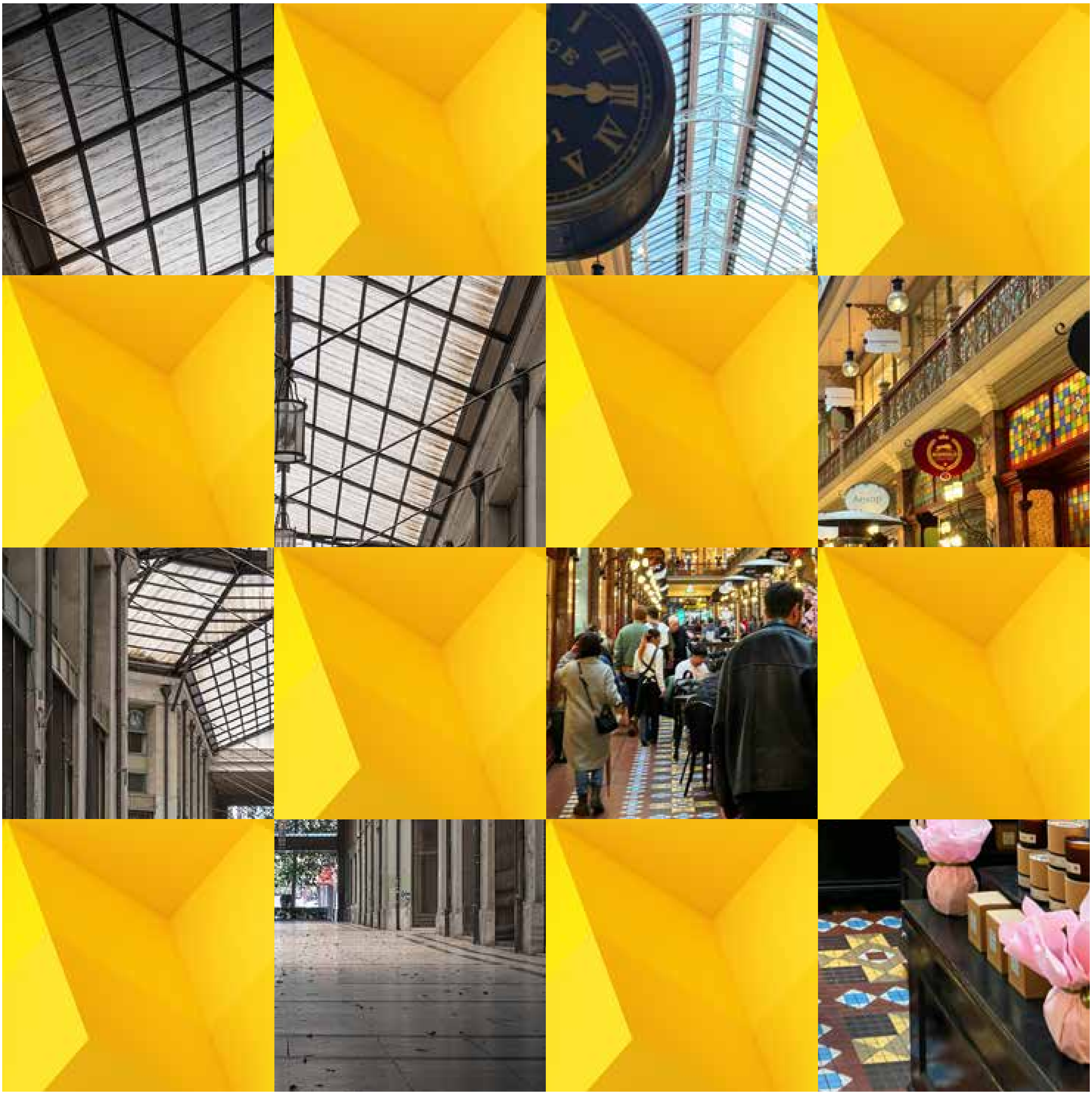

DETERMINING THE NEED FOR REPOSITIONING IN SHOPPING CENTRES

A CLUSTER ANALYSIS

savills IPH BBE

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From hype to reality

Text: Rebecca Hummel & Matthias Pink

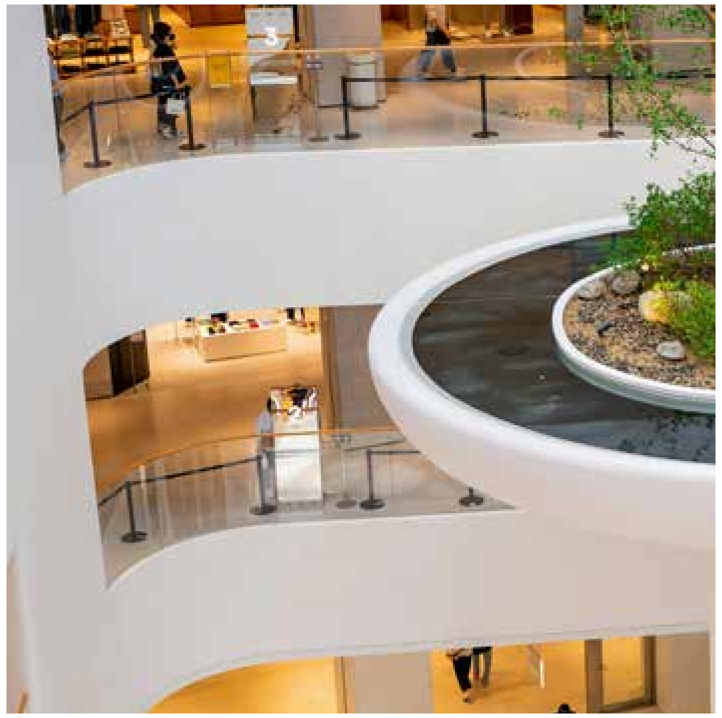
How many shopping centres in Germany are still fit for the future, and how many need to be repositioned? These questions from our analysis already indicate that there is a need for action in this sector. This was not always the case at least from an investors‘ point of view. But let us take it step by step:

