European Commercial – July 2023

SPOTLIGHT
Savills Research

European Factory Outlet Centres

Outlets to outrun surging prices

KEY POINTS:

- Factory outlet centres offer cost-conscious consumers the chance to purchase both luxury and mass-market goods at a discounted rate, leaving outlets well-placed to benefit from economic uncertainty and a cost of living crisis.
- Factory outlet schemes are, in many instances, more profitable than brands' high street stores, largely due to lower rents and fewer staff.
- Factory outlets are increasingly competing with traditional shopping centres by incorporating leisure facilities that encourage consumers to extend their stay, and have the added benefit of heavily discounted goods.
- Despite factory outlet centres faring better than other retail formats, notably shopping centres, the sector is not immune to the current retail challenges of rising operating costs.
- The sector is considered a niche segment with fragmented transaction activity over the years. Sales between investors are limited due to the low amount of stock, and in the current downward price correction climate, many investors want to hold their profitable prime properties.

European Factory Outlet Centres - July 2023

Discounted prices attract cost-conscious consumers

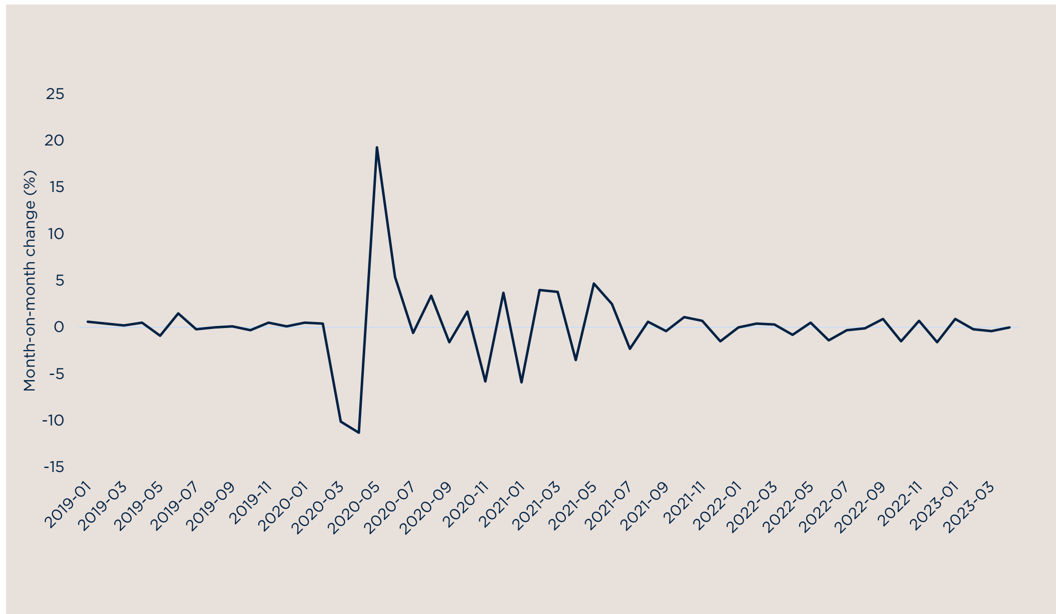
In the current economic landscape of high inflation - currently at 6.1% in the euro area - fears of recession and general uncertainty surrounding consumer finances, factory outlet centres (FOC*) hold appeal for consumers, operators, developers and investors. Considered a resilient sector, the attractiveness of FOCs becomes more prominent in times of economic uncertainty, where the cost of living has a squeeze on retail spending and steers the consumer to where they know they can find a better price for desired goods.

Indeed, retail sales in the euro area were unmoved at 0% month-on-month (MoM) and down -2.6% year-on year (YoY) in April 2023. Spain in particular stands out as a positive retail environment, with the volume of retail sales increasing by 1.4% MoM and 7.8% YoY in April 2023, while in Germany, retail sales increased by 0.5% MoM and decreased by 4.5% YoY, and in France, it decreased by 1.3% MoM and by 2.9% YoY. As a result of lower retail spending, consumer shopping habits will adapt to seek the best value for money, increasing the pool of FOC consumers.

As a result of the pandemic, FOCs have increased in attractiveness as consumers lowered their consumption for discretionary goods and instead are spending more on 'one-off' items typically found in outlets. Additionally, the excess stock created during the pandemic, which retailers were unable to sell, means outlet stores can offer increased stock at discount prices for quality goods. Moreover, with FOCs predominately open-air and in out-of-town locations, many consumers felt they were a safer option than traditional shopping centres following the lockdowns.

