around half of consumers make local shopping trips each week, but less than a third of outlet visitors make the trip more than once a year. The visitation statistics strongly indicate that those consumers that make the journey will contribute good spend levels. There is therefore a rationale for increasing market penetration by sitting the offer closer to areas of high population density. OCs have traditionally been located in out-of-town locations with a distinct 'drive to' model. In recent years however, there has been an increase in the number of OCs located in more urban environments that are closer to shoppers, benefit from better public transport hubs, or are located close to other retail or leisure attractions to capitalise on existing footfall. This has been referred to as 'proximity outlet retailing'.

Realm data shows that consumers are willing to travel to OCs (40-50 minutes on average), but there remains a bias to more affluent households making these trips and 30% of all consumers have never even visited an outlet. This implies a significant untapped potential should outlets be located closer to consumers, particularly to those that are less affluent and Value/Discount driven.

Mintel state that consumers, particularly Millennials, are more likely to visit an OC if located in 'proximity' schemes; i.e. locations that are more accessible to consumers. This is also true of less affluent households. Both of these consumer groups have above average representation in urban environments.

The brands represented on most OCs also suit these two demographic groups, with provision being biased to the Mass market price point, despite the high profile 'designer' element. Since 2011 there has been a reduction in the proportion of OC retail units devoted to both Value and Premium brands and an increase in Mass and Aspirational brands.

30%

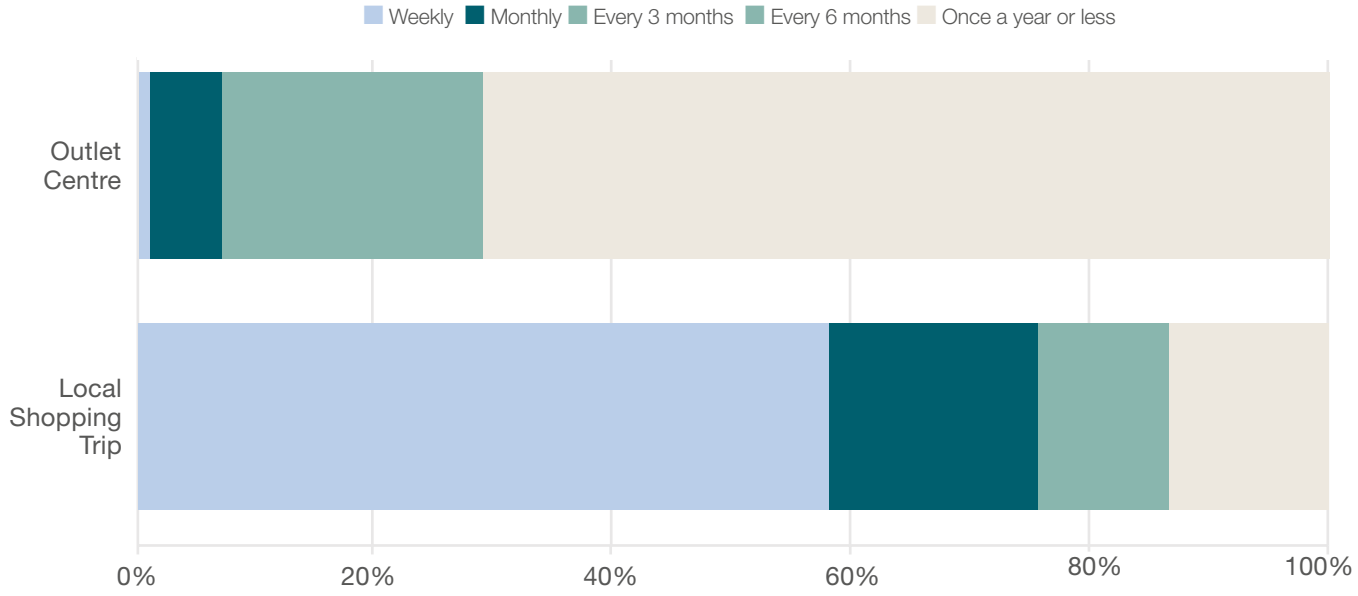
of all consumers have never even visited an outlet, reflecting a significant untapped potential should outlets be located closer to consumers

Savills

Mintel suggest that increased discounting on the high street has made it less appealing for some demographic groups to travel to less-accessible locations to visit OCs.