On May 2, 1964, the Main-Taunus-Zentrum opened its doors as the first shopping center in Germany. More than sixty years later, the Main-Taunus-Zentrum still exists, along with more than five hundred other shopping centres that have been established since then. However, the year of its 60th anniversary could mark a historic turning point for the shopping centres: for the first time in their history, the number of centres in Germany has declined, and this is likely to set the direction for years to come. Although the acute concerns caused by the pandemic have been overcome, the structural problems of bricks-and-mortar retail remain. The fashion retail sector, in particular, is under pressure, as evidenced by numerous insolvencies in recent years, including major brands such as Gerry Weber, Hallhuber, and P&C. This is especially problematic for shopping centers, which have traditionally been focused on fashion retail. In contrast, the grocery retail sector, which has seen significant sales growth in recent years, plays only a minor role in most centres. Given the location and size constraints of many centers, this is unlikely to change significantly, putting their future as a retail format increasingly in doubt. Two-thirds of shopping center operators surveyed by PwC believe that the traditional, retail-dominated usage concept is not sustainable for the future. And who would know better than those who observe the day-to-day operations of shopping centers with a professional eye?

The malaise is also reflected in the investment market. Not long ago, shopping centers were something of a favorite among risk-averse investors and a kind of gold standard for core properties. They offered an unusually diversified income stream for commercial properties, seemingly reliable due to the very long lease terms, coupled with high liquidity in the investment market. This perspective shaped the years following the global financial crisis and peaked around 2015, maybe a little later. During this period, more than one in ten euros in the commercial property investment market was invested in shopping centres, and with prime yields around 4%, they were among the most expensive properties one could buy.

Today, there is nothing left to remind us of this boom phase. Shopping centers now have the highest initial yields by far of all asset classes relevant to institutional investors, and their share of the total transaction volume has been in the low single-digit percentage range for years.

The euphoria has given way to disillusionment, to put it mildly. In retrospect, it is clear that shopping centres were viewed too uncritically by many investors in light of the already visible rise of online retail. Today, no one needs to be warned about the risks anymore. Most investors simply avoid shopping centres. However, just as the blind shopping centre euphoria of the early 2010s proved short-sighted, the blanket ignoring of the sector could be a mistake of the opposite kind. At the very least, it leads to an indiscriminate lumping together of all centres, which no longer reflects the increasing heterogeneity of the centre landscape. Undoubtedly, many centres are at the end of their life cycle and the only option is to redevelop them. This will also require capital, but not from risk-averse investors. On the other hand, there are centres that have been generating stable returns for many years or, as in the case of the Main-Taunus-Zentrum mentioned above, for many decades and are likely to continue to do so. And in between, roughly speaking, are those centres that are at a crossroads, heading in one of two directions. With this study, we aim to make this heterogeneity somewhat visible and analysable, fully aware that we are also simplifying. However, if we contribute to a more differentiated discussion of the German shopping centre landscape (preferably including us), then we will have achieved our goal.



> “As a result, all centres are being lumped together indiscriminately, which fails to adequately reflect the growing heterogeneity of the centre landscape.”

Five hundred centres, three indicators: our cluster approach

In order to assess the future viability of each centre as a traditional shopping centre, we evaluated each centre on the basis of three indicators.

Table 1. **OVERVIEW OF INDICATORS FOR ANALYSING THE SHOPPING CENTRE LANDSCAPE**

DIMENSION	INDICATOR	KEY FIGURE
Strength	Vacancy	Vacancy as % of rentable retail space
Prospect	Population forecast	Predicted change in the number of people living within a 30-minute drive from 2022 to 2035 in %
Resilience	Sector mix	Proportion of shops in sectors with declining bricks-and-mortar sales from 2016 to 2019 as % of all shops in the centre

In order to assess the future viability of each centre as a traditional shopping centre, we evaluated each centre on the basis of three indicators. These indicators are: firstly, the current vacancy rate; secondly, the population forecast in the centre's catchment area; and thirdly, the sector mix and its resilience to structural changes in the retail sector (see Table 1). These three indicators, the metrics used to measure them and the data collection methodology are described in detail in the Methodology box from page 6. Here we focus on our fundamental considerations.

Our aim was to assess the future viability of a shopping centre in a way that is both reliable and comprehensible. This led us to adopt the following principle when selecting indicators: "As few as possible (and therefore as understandable as possible), as many as necessary (and therefore as reliable as possible)".

We discussed and evaluated far more than the three indicators that we ultimately decided on. However, either substantive considerations or a lack of data availability argued against their inclusion. It goes without saying that we cannot adequately reflect the diversity of the German shopping centre landscape with just three indicators and consequently our approach also has "blind spots" when it comes to assessing the future viability of individual centres. Nevertheless, we believe that we have considered the essential aspects and have come up with a fundamentally reliable and comprehensible assessment. The three selected indicators are based on the following ideas:

1. **Vacancy:** the vacancy rate of a centre can be used to draw direct conclusions about its position in the market or the "**strength**" of a centre. To put simply, a centre with no vacancies is in a strong starting position, while a centre with a high vacancy rate is in a weak position.

2. **Population forecast:** the population forecast for a centre's catchment area provides an insight into the centre's "**prospect**" regardless of its current position. A centre located in an area with a declining population will be weakened by a loss of purchasing power, whereas a growing population will strengthen its position, all other things being equal.