*Factory Outlet Centre (FOC) is a term used to describe both traditional outlet centres that trade unsold stock from brands direct to consumers at a discount and designer outlets made up of premium/luxury brands which also sell goods at a discounted rate. According to Savills definition, a FOC includes a group of at least 10 outlet stores and service establishments gathered within the same centre of all sizes but at least ≥5,000 sqm. Outlet centres are often but not always open-air rather than enclosed shopping centres and are generally located outside a town or a city.

Fig 1: Monthly change in retail sales in the euro area



Source: Eurostat

Relatively shielded from the rise of e-commerce

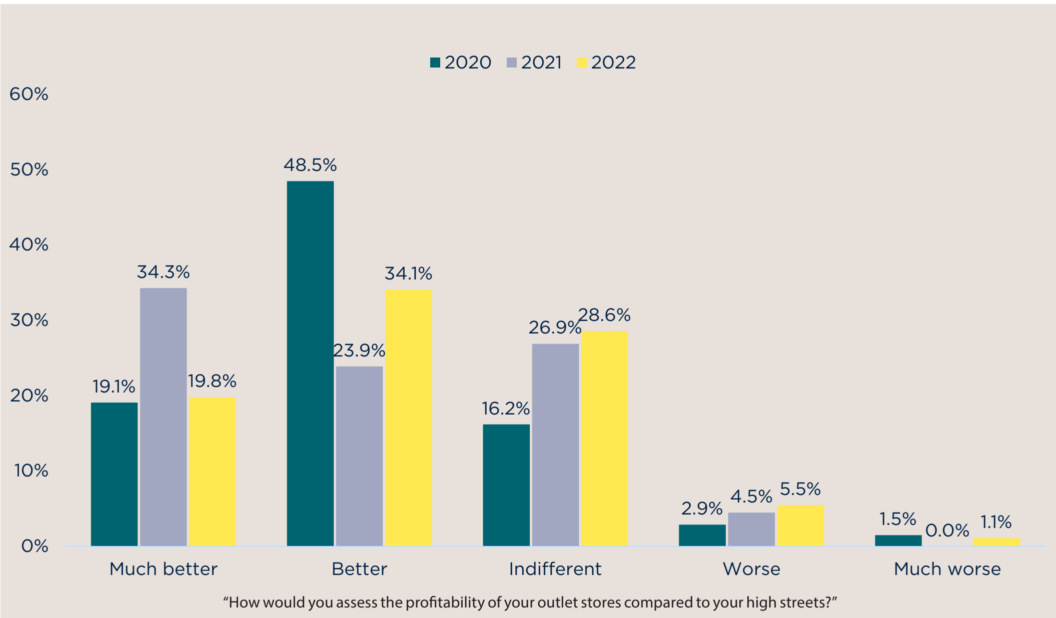
The attractiveness of outlet centres is in part due to their high performance during periods of economic downturn due to their typical 30-70% discount on goods, offering value for money to an increasingly cost-conscious consumer. High-quality design, a wide range of brands and an attractive mix of shopping and leisure have been additional elements of the desirability of FOCs. Additionally, they are relatively shielded from the rise of e-commerce. Indeed, FOCs are under less threat than traditional shopping centres as, generally, FOC discounts are only available in-store.

Over time, FOCs evolved from solely big box retail destinations to places where consumers are encouraged to spend the day as spaces have adapted to include similar amenities to shopping centres, with the additional attractiveness of discounted goods. The Alegra FOC in San Sebastian de los Reyes is one example of this, whereby food and beverage sites have been incorporated into the centre which sits amongst another complex home to a cinema, bowling alley and a recreational scaled-city for children's entertainment, highlighting that FOCs are increasingly evolving to become destination locations.

The sector has been popular both with shoppers and tourists, leading a rising number of international retailers to include outlets in their strategy. In turn, the mix of well-established, aspirational brands has made these schemes appealing to consumers, drawing visits from extensive catchment areas complimented by services that enhance people's visits and encourage them to stay longer. FOCs are often strategically placed in large urban clusters and tourist regions for this reason. The McArthurGlen Cheshire Oaks Designer Outlet in the UK is located within the city triangle of Liverpool, Manchester and Birmingham, drawing consumers from three major UK cities that are additionally well-connected to the rest of the UK.

Sites in the 'village style' (incorporating leisure facilities, food and beverage sites and consumer services) are the most successful type of outlet centre. According to Ecostra, 15 of the 20 top-ranking centres are outlet villages.