The performance data we have analysed does not support the notion that OCs have lost relevance, as trade growth has consistently been positive. However, it does suggest that there is a consumer (and therefore operator) advantage to schemes locating within urban centres, where there is a complementary offer and existing footfall.

FIGURE 8: Outlet centre visitation frequency



Source: Savills

Reaching an untapped market

Realm have identified two key kinds of shopping trip to OCs based on their experience of assessing visitors to their centres; the Leisure Shopper and the Economic Shopper.

The Leisure Shopper visits for a non-essential purpose, does not have a specific purchase in mind, will travel to the scheme and is likely to dine during the visit. The Economic Shopper is on a bargain-hunting mission and may be visiting solely to buy things that they want, but would struggle to afford at full price.

Yet as discussed earlier in this report, there are demographic groups that are underrepresented in Outlet visitation, while offering a significant potential in terms of frequency and spend (see Figures 3 &10).

Our analysis of Realm's customer data has found several indications that more centrally located supply can increase market penetration.

Less affluent households are an important outlet shopper group as they spend £47-73 on average per visit. They also have some of the highest visitation frequency, often with more than 10 visits per year. However, not enough of these shoppers do in fact visit as less affluent households account for fewer visitors than more affluent groups; the distance that shoppers are prepared to travel to visit an OC increases with affluence and mobility.

For example, Mozaic group 'Municipal Challenge' account for 4% of Realm's overall visitor profile, but those that do visit in fact have the highest frequency of any group (16 trips annually) and spend £47 each visit.

Less affluent urban centric shoppers are therefore an important but underrepresented consumer group. Similar Mozaic groups include Family Basics, Transient Renters, Municipal Challenge, Vintage Values and Modest Traditions. Each account for below average proportion of existing outlet shoppers, but their visitation statistics for those that do shop in OCs are in fact strong in terms of frequency and spend.

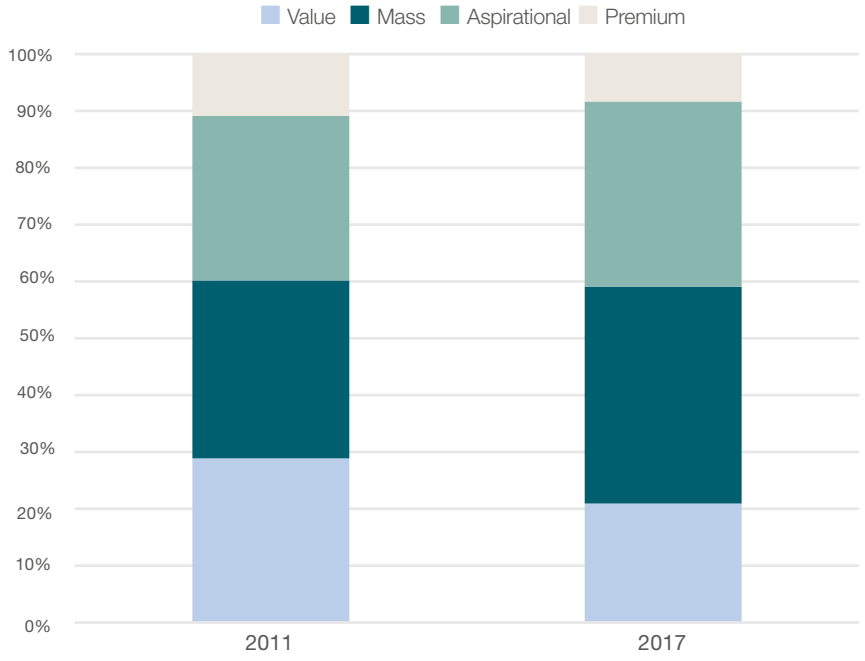
These households are of average or below average affluence, but they are not deprived and make up a significant proportion of the UK's consumer market, accounting for 30% of households nationally, but around 50% of households in urban cities and towns.

Additionally, we know from other Savills research that below average affluence households tend to have increased loyalty and frequency to local shopping locations and there is real potential for the in-town and hybrid OC model to grow, particularly in cities with fewer designer names on the high street.

Existing OCs are not poorly located, as their footfall and visitation statistics continue to grow from strength to strength. However, there is clearly an untapped market that has yet to be fully exploited. It is also one of the primary reasons that the market has seen an increase in urban schemes in recent years.