3. **Sector mix:** the sector mix of a shopping centre determines its "**resilience**" to the general structural changes in the retail sector. A centre with many shops in sectors affected by structural change and declining in-store sales will lose a disproportionate amount of sales, even if the purchasing power of the catchment area remains stable, as consumers may continue to shift to online shopping.

Equipped with these tools, we want to shed light on the future viability of German shopping centres. In the first step, we will look at the results for the three dimensions separately and then summarise them in a further step.

Methodology

All shopping centres in Germany according to the EHI definition of 2023 are considered, with a few centres excluded from the analysis due to missing data. In total, 485 centres were analysed.

We considered three indicators for the cluster analysis:

1. Vacancy

We researched the vacancy rate as a percentage of lettable retail space for a total of 347 shopping centres. For around 50 shopping centres, however, we were unable to verify that the vacancy rate determined related to the lettable retail space. In these cases, we collated the vacancy data from various sources, including transaction reports and annual reports. Overall, we have relied on data up to the year 2021, although the vast majority comes from 2023. For most centres, we estimated the vacancy rate based on the site plans on the centre websites and verified these estimates in some cases through site visits. We adopted a conservative approach, for example, by excluding ancillary areas associated with retail spaces from the estimates.

For clustering purposes, we have categorised the centres as follows:

- Low vacancy: < 10%
- Moderate vacancy: 10% to < 20%
- High vacancy: from 20%

2. Population forecast

BBE determined the population forecast in the catchment area up to 2035 for all 485 centres analysed. The base year is 2022 and we have simplified the catchment area by defining a car journey radius of 30 minutes.

For clustering purposes, we have categorised the centres as follows:

- Declining population: < 2%
- Stable population: - 2% to < 2%
- Growing population: from + 2%

3. Sector mix

For all 485 centres analysed, we determined the proportion of shops in segments with declining stationary sales between 2016 and 2019 in relation to all shops in the centre. We chose 2016 to 2019 as the reference period because the sales trend in the following years was significantly affected by the pandemic.

The following retail segments experienced declining bricks-and-mortar sales during the reference period: Fashion & Accessories, Consumer Electronics/Electrical, and Home & Furniture. For each centre, we calculated the share of shops in these segments relative to the total number of shops.

For clustering purposes, we have categorised the centres as follows:

- Resilient sector mix: share of shops with declining bricks-and-mortar sales < 25%
- Moderately resilient sector mix: share of shops with declining bricks-and-mortar sales 25% to < 50%
- Minimally resilient sector mix: share of shops with declining bricks-and-mortar sales of 50% or more

For the cluster formation, we only took into account those 347 centres for which we had data on all three indicators and left out those 138 centres for which no vacancy data was available. Thus, our cluster analysis covers approximately two-thirds of all shopping centres in Germany.

We checked various parameters to see whether our vacancy data could be systematically distorted (e.g. for the population forecast, the sector mix or the age and size of a centre) but found no such distortion. We therefore have reason to believe that the vacancy data we have collected is representative of all centres in Germany. Consequently, we can assume that our cluster analysis is also representative of all centres.

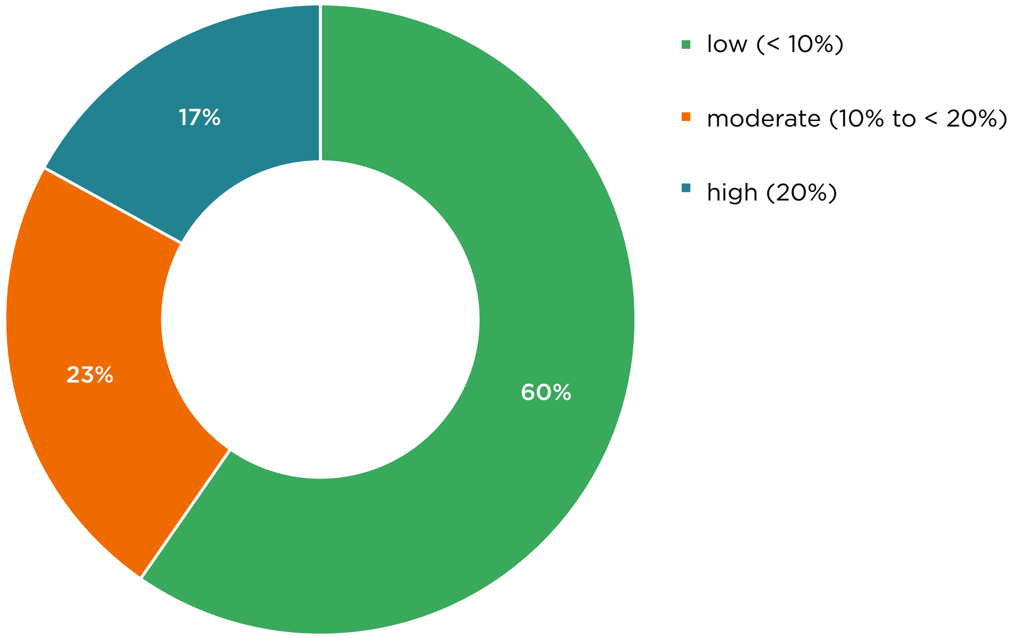
Dimension "Strength": the vacancy

For 347 shopping centres, we determined or estimated the vacancy rate based on various sources and believe that our vacancy data are representative of the entire German shopping centre landscape (see the "Methodology" box for details).

According to our survey, an average of 11.8% of retail space in the centres is vacant. By comparison, nationally around 5% of all office space is vacant, and the vacancy rate for residential space is only around 2%. However, more than half of all shopping centres have a vacancy rate of less than 10%, although in nearly one-fifth of cases, the vacancy rate is above 20% (see Fig. 1).