Fig 2: Assessment of profitability of outlet stores compared to high street stores



Source: Ecostra Survey 2023

European Factory Outlet Centres - July 2023

Factory outlets still performing better than high street stores

According to the latest survey from Ecostra, the profitability of outlet stores is significantly better than the performance of their high street stores. Indeed, 34% of the brands surveyed state that their outlet stores' profitability is better than that of their high street shops, whilst nearly 19% consider their outlet profitability to be much better (chart 2). Two reasons for higher profitability include lower rents in outlet schemes, and a lower staff to customer ratio, both of which would be higher in a brands high street store.

ROS Retail Outlet Shopping, one of the top four operators across Europe, closed 2022 with an average sales performance of +18% compared to the pre-pandemic year 2019, while Value Retail, who owns The Bicester Collection in Europe and China, has delivered double-digit growth in gross sales every year. In 2022, their total gross sales increased by 22% compared to 2021. Bicester Village, located north of the university city Oxford in the UK, has one of the highest area productivity in the European outlet market with €40,000 per sq m.

The 2022 ranking from Ecostra, which benchmarks European factory outlets on the performance of stores in outlet centres against the same brands' stores in other outlet centres on metrics such as turnover and site costs, based on the tenants' point of view, places four of the top 20 FOCs in the UK. In first place sits the McArthurGlen Cheshire Oaks Designer Outlet, the UK's first designer outlet and largest scheme (38,000 sq m), which has just under 8 million visitors per year. Bicester Village, which has ranked 1st in Ecostra's European ranking for the past five years, is now placed 2nd. It remains one of the most premium schemes in Europe, offering a range of luxury international brands. Gunwharf Quays follows in joint 10th place in the European ranking and McArthurGlen East Midlands places 20th.

France is also home to four of the top 20 European FOCs. The most notable, The Style Outlets in Roppenheim, places 6th in Europe. With over 100 boutiques, this FOC is strategically located along the French and German border, hence widening the pool of consumers from both France and Germany. The Village in Villefontaine (7th), McArthurGlen Troyes (10th) and La Vallée Village (15th) are also among the top 20 European FOCs.

In Italy, three centres are ranked within the top 20 outlets in Europe, all operated by McArthurGlen. At the top of the league, the McArthurGlen Serravalle Scrivia, ranked third in Europe and is home to more than 240 stores spread across 50,000 sq m GLA. Serravalle Scrivia is a village concept with a great leisure offering. It includes the newly opened "Play Land", a brand new 6,000 sq m leisure concept dedicated to family entertainment anchored by Lele's Aqua Park. The second and third best-performing FOC in Italy are the McArthurGlen Castel Romano, which places 10th in Europe, and McArthurGlen Noventa di Piave, in 15th place.

Three FOCs in Spain are among the top 20 European schemes, Las Rozas Village (5th), La Roca Village (9th) and The Style Outlets in Getafe (19th). Spain's top scheme, Las Rozas Village, is part of Value Retail's designer outlet collection, which also owns Bicester Village in the UK. This is an international shopping destination located only 25 minutes from Madrid and that houses over 100 brands.

Brands plan to open between two & three outlet stores in the next 12 months

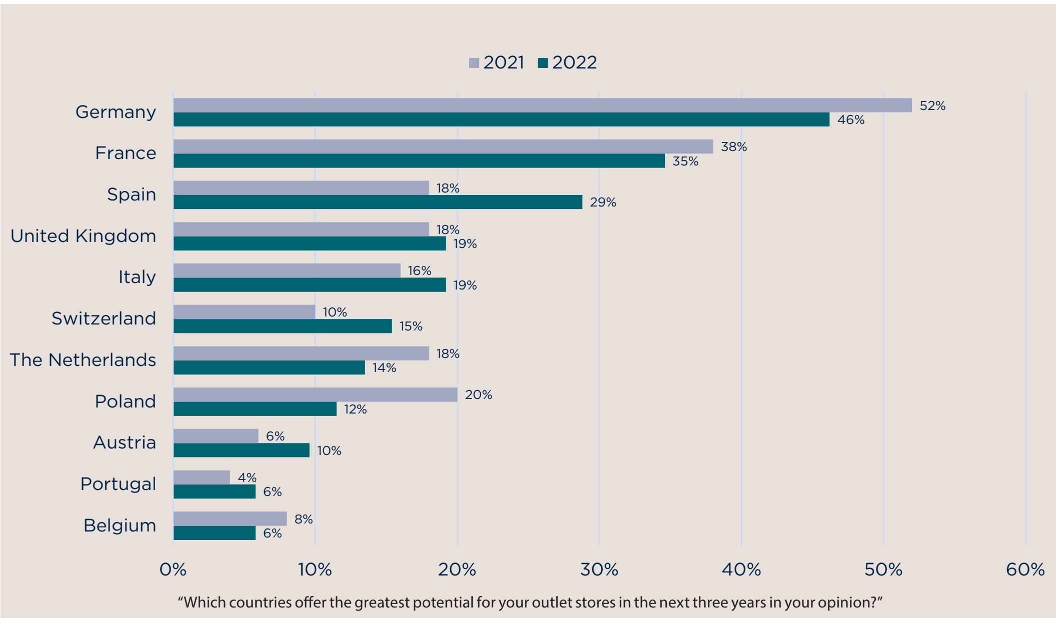
Interestingly, despite the unstable economic landscape in 2022, based on Ecostra's brand representative survey, the expansion plans of respondents remained relatively unchanged, with brands planning to open, on average, 2.5 outlet stores within the next 12 months in January 2023 compared to 2.6 in 2021. This gives an indication that the FOC market remains resilient in the face of economic uncertainty and explains the high occupancy of FOC properties, generally around 96-97% up to 100% for the best villages. In Poland, for example, the occupancy rate was between 94-98% between July and August in 2022.