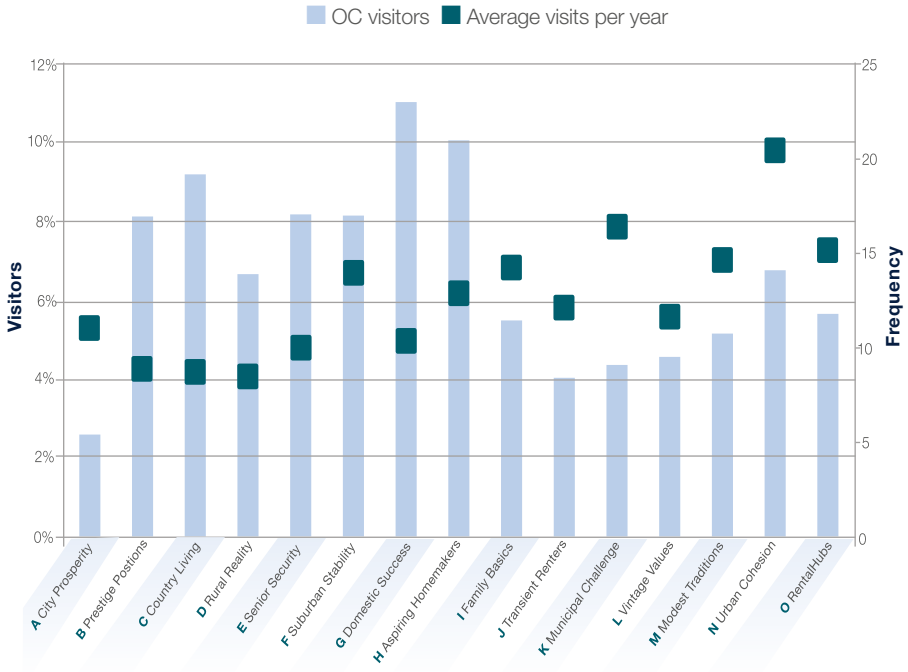
FIGURE 9: Outlet centre changes in brand 'VAMP' 2011-2017

VAMP is Savills classification of retail brands according to value, mass, aspirational or premium offer.



Source: Savills

FIGURE 10: Demographic profile of OC visitation and their frequency



Source: Savills; Realm; Experian

Examples of urban schemes

There has been a shift away from the footprint of the typical out of town outlet scheme

Urban schemes are not an entirely new proposition. Livingston has an outlet mall adjacent to the shopping centre that is in effect the town centre. Gloucester has a recently improved outlet scheme with a strong F&B component on the edge of the city centre and Hatfield Galleria is the conversion of a challenged shopping centre that essentially forms the town centre.

Recent scheme developments have responded to consumer demand for the outlet proposition to be located closer to shoppers and to a more diverse and younger demographic. Yet, it has been the absence from the largest cities and towns where these groups are most prevalent that has been most striking. In particular, the challenge of locating an outlet centre in Greater London in the shadow of the strong designer retail supply found in London's West End.

This potential conflict with the designer element of the outlet market has been addressed by operators by ensuring that outlet schemes provide a point of difference from existing retail in the locality.

Urban schemes often use other local attractions to increase the critical mass and overall appeal of the offer. For Gunwharf Quays it is the water front, for the London Designer Outlet it is the adjacency to, Wembley Stadium and Arena, and for Greenwich, the O2 already has a significant leisure appeal to Londoners and tourists alike.

London Designer Outlet in Wembley has a strong leisure component additional to the adjacent stadium and arena offer, with F&B accounting for almost 30% of occupants of the scheme as well as a cinema. The scheme is part of a high density urban development, with the retail and leisure offer provided over three floors and, unique to the outlet centre market, a hotel and residential towers are located above.

"Urban schemes often use local attractions to increase critical mass and appeal"

Livingston Designer Outlet, while out-of-town in style, is located adjacent to the The Centre shopping mall that makes up Livingston's town centre. The scheme is not new as it opened in 2000, but it does demonstrate that the outlet model is not incompatible from high street retail. For consumers the two schemes are essentially a combined and complimentary offer, with the main F&B offer sandwiched between the two. Both M&S and Next have a full price offer in The Centre and a discounted offer in the outlet scheme.

Princes Quay in Hull has taken a different approach by merging an outlet, F&B and leisure offer, as well as providing a full priced retail offer, all within the city centre. The rationale behind the scheme is to fulfill a range of consumer retail and leisure needs through a blended offer, thus serving both the outlet and high street shopper all under one roof. By locating adjacent to the existing high street retail, the scheme benefits from access to city centre footfall, while providing shoppers with an experience that is not available elsewhere in Hull's shopping catchment.