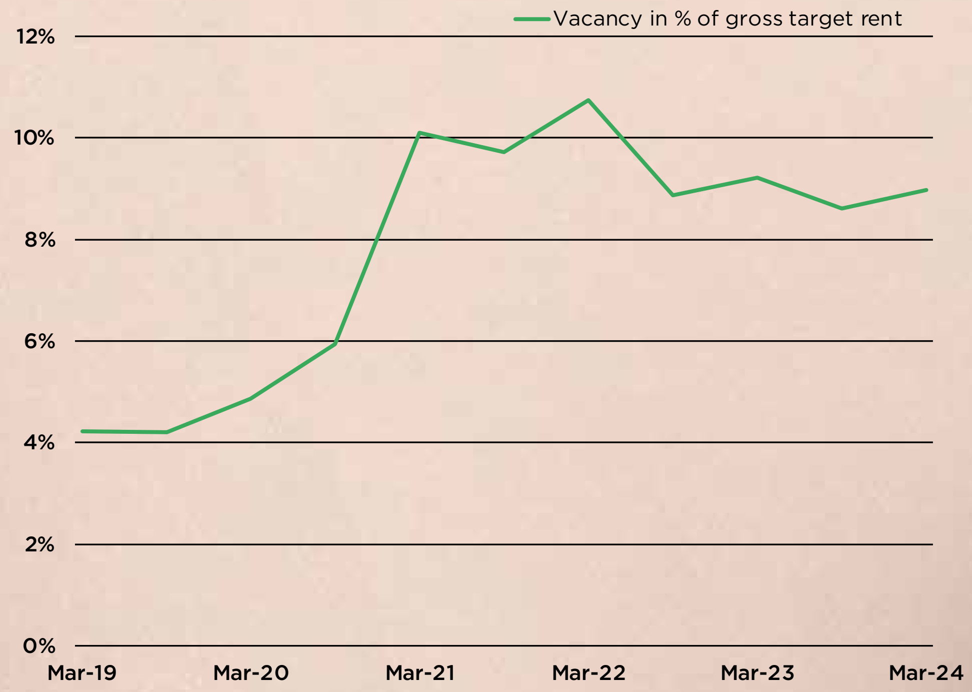
For most centres, we recorded the vacancy rate on a specific reporting date, primarily at the end of 2023. However, we also have vacancy data for some centres at various points in time, which allows us to assess the dynamics of vacancy trends. For instance, in the eleven centres owned by open-ended public property funds, the vacancy rate surged from around 5% to approximately 10% with the onset of the pandemic. By the end of 2022, it had decreased to 9% and remained at this level until early 2024 (see Fig. 2). It is important to note that the vacancy rates published by the fund companies are based on gross potential rental income and not on actual floor space.

Figure 1. **SHOPPING CENTRE BY VACANCY RATE**



Source Savills / n = 347

Figure 2. **DEVELOPMENT OF THE VACANCY RATE IN SHOPPING CENTRES OF OPEN-ENDED PUBLIC PROPERTY FUNDS**



Source Savills based on the annual reports of open-ended public property funds / n = 11

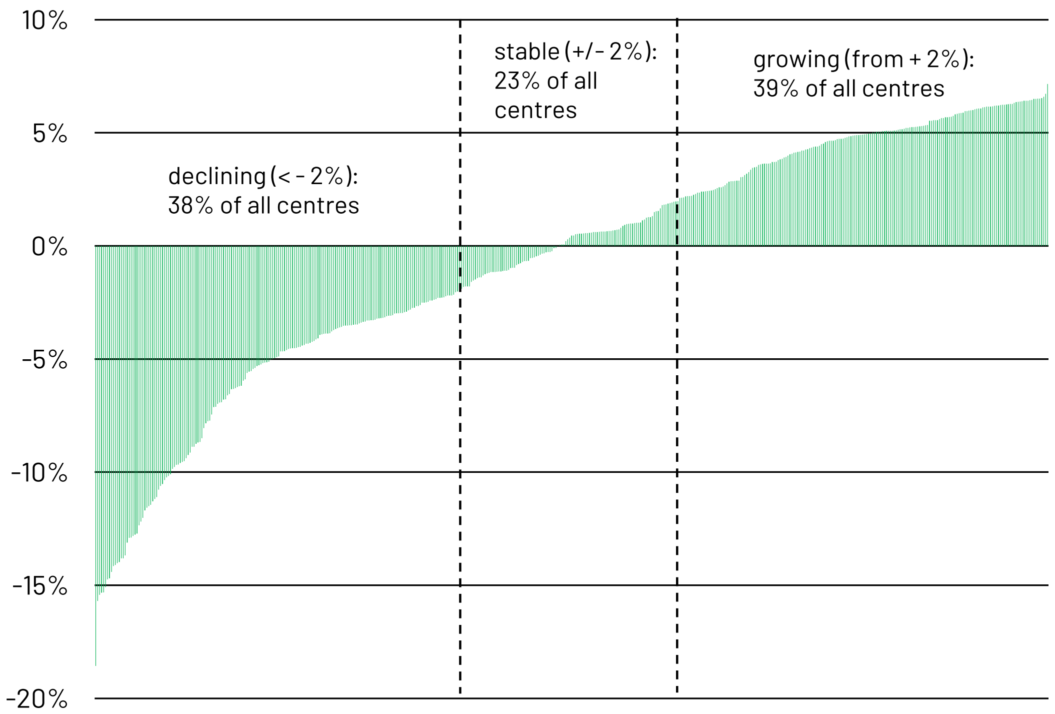
Dimension “Prospect”: the population forecast

The future development of a centre’s vacancy rate is also influenced by changes in the number of potential customers in its catchment area.