However, retrospectively, brands' expansion intentions have somehow eased since 2018 (from approximately 3.7 stores in 2018 to 3.3 in 2019 and 3.0 in 2020). Also, whilst 42% of brands responded that they do not intend to close any FOCs in the next 12 months, 33% plan to close 1-3 stores.

In a separate question, brands were asked which countries offer the greatest potential for outlet stores across Europe in the next three years. The results of the survey show that Germany is the most popular destination to expand, with 46% of brands interested in expanding there in the next three years (chart 3). France (35%), Spain (29%), the UK (19%) and Italy (19%) follow.

Germany takes the top spot largely as a result of the high GDP per capita (€38,905) and the low density of outlets per inhabitant compared to other European countries; approximately 4 sq m of factory outlets per 1,000 inhabitants against 11 in the UK and 12 in Italy. France, the second most popular destination for expansion, is also unsurprising given the relatively high GDP per capita here (€35,174), with the added draw of the Olympic games held here in 2024. The country observing the largest increase in popularity between 2021 and 2022 is Spain, increasing 11 percentage points from 18% to 29% of brands looking to expand there in the next three years. The wider retail market in Spain excelled in 2022 due to the post-Covid rebound of tourism and physical retail sales and so the strong growth undoubtedly has incentivised occupiers to grow their international portfolios in Spain.

Fig 3: Destinations for expansion of brands in the next three years



Source: Ecostra Survey 2023

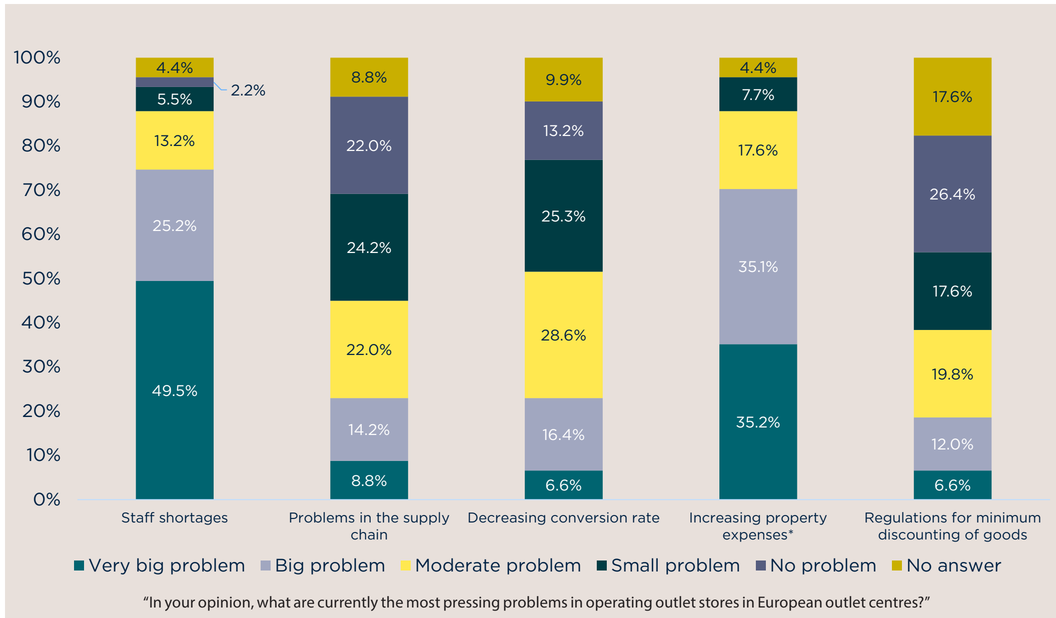
...but the sector is not immune to challenges

Under the combined effect of the growing adoption of online purchases, the lockdown measures during the pandemic and the surging inflation following Russia's invasion of Ukraine, the retail sector, as a whole, has faced many challenges over the past five years. Whilst the factory outlet segment has certainly played the game better than other retail formats - notably shopping centres, the sector is not immune to the current retail challenges.