Hackney Walk in East London has seen the redevelopment of a block of railway arches and conversion of several traditional building into an 'outlet quarter', in an area of London with historical links to fashion manufacturing that includes Burberry's original factory. The scheme breaks from tradition in that there is no designated parking or F&B offer and instead draws on the recent gentrification of Hackney and public transport links that brings people into the area. The concept is attempting to appeal to a new urban outlet shopper who have not previously been engaged with the outlet market. Further development of the scheme is planned.

Tenant performance, asset management and lease structures

Turnover rents benefit both retailer and landlord

Lease structures

Traditionally turnover leases in the retail market were unfavoured by landlords due to unpredictability of income, and there remain issues surrounding how ecommerce, 'show-rooming', C&C or online returns are attributed to a store's turnover.

However, turnover leases are well established in the outlet centre market, where these issues are less relevant and the flexibility provided through the lease structure is seen to be mutually beneficial to both landlord and tenant.

With lease lengths of around 10 years, a typical turnover lease will set a turnover percentage, commonly between 6% and 12%, depending on the trading patterns of the occupier. The lease will include a base or minimum rent, assessed by reference to the expected turnover and often set at c.80% of the expected rent payable. Rent is collected every month, with a catch-up provision at the end of the year.

Leases often include an annual rebasing of the minimum rent based on the previous year's turnover. In the case of the leases on schemes managed by Realm, turnover information is provided by the tenant every week, with an audited figure for the year provided after the year end.

There is flexibility for both retailers and landlords from this relationship. For retailers, turnover rent models can become an attractive proposition by lowering the risk associated with committing to a lease before being certain of trading levels. A lower than usual base rent might help persuade an occupier to take space, while the flexibility within the lease means that once there is a track record of performance the rent can increase while remaining affordable.

This flexibility helps to share risk and more closely align the interests of landlord and tenant, whilst compensating the landlord for strong sales performance. In turn this provides comfort to investors, while maintaining the sustainability of the scheme.

Asset management

Landlords receive turnover data from tenants on a weekly basis and this has the benefit of monitoring performance and capturing growth early, which plays an important role in the everyday management and forward strategy of the centre.

The use of turnover rent data combined with the lease structure enables the Landlord to easily replace tenants who are underperforming, but more importantly to help find ways to avoid this drastic and costly measure.

By identifying weak performing tenants at an early stage, strategies can be implemented to improve their trading position before there is a negative impact on other occupants, or the leases can be terminated altogether. In doing so void rates are minimised and the tenant mix remains relevant to the preferences of shoppers.

This changes the dynamics of the investment, with a vested interest for both parties to ensure the tenant mix is strong and that all the units in the centre are at full capacity.

However, the benefits of receiving regular performance data outreach the advantage of scrutinising individual leases. A modern outlet centre uses turnover information to improve performance for the whole centre, making changes to the overall line-up, meeting changing consumer demand, or with marketing strategies.

For the investor, there is the benefit of having a transparent and regular view as to how the asset as a whole is performing.

FIGURE 11: Outlet centre sales growth and voids 2008-2017 (from Realm portfolio)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 to date	10 year average
Total sales growth	0.65%	2.68%	0.28%	1.33%	2.14%	2.75%	3.33%	8.78%	7.39%	4.70%	3.40%
Like for like sales growth	0.60%	2.40%	-1.25%	0.25%	1.02%	1.27%	2.84%	4.79%	4.82%	4.18%	2.09%
Vacancy % by area	1.26%	0.52%	1.89%	5.17%	5.22%	3.57%	4.85%	0.87%	3.19%	3.20%	2.97%

Source: Realm

Tenant performance

One of the features of outlet centres has been the low level of voids, compared with the high street. The Realm portfolio records an average vacancy rate of 3% over the last 10 years; significantly below other asset classes, including regional shopping malls (7%).

While footfall in OCs has been resilient to a tough economic backdrop, low void rates can be in part attributed to the reduction in over-renting as a consequence of turnover leases and the ability to manage the tenant mix to optimise trading.

Figures from Realm also show a 10 year average sales growth of 3.4%. As the OCs are let on turnover rents, this growth will be directly translated into the growth in income for the landlord, making a consistent improvement in both income returns and capital values.