The centres vary significantly in this respect, as illustrated in Figure 3. For over a third of all centres, the forecast is positive, meaning the population in the catchment area (here defined as a 30-minute driving radius) is expected to increase by at least 2% by 2035.

Similarly, around the same proportion of centres are likely to face a population decline of at least 2%, while nearly a quarter will see little change in population numbers (+/- 2%). A decline in the catchment area’s population could theoretically be offset by an increase in the purchasing power of the remaining residents (and vice versa). However, since demographic and economic developments in a region often go hand in hand, the disparity in purchasing power potential among centres may be even greater than suggested by the population forecast alone.

Figure 3. **SHOPPING CENTRE ACCORDING TO POPULATION FORECAST 2022 – 2035**



Source BBE / n = 485

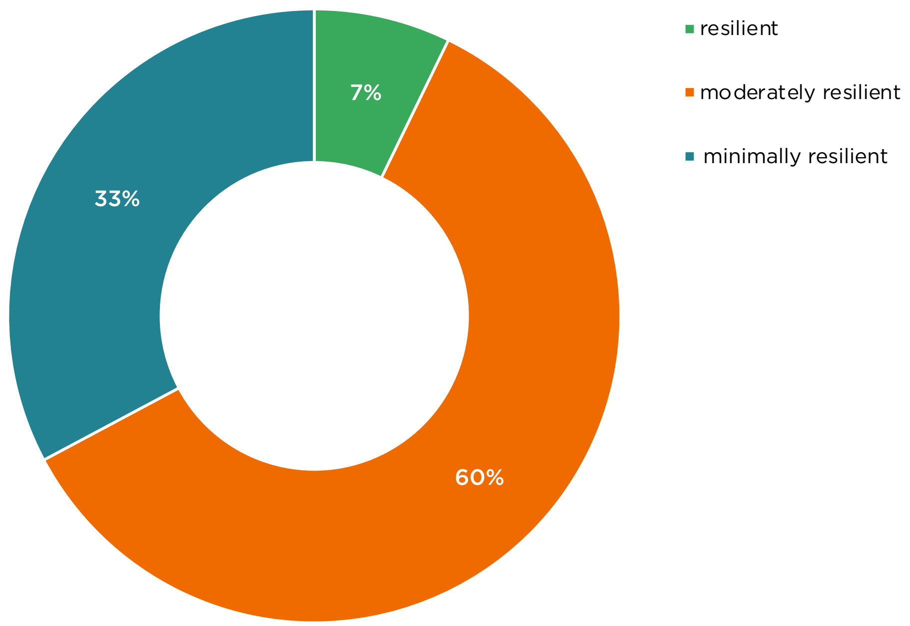
Dimension “Resilience”: the sector mix

While shopping centres vary considerably in terms of vacancy rates and population projections, they are relatively similar in terms of sector mix.

In most centres, a significant proportion of the retail space is occupied by sectors that have experienced declining bricks-and-mortar sales in recent years, such as fashion and electronics. However, this does not necessarily mean that each retailer in these sectors is detrimental to a centre, but rather that the sector as a whole is less resilient. Only 7% of all centres have less than a quarter of their shops in these declining sectors (see Fig. 4).

We consider the sector mix in these centres to be relatively “resilient” to structural changes in retailing, as the segments with stable or increasing sales predominate. At the other end of the spectrum is the third of centres where sectors with declining sales account for more than half of the shops, and whose sector mix we classify as “minimally resilient”. The remaining almost two-thirds of centres have a “moderately resilient” sector mix, with the share of vulnerable sectors ranging from 25% to 50%.