The rise in energy costs is having an upward-spiralling effect on property charges. In the same vein, surging prices on raw materials are pulling construction costs up. The disruption in supply chains, which have not yet settled down since the pandemic, is postponing the completion of new developments. Savings from the pandemic have been eroded after frantic post-lockdown consumer behaviour, which was followed by surging inflation. Hence, the loss of purchasing power brought consumers towards a higher sensitivity to product prices. Finally, persistent tight labour markets across Europe exacerbate staff shortages, sometimes ending in upward pressure on wages. All in all, these issues are affecting retailers' balance sheets, notably squeezing their profit.

Ecostra's survey of the most pressing problems in operating outlet centres highlights the main issues facing the European outlet market at present (chart 4). The two biggest issues are staff shortages and increasing property expenses (heating and energy)

Fig 4: Most pressing problems in operating outlet stores in European



Source: Ecostra Survey 2023, * *energy, heating

Supply - Bigger is better

The stock of outlet centres in Europe remains limited, representing approximately 2% of the European shopping centre stock. There are currently around 200 operating FOC schemes across Europe, of which cover approximately 3.6 million sq m of gross leasable area (GLA) retail space. The UK, Italy and France are the top three countries in terms of size of stock, correlating to 20%, 19% and 12% of all European stock, respectively.

Despite strong development in the 90s, with total European stock increasing by 230% in 1995, over the past decade, the development of new stock in Europe has been constrained, with supply increasing by an average of 3% annually. The supply of factory outlet centres in Europe is limited due to restrictive planning permission procedures and complicated approval applications, although this is gradually changing. At present, there are about 370,000 sq m GLA in the pipeline for completion between 2023 and 2025 in the markets we analyse, corresponding to about twenty schemes, of which five are in the UK (114,000 sq m), three in France (59,400 sq m) and three in Italy (59,000 sq m). With this pipeline, we expect the stock to grow by 4% annually, on average, until 2025.

The average sales area size per centre is 16,000 sq m, with the largest scheme 39,000 sq m of sales area (McArthurGlen Roermond Designer Outlet). According to Ecostra, the best-performing sites are predominantly large-scale outlet centres with a sales area of at least 20,000 sq m (nine of the top ten ranking outlet centres). Larger FOCs seem to attract premium brands and anchor tenants, in turn, incentivising extensions.

Due to the attractive performance of large centres and tight planning permission for new developments, many outlet centres have extended or plan to extend their sales areas. Typically, in the first phase the general area is around 10,000/15,000 sq m, where owners will typically reserve space for a second phase which will be developed depending on the success of the first phase and availability. The One Nation Paris outlet centre in France opened in 2013 with 24,000 sq m of sales area, of which was extended in 2022 to include a further 2,000 sq m. Additionally, the Kildare Village outlet centre in Ireland was granted planning permission in January 2018 for phase three of development which will add another 5,500 sq m of sales area to the centre. The McArthurGlen La Reggia Designer Outlet in Italy, which opened in 2010, was also recently granted an extension of 5,000 sq m.

Fig 5: European factory outlet stock and pipeline

Source: Savills

European Factory Outlet Centres - July 2023

Operators slowly moving closer to shopping centres

Across Europe, the top four operators account for 38% of all factory outlet stock in this consolidated market. Many have also secured themselves as international players. The FOC segment is a tiered market, with operators divided amongst premium schemes, such as Value Retail, or mass market schemes, such as Neinver. There are few operators specialised in the FOC segment and, as a result, there are some who have entered this market with little success. The reason behind the failure is that expanding brands prefer to locate in schemes with an experienced operator, meaning there is little chance for new operators to enter into the market.

The top operator, McArthurGlen, has a presence in eight countries across Europe and is home to more than 3,000 stores across 24 FOCs in Europe. Ranking number one in the most recent Ecostra Outlet Centre Performance report, the McArthurGlen Cheshire Oaks Designer Outlet in the UK has 8.4 million visitors per year and is home to 150 stores.