With average visitor spend in OC environments increasing, the contribution received by landlords from retailers has increased at rates that exceed standard shopping centre rental growth levels.

Furthermore, the investment delivers annual increases in the actual income received, as compared to waiting for five years to see any rental growth reflected in the income from the asset.

These improvements demonstrate the advantages of active shopping centre management with a strong strategy to ensure the needs of both retailer and consumer are being met.

This characteristic is especially beneficial for Pension Funds looking for lower risk assets with consistent income growth rather than the lumpy income increases from traditional core assets.

As the sector matures it will be of increasing appeal to institutions looking for low risk diversified income, although it is interesting to note that recent purchases have been by the more entrepreneurial property companies and opportunity funds, likely to be associated with the extra performance that can be generated by active management.

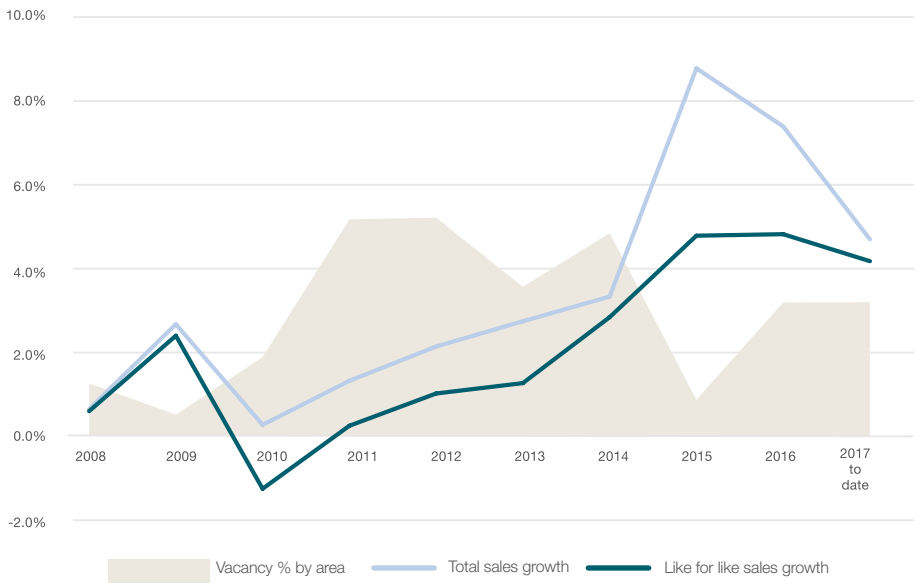
7.4%

2016 saw sales growth of 7.4%
Realm

3%

10yr average vacancy of 3%
Realm

FIGURE 12: Outlet centre sales growth and voids 2008-2017 (from Realm portfolio)



Source: Realm

Transaction activity and valuation challenges

The last 18 months has been busy one for the sector

Recent & historic deals

The outlet centre investment market is still in its relative infancy. To date, the majority of OC development has been funded by developers and operators with minimal institutional involvement.

The main operators, Realm, McArthurGlen and Value Retail who dominate the market, have primarily funded their developments by a combination of cash, debt and equity capital. Due to the small number of outlet centres, there have been relatively few transactions during the last two decades and as a consequence yields have varied between assets. However there has been an increase in investment activity in the last 18 months.

The first significant outlet centre transaction was the partial sale of McArthurGlen's Cheshire Oaks which achieved a yield of 5.5% in 1998.

Since this sale, yields have varied from 5.5% to 8%. Historic sales have shown yields of 5.5% to 6.5%, evidenced by the sales of Gretna Gateway and the Hatfield Galleria in October 2005, which showed net initial yields of 6.5% and 5.5% respectively. The sale of Springfields in Lincolnshire in January 2007 reflected a net initial yield of 5.5% when UBS Triton Property Fund purchased the interest in the property in conjunction with its asset manager.

Livingston Designer Outlet sold to LaSalle IM in 2014 for c.£52m, which provides an initial yield of 9.00%. Three years later and following considerable asset management, the scheme has recently transacted again, with Blackstone reportedly paying c.£100m, with the yield rumoured to be 6.5%.

More recently, two schemes transacted in December 2016, sold by Hermes to Karlin Capital. The schemes, Freeport Talke and Freeport Fleetwood, accounted for 250,000 sq ft and sold for £31.5m, both reflecting yields of 8.00%.