Figure 4. **SHOPPING CENTRES BY RESILIENCE OF THE SECTOR MIX**



Source Savills / n = 485

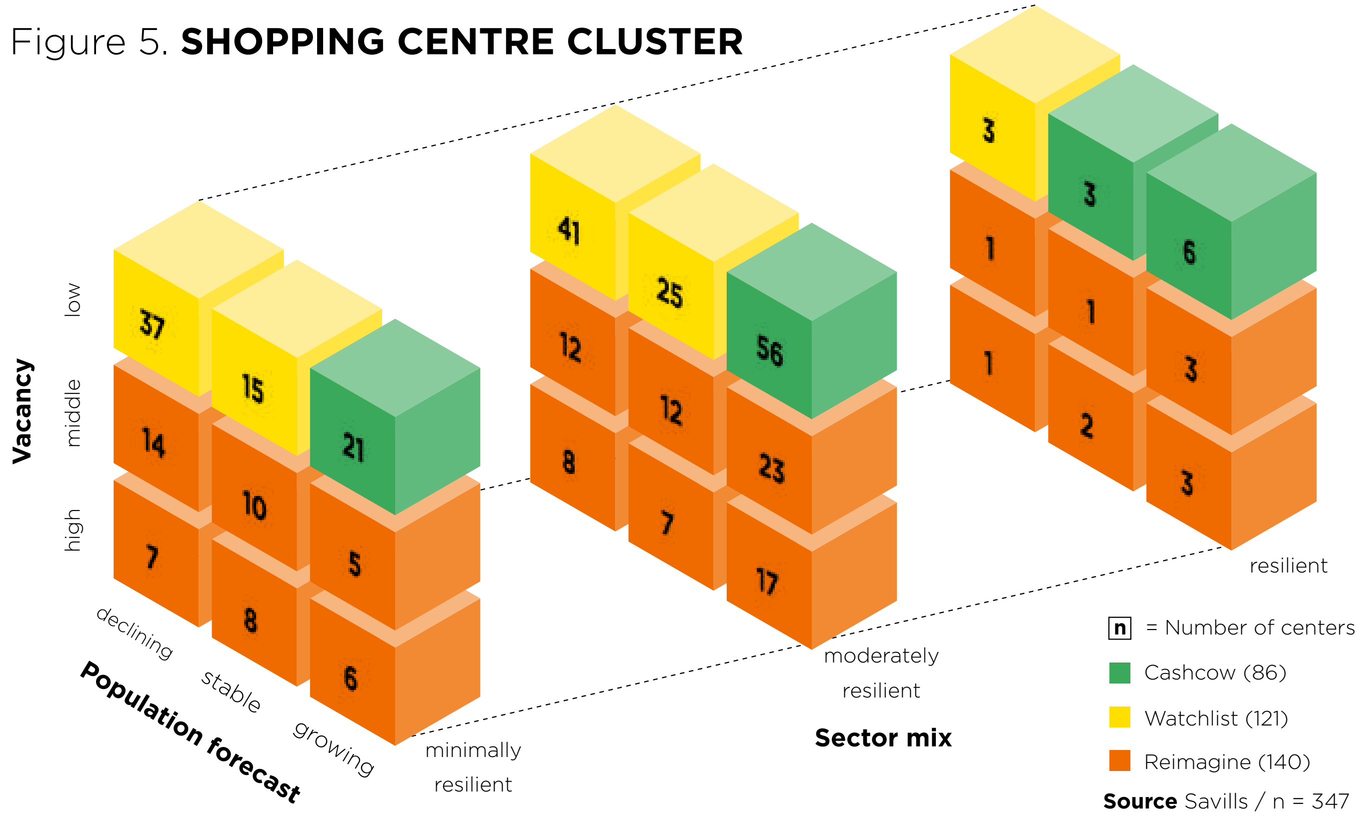
Three dimensions, three clusters

Combining the results from the three individual dimensions results in 27 possible combinations, to which each shopping centre can be assigned (see Fig. 5).

Most centres exhibit a combination of low vacancy, growing population, and a moderately resilient sector mix (56). Conversely, there are several combinations that appear only once, such as high vacancy with a declining population and a resilient sector mix.

Each of these 27 characteristics could be analysed individually and this would also be useful in order to shed light on the position of the individual centres and the resulting options for action. For the purposes of this study, however, we will limit our analysis to dividing the German shopping centre landscape into three broad clusters and providing a general overview of the current position and future prospects of the centres. We have labelled these three clusters “Cash Cows”, “Watchlist”, and “Reimagine”.

Figure 5. **SHOPPING CENTRE CLUSTER**



Source Savills / n = 347

Cluster “Cash Cows”

The “Cash Cows” cluster includes all centres with low vacancy rates and a favourable population forecast, as well as those with low vacancy rates, stable populations and a resilient sector mix. This group represents a quarter of all centres. In summary, they are in a strong position with a generally positive outlook and are likely to be profitable, assuming good asset management. Within our analytical framework, the primary focus should be on whether the sector mix can be further optimised, as only around 10% of the “Cash Cows” centres have a resilient sector mix. Nevertheless, these centres have the characteristics of a defensive investment, making them attractive to risk-averse cash flow investors.

Examples of centres from the cluster:

- PEP shopping centre in Munich
- Tibarg Centre in Hamburg

Cluster “Reimagine”

A completely different type of investor is required for those centres that we have grouped together in the “Reimagine” cluster - in line with our European “RE:IMAGINING RETAIL” programme, in which Savills has been working with several partners for many years to explore repositioning and repurposing options for retail properties that are no longer functioning. These centres face a similar challenge: they already have a vacancy rate of at least 10%, and in most cases the vacancy rate is likely to increase in the future due to unfavourable population forecasts and/or a minimally resilient sector mix.

This cluster is quite heterogeneous, but fundamentally, centres in this group will likely need to pursue one of two strategies: repositioning or repurposing. Repositioning aims to retain the shopping centre as a retail-focused format, possibly by altering the sector mix or adding/strengthening complementary uses (such as medical practices, coworking spaces, or fitness centres). Such repositioning is particularly relevant for centres with only moderate vacancy rates and favourable population forecasts. On the other hand, repurposing shifts away from a retail focus, replacing retail spaces entirely or partially with other uses, such as offices, laboratories, or residential units. This typically involves significant structural changes. For many shopping centres with already high vacancy rates and a declining population in the catchment area, repurposing may be the only “life-preserving” measure.

The analysis approach used here can at best provide a rough distinction between potential repurposing and repositioning candidates. A more thorough assessment would require a comprehensive analysis of the specific property and its conditions. However, we believe it is clear that for all of these centres - representing 40% of the centres analysed - immediate action is required and that without appropriate measures, these properties are approaching the end of their lifecycle.

Examples of centres from the cluster:

- Königsgalerie in Duisburg
- Rhine-Ruhr Centre in Mühlheim an der Ruhr

Cluster “Watchlist”

The need for action is considerably less urgent for the centres in the “Watchlist” cluster, which comprises about one-third of the centres studied. All these centres currently have a relatively low vacancy rate (< 10%), but this could increase either due to declining populations in their catchment areas or an unfavourable sector mix – in many cases, both factors are at play. Therefore, it is advisable to monitor the development of these centres closely to address any rising vacancies in a timely manner. However, action might be needed even at lower vacancy rates or in the current status. Similar to the “Reimagine” cluster, our analytical framework here serves only as a starting point. The specific measures needed to stabilise a centre in this cluster can only be identified through a thorough analysis of the individual property and its conditions. It is clear in advance that some of these centres will eventually become “Reimagine” candidates, particularly those with rapidly declining populations in their catchment areas. Other centres in this cluster, with the right measures, could be transformed into “Cash Cows”.