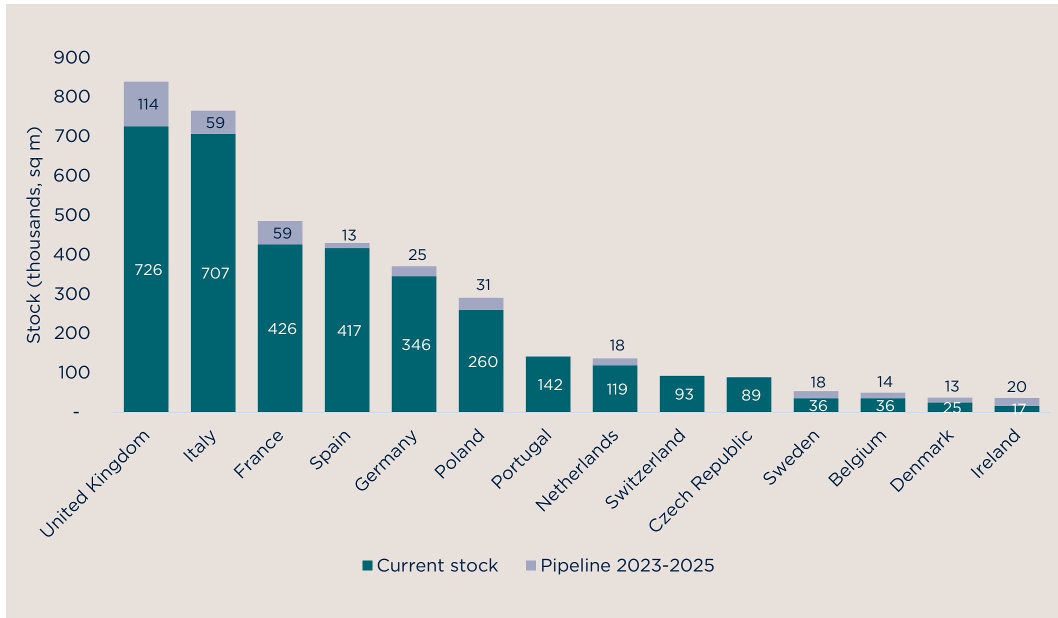
Neinver, the second largest operator, is home to more than 800 brands across 17 FOC in six European countries: France, Germany, Italy, Poland, Spain and the Netherlands. The Neinver Group is the only company in the industry in Europe that has earned sustainability certification for all the outlet centres it operates.

The third largest operator, ROS Retail Outlet Shopping, owns 12 FOC across Europe. Founded in 2011 and one of the newest companies in this industry, ROS has established itself among the top outlet operators in Europe, highlighting the growth of the FOC concept. For the first time, operated by ROS, a FOC in Poland was in the top three outlet centres in Europe ranked by Ecostra: The Designer Outlet Warszawa opened in 2005 and is 22,900 sq m.

Value Retail currently holds 11 FOCs across Europe and own the luxury Bicester collection, which includes Bicester Village, one of the most successful designer outlets in the UK. According to Value Retail, three out of four guests purchase a luxury brand for the first time during their visit to a Village, and 37% of them go on to become customers of that brand at full price.

Recently, some of these large factory outlet operators have shown some interest in setting in more 'traditional retail areas'. Indeed, some operators opt for locations where there is already a 'full price' retail offering, such as a shopping centre, in order to reach a larger customer base. This is true of the McArthurGlen Designer Outlet in Malaga, Spain and the Designer Outlet Kraków, Poland (scheduled to open in 2024), which is part of a mixed-use shopping complex with supermarkets and power stores close by.

Fig 6: Distribution of stock and pipeline



Source: Savills / Ecostra

An attractive asset class constrained by the lack of opportunities

From an investor perspective, the sector is considered a niche segment with fragmented transaction activity over the years. Sales between investors are limited due to the low amount of stock, and many investors do not want to sell due to how successful the schemes are. The most successful FOCs, operated by the likes of McArthurGlen and Value Retail, hold much of their investor appeal in their branding and profitability and therefore their ability to reach a wide customer base.

Over the past decade, factory outlet investments have typically accounted for only 1% of total retail activity in the countries covered in this analysis. Since 2013, there have been approximately 100 investment transactions in the market, corresponding to around €6 billion of turnover, where the average deal size is €75 million. Most of the investment activity is concentrated in the UK (31% over the past ten years), Italy (21%) and France (13%), where the majority of the supply currently stands.