Further to this, Hermes sold Clarks Village, Freeport Braintree, and Junction 32 Castleford in May 2017 to Landsec for £340m, with yields rumoured to be 6.4%. Atlantic Village, Bideford, Devon was transacted early October 2017 in an off-market deal by Karlin Capital.

Although OC transactional evidence is sporadic, yields have tended to sit between Prime and Secondary shopping centres. However, the most recent deals show an improved yield position, closer to prime and more aligned to Town Centre Dominant shopping centres, for which Savills record a long term average of 6.5%.

Is the sector undervalued?

There are a number of challenges that relate to the valuation of OCs and the assessment of their potential for future performance, which sets them apart from a conventional shopping centre.

First, if the centre is let on 100% turnover rents, then the theoretical approach to the valuation should be a discounted cash flow, so that the prospects (or otherwise) of growth in turnover for each individual tenant is reflected in the cash flows. This requires making an informed assessment of turnover growth as compared with a forecast of rental growth.

The difficulty in assessing each retailer's potential turnover growth has however, often led the market to revert to the conventional approach of income times yield. It is an interesting question, as to which income figure should be adopted as many turnover rents are based on a minimum rent that is below the ERV (commonly 80%), but with annual growth generated by turnover rents. Conventional valuation may therefore under estimate the performance potential of the investment.

These include the diversity of the source of income across a wide range of tenants and the low obsolescence compared with non-Prime shopping centres. The investment risks relate more to systematic market than asset specific issues which should be reflected in the yields.

Furthermore, in common with many of the most successful shopping centres, the outlet market requires specialist operational management. The lease structure and the use of turnover leases means the assets are particularly suited to the use of asset management initiatives to generate enhanced performance.

Pre-2017 investment yields for OCs had moved closer to that of secondary shopping centres. However, the long held view of stakeholders has been that yields should revert back towards Prime as OCs offer advantages over shopping centres on conventional leases; Blackstone and Landsec's latest transactions are evidence that this is now occurring.

Benefits for managers and investors in the outlet market

- As the sector matures, there is a greater understanding of benefits to investors.
- Captures growth in income annually compared to 5 year rent review pattern.
- Leases outside the act allow active management of tenant mix.
- Turnover based rents provide a buffer to retailers avoiding excessive over-renting.
- Rental income geared to sales growth provides hedge against inflation.
- Provides diversification from 'over crowded' mid-market retail sector.
- Data capture facilitates proactive management at the retailing level.
- Enhanced scope for active management
- Instant payback for marketing and branding initiatives.
- Operational control allows holistic approach to centre performance.
- Less competition from internet sales as merchandise is not available on-line.

For these reasons and given the limited availability of prime stock, this makes the outlet market a viable and attractive alternative for retail investment.

Outlet Market Myth Busting

There are several market perceptions against outlet centre investment and development that are inconsistent with the experience of operators

A. Outlet centres draw from a 2hr catchment
They can, but market penetration is significantly higher at closer distances. If the catchments were really this large then there would be far fewer outlet malls trading successfully in the UK. In reality catchments are about one hour, but most customers will come from a more local area.

B. Outlet centres need 200,000sq ft to reach the critical mass required to draw occupiers and shoppers.
Bigger certainly helps create destination appeal, but many OCs are smaller. Only the top 15 UK schemes currently exceed 200,000 sq ft and the average size is 150,000 sq ft.

Arguably, where sited in an urban context schemes can benefit from a smaller footprint due to the critical mass gained from other retail and leisure provision in the location (e.g. Hackney Walk @ 50,000 sq ft). Furthermore, the larger the OC proposition, the bigger the leasing challenge.

C. Outlet centres need 1,000,000 footfall to be viable
Footfall is critical in schemes that are remote and rely on standalone appeal to draw shoppers. For the top 15 UK schemes the average footfall is c.4.2 million (ranging from 2-8 million annual visitors).

However, in more urban schemes Outlet centres can benefit from footfall associated with complementary adjacent retail and leisure provision and do not rely on their own footfall drivers alone. In both settings, retail conversion and average visitor spend are key drivers for success.

D. Outlet centres include a 60-mile retailer exclusion zone, which limits potential for new development
Exclusion zones are not typically implemented. Bicester Village has reportedly enforced the rule, but this is not common practice for other locations. In practice if implemented there would be far fewer schemes in the market or in development.

E. Outlet centres are not seen as institutional stock
It only requires a look at the list of owners that have bought or sold in the last 18 months to see that for several institutions the Outlet market is an enticing proposition.

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