Examples of centres from the cluster:

- City-Point Kassel in Kassel
- REIZ Ruppiner shopping centre in Neuruppin

The state of the shopping centre investment market

Commentary by Peter Hablizel

Our cluster analysis, which used only a few criteria, showed how heterogeneous the shopping centre landscape actually is. However, this insight seems to have largely escaped the investment market. Too often, the decline of shopping centres is proclaimed by generalising the structural problems of the segment to all centres. This has contributed to the high level of illiquidity in the investment market in recent years.

The investment market for core assets, which correspond to the "Cash Cows" cluster in our analysis, has been particularly quiet. Transactions in this segment, such as those involving the PEP, are rare. This is due to a number of factors, including banks' limited appetite for financing and property volumes that are too high for the current market environment. Most importantly, such centres do not feature in the acquisition profiles of risk-averse investors. On the other hand, investors seeking higher yields cannot meet the price expectations of potential sellers, so current owners prefer to maintain stable yields rather than accept significant discounts - resulting in an illiquid investment market.

In contrast, the "Reimagine" and "Watchlist" segments, which are riskier, are experiencing a significantly stronger market movement. More and more owners are looking to dispose of their centres with an immediate or foreseeable need for action. Faced with stagnating or falling rents and rising vacancies, they are accepting lower sales prices. This trend is attracting new value-add investors. As price expectations in this segment have already converged, this part of the market is likely to become liquid again more quickly.

Writing off shopping centres as an investment per se is too simplistic. But this assessment also reveals the many uncertainties regarding the future viability of these centres. This is understandable, as many of them will need more than just fine-tuning to remain competitive in the market. Many are likely to be converted from shopping centres to mixed-use properties. These converted assets may then return to the acquisition lists of risk-averse investors.

"Too often, the decline of shopping centres is proclaimed by generalising the structural problems of the segment to all centres."

Conclusion: For a guiding view, differentiation is due

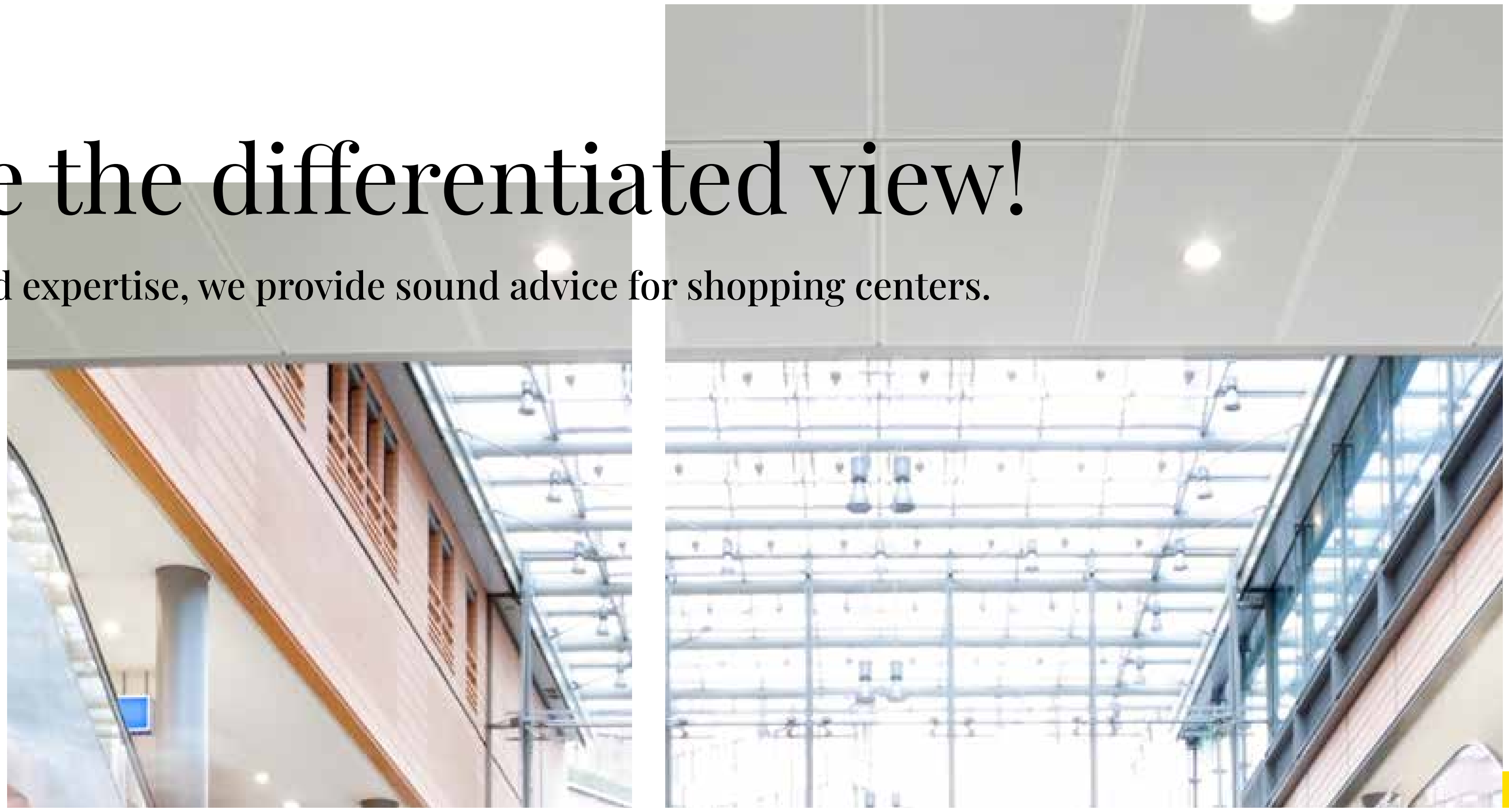
As the Main-Taunus-Zentrum celebrates its 60th anniversary this year, another shopping centre, Westfield Hamburg-Überseequartier, is about to open its doors. It is likely to be one of the last of its kind, especially on such a large scale. The German shopping centre landscape is no longer a growth sector, but a saturated market. Many centres will not reach their 60th birthday.