In 2022, the European factory outlet investment volume reached €952 million (accounting for just 3% of total European retail investment), up 503% on the volume in 2021. This was largely a result of one deal, the Nuveen UK Outlet Portfolio, which was responsible for 73% of the annual volume. The Nuveen portfolio was sold to LaSalle for a total of €699 million, reflecting a yield of 6.50%. It includes two properties, the first Cheshire Oaks Designer Outlet, sold for €563 million, and the Swindon Designer Outlet, which sold for €136 million. Both FOCs are considered premium assets.

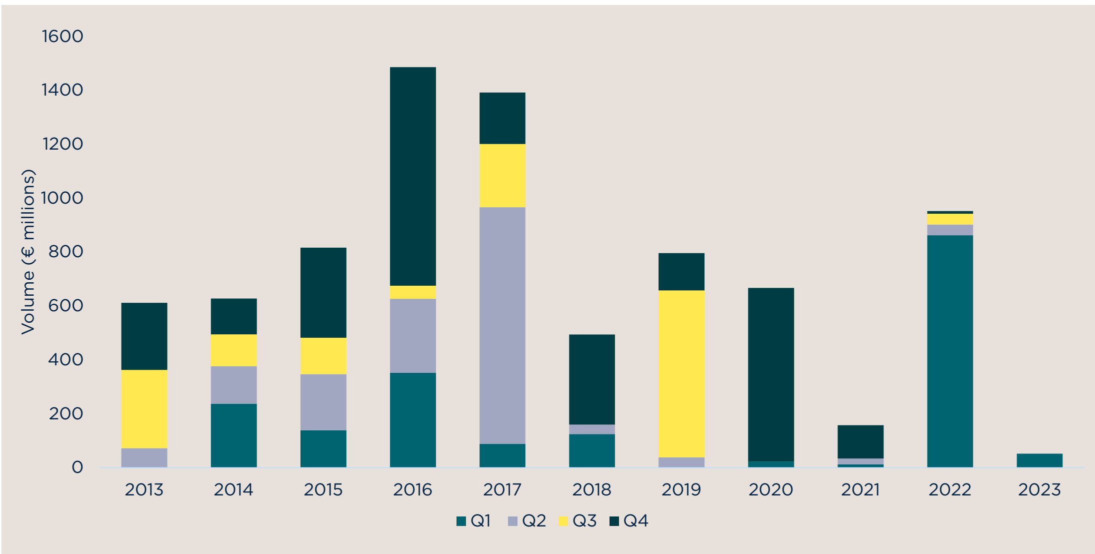
Other 2022 deals include the 21,200 sq m Athens Designer Outlet, sold by McArthur Glen & Bluehouse Capital to Lamda Development for €109 million, reflecting a net yield of 7.50%. In Belgium, the Designer Outlet Luxembourg sold for a smaller €10 million. Also in 2022, The Project Revolve Portfolio was sold to Oval Real Estate, which included the Dalton Park Outlet Centre in the UK, for €40 million, representing a yield of 4.80%. The Bridgend Designer Outlet was also sold, for €110 million to Ares Management, representing a yield of 6.0%.

Since 2023, €69 million has transacted in Europe. This includes the Ringsted Outlet in Denmark, sold for €52 million to Patrizia in January 2023 with a yield of 6.20%. With a 97% occupancy and 13,200 sq m floorspace, Ringsted Outlet is located in the Zealand, Denmark's region with the highest consumption per household outside Copenhagen. In March 2023, Hines and Apollo acquired Aedes SIIQ 2023, taking over a mixed portfolio which included the Serravalle Designer Outlet in Italy.

According to RCA, the top three largest FOC buyers of all time are LaSalle, with total global acquisitions of €52 billion (1,593 properties), Patrizia, with €29 billion (1,327 properties) and Ares Management, with €21 billion (1,448 properties).

There is too little transactional evidence to be able to report on prime average FOC yields. However, the sector is generally more attractive than traditional shopping centres, offering a yield premium ranging between 100 and 150 bps on average. Attractive yields compared to traditional shopping centres has been key for the rising investors' interest in the sector.

Fig 7: European factory outlet investment volume



Source: RCA

The sector is better armed to weather adverse economic landscapes

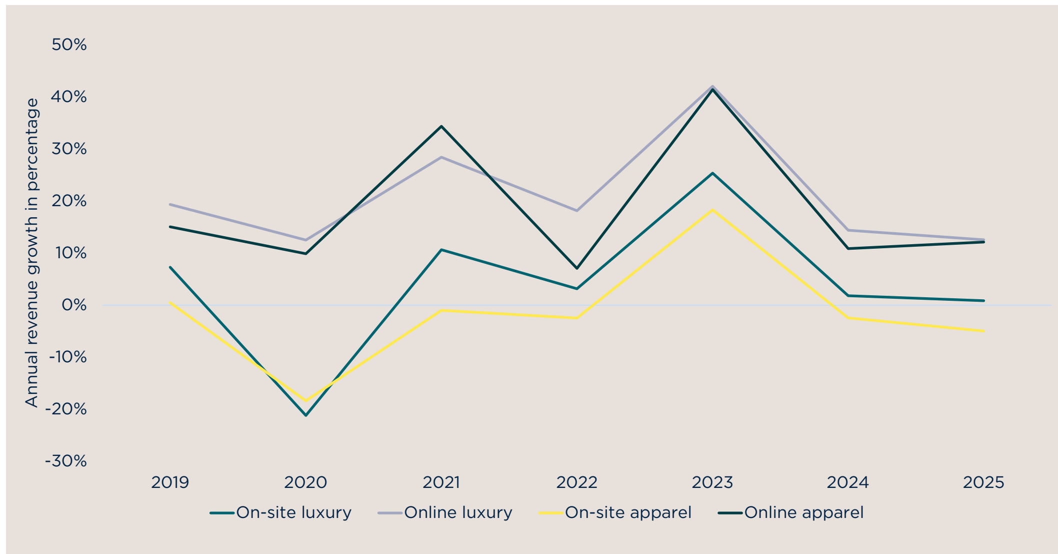
In the context of stagnating/low economic growth, Oxford Economics forecasts that retail spending in the eurozone will decline by 1.85% in 2023 and then expand by 2.05% in 2024. Luxembourg, Romania, Ireland, Czech Republic and Spain will be the outperforming countries, with Spain expected to record the highest retail spending growth this year. Whilst France, Denmark, the UK, Switzerland and Norway will be the underperformers.

With inflation expected to remain at high levels in the next two years (5.7% in 2023 and 2.7% in 2024) and wage growth forecasted to ease from 4.5% in 2023 to 3.0% in 2024 in the eurozone (Focus Economics), consumers will likely remain heavily cost-sensitive. Whilst this is bad news for the whole retail industry, the factory outlet segment is better armed to weather adverse economic landscapes than other types of retail formats, notably traditional shopping centres. Nonetheless, in the next two years, growing operating costs will remain a major concern for operators. In this sense, Southern Europe will be more insulated due to being more relatively shielded from energy price hikes.

The other issue that operators will have to face and integrate is the rising consumer behaviour towards online shopping. So far, the online penetration rate within factory outlet centres has been relatively shielded from that of the general retail sector. However, with the strong e-commerce growth forecast for 2024, notably within the textile and luxury segments, we expect the outlet segment will eventually be impacted. According to Statista, online sales are forecasted to grow by 15% this year and 13% next year in European, meaning that the online penetration rate will reach 14% in 2024 from 13% in 2023. During the same timeframe, the share of online sales for apparel will grow to 39% (from 36% in 2023) and the share for luxury goods will reach 23% in 2024, from 21% in 2023. Note that the online penetration rate in Portugal (9%), Belgium (10%), Spain and Italy (11%) are expected to remain the lowest among Western European countries in 2024.
Initially primarily focused on discounted offers, factory outlet centres are increasingly evolving to incorporate new consumer facilities, notably leisure attractions. Hence, village outlets are beginning to compete with traditional shopping centres. The progressive return of tourists will also fare well for the sector as the importance of the 'retail experience' grows and support physical retail. In turn, this will continue to attract domestic and international brands, most notably in large tourist gateways such as London, Paris, Madrid and Barcelona.

High occupancy levels and strong performances of the sector, as well as attractive yields compared to other asset classes, will continue to catch investors' interest. Additionally, although the sector remains a niche, growing expansion plans and development activity should provide the investment market with acquisition opportunities, particularly in countries where the stock and the pipeline, such as the UK, Italy, France and Spain.

Fig 8: Luxury and apparel revenue growth by sales channel



Source: Statista

Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

Larry Brennan
European Retail
Director
+353 1 618 1302
larry.brennan@savills.ie

Mark Garmon-Jones
UK Investment
Director
+44 (0) 20 7409 8950
MGJones@savills.com

Tristam Larder
European Capital Markets
Director
+44 (0) 7870 999 673
TLarder@savills.com

Lydia Brissy
European Research
Director
+33 624 623 644
LBrissy@savills.fr

Georgia Ferris
European Research
Analyst
+44 (0) 798 973 3368
georgia.ferris@savills.com