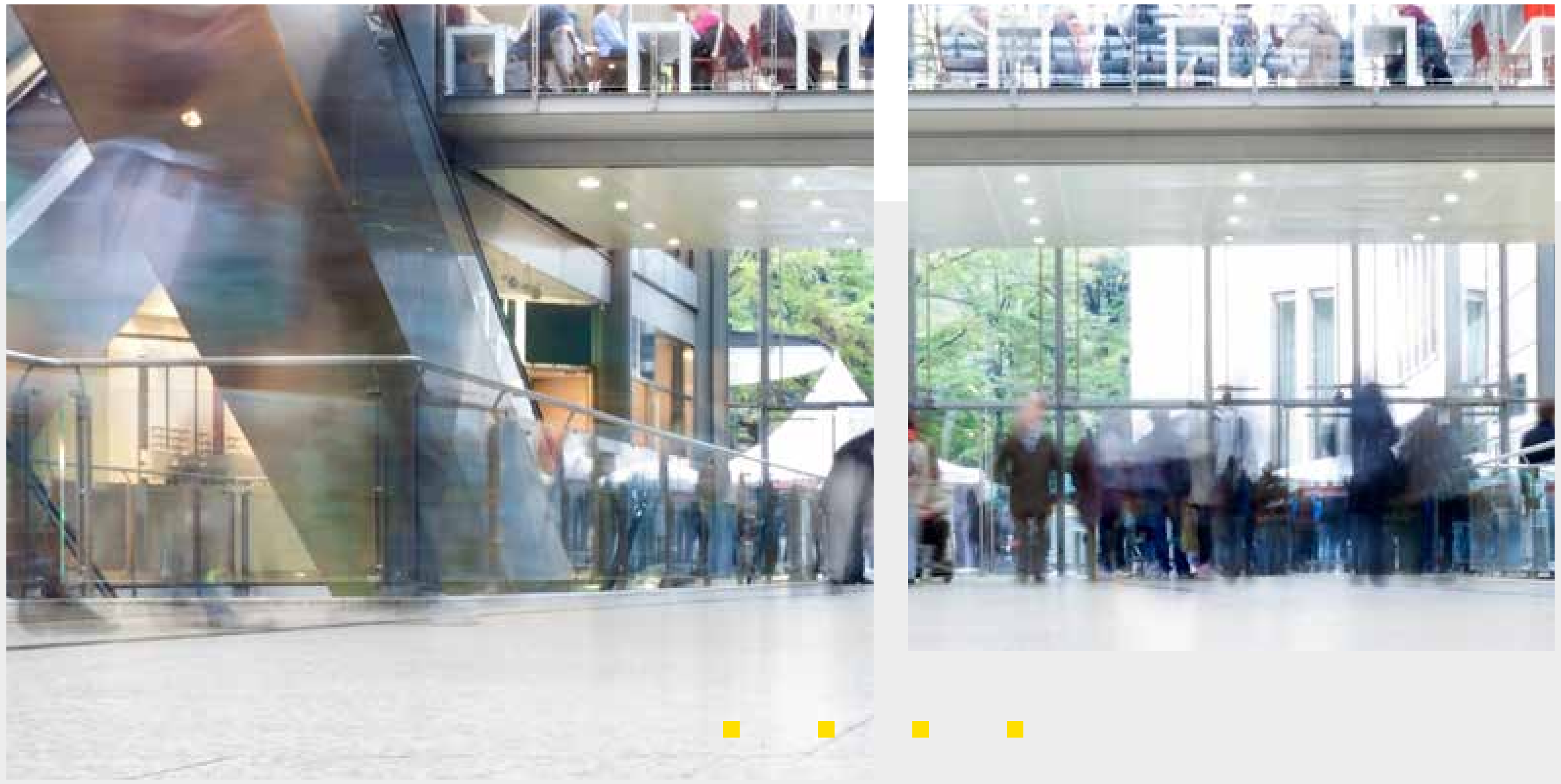
This is not a new insight, but it is rarely expressed. But it is equally wrong to pronounce a death sentence on the entire sector. In a saturated market, it is a matter of separating the wheat from the chaff, and that requires a nuanced perspective rather than a sweeping judgement. Our analysis aims to do just that, and pave the way for a more differentiated view.

> “In a saturated market, it is a matter of separating the wheat from the chaff, and that requires a nuanced perspective rather than a sweeping judgement.”

We have the differentiated view!

With our combined expertise, we provide sound advice for shopping centers.





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PETER HABLIZEL
Director Investment
Savills Immoblien Beratungs-GmbH

T. +49 30 726 165 221
E. phablizel@savills.de

LARS JÄHNICHEN
Managing Director
IPH Handelsimmobilien GmbH
& IPH Centermanagement GmbH

T. +49 89 55 118 151
E. L.Jaehnichen@iph-gruppe.de

JÜRGEN KREUTZ
Managing Director
IPH Transact GmbH

T. +49 89 55 118 196
E. j.kreutz@iph-gruppe.de

AUTHORS

Matthias Pink
Director / Head of Research Germany

E. mpink@savills.de
M. +49 172 399 76 06

Rebecca Hummel
Senior Consultant Research

E. rhummel@savills.de
M. +49 174 862 72 95

Savills Immobilien Beratungs-GmbH
Zoofenster
Hardenbergstraße 27
10623 Berlin

Concept & Layout

SAVILLS GERMANY PITCH & DESIGN

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