



One way for shopping centres to enhance footfall is to increase the range of leisure and catering options. Vietnamese street food restaurant chain Pho recently increased the number of UK outlets by taking space in Hammerson Plc's Highcross Shopping Centre in Leicester.

Improving the offer

Shopping centres in Germany are in transition, and that provides an investor opportunity

by Martin Mörl

The revolutionary structural change that is taking place in the retail sector worldwide has also reached the shopping centre market in Germany. With rising purchase prices and the effect of Amazon on everyday life, it is not getting any easier for institutional and private investors to generate suitable returns on German shopping centres. However, there are some areas in which investors can take action on footfall to ensure and increase customer frequency, duration of stay and revenue, and this will also have benefits for future rental income.

In Germany and other European countries, the retail sector is undergoing a comprehensive structural change. While its momentum is slow-

ing, the market share of online retail is growing all the time, competition with bricks-and-mortar shops is increasingly intense, tenant changeovers and vacancies in many shopping centres are on the rise and foot traffic is falling, especially in weaker cities. This is all having a direct impact on shopping centres and the market for retail properties. Nonetheless, with the right approach, it is still possible to operate shopping centres successfully and to generate attractive rental income.

Supply and modernisation issues

There are currently 480 shopping centres in Germany. Not a single new conventional shopping centre will open in the country this year.

Eight new shopping centres of at least 10,000 square metres are expected to be completed in 2018. Existing shopping centres in Germany are also getting long in the tooth. Around two-thirds of all shopping centres in Germany were built before 2000. Fewer than 20 percent of German shopping centres were completed and opened in the past 10 years. By our estimates, around 50 percent of shopping centres in Germany have a significant modernisation backlog — with corresponding consequences for their attractiveness, tenant structure and revenues. In addition, the expectations that both tenants and customers have of shopping centres are different now than they were five years ago.

According to JLL, transaction volume for German commercial properties in 2016 amounted to €52.9 billion. Shopping centres accounted for €3.6 billion of this, or nearly 7 percent. 44 percent of buyers were from outside the country. The shopping centre transaction volume in 2015 was still above €5.5 billion. Prime yields fell to 4 percent in 2016, according to JLL.

The high level of investor interest is being limited by the lack of properties on offer. Firstly, very few new shopping centres are being completed. Secondly, hardly anyone wants to sell excellent core properties because the majority of investors are happy to have core properties in their portfolio, and there are few opportunities for re-investment. Below the level of core properties, there are numerous problematic shopping centres on the market, many of which do not have sufficient value-adding potential and for which there are often big discrepancies between the price expectations of sellers and buyers. Furthermore, vacancies are on the rise, especially in weaker shopping centres.

Big spread on retail rents

Retail rents in German shopping centres are in flux — with major differences, depending on location and property. On the one hand, rents are rising in good and very good locations because retailers want to leverage existing revenue potential and are willing to accept the rental levels that this entails. On the other hand, retail rents are dropping significantly in weaker shopping centres and non-central locations, in particular, because revenue potential is vanishing. For example, BNP Paribas Real Estate found falling prime yields in 24 out of 64 cities across Germany.

Furthermore, potential tenants' price sensitivity and expectations for retail properties are tending to rise. Tenants are demanding, are considering their options intensively and have very definite ideas about aspects such as layouts and shop façades. The time it takes to negotiate leases is getting longer, and the number of points to be negotiated is growing, but the terms of leases are getting shorter.

Low density but saturated market

The density of shopping centres in Germany is low — but the market for shopping centres is nevertheless saturated on account of the intensive bricks-and-mortar competition in the German retail sector. While Cushman & Wakefield counted 921.0 square metres of shopping centre space per 1,000 inhabitants in Norway in its *European Shopping Centre Report 2017*, in Germany it was just 179.6 square metres

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of shopping centre space per 1,000 inhabitants. The figure in the Netherlands was 327.7 square metres, in Italy 232.3 square metres and in Sweden 459.9 square metres of shopping centre space per 1,000 inhabitants. In total, the Cushman & Wakefield report identified 108.6 million square metres of shopping centre space in western Europe, with Germany, the United Kingdom and France accounting for 47 percent of the space (51 million square metres).

Action areas for investors and operators

In five years' time, there will be the same number of shopping centres in Germany as there are today. Given the outdated condition of existing shopping centres and the low level of

Action areas for investors and operators

- Refurbishment/getting centres into shape
- Food services for specific target groups, new/high-quality concepts
- Contemporary tenant and sector mix with targeted tenant selection
- Integration of complementary uses, such as hotels or gyms
- Positioning by focusing product range
- Centre management expertise
- Quality of stay/multichannel concepts
- Objectives are: increased frequency, duration of stay, revenue, rental income



The 27,924-square-metre LAGO Shopping-Center Konstanz, part of Union Investment's Unilmmo: Global property portfolio, is attractively located close to Konstanz's pedestrianised zone and main railway station.

new construction activity, a market shake-out is expected in the next few years. New shopping centres in promising locations will still be developed — but many weak ones will disappear from the market. If the owners have the necessary willingness to act and the fundamental data are right, i.e. quality of location, transport links, customer frequency, purchasing power, catchment area, competitive situation and outlook, five action areas — other than multichannel and quality of stay — can be identified:

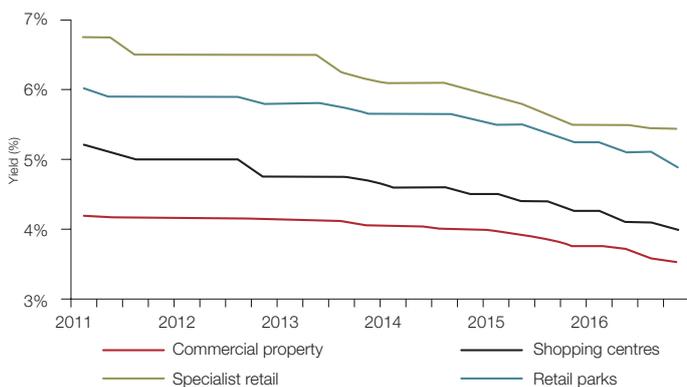
Refurbishment: By far the most important issue for owners, centre managers and operators is the refurbishment of existing shopping centres. Old buildings, the structural changes in retail and shorter renovation cycles make refurbishment — meaning the comprehensive adaptation of an

existing property to current requirements while retaining the type of use — the central area for action. The risks of a lack of investment are high: declining customer frequency and thus a drop in revenues, vacancies and a loss of value for owners are the result in the vast majority of cases. By contrast, unprofitable or “weaker” centres can be the starting point for a repositioning that ends with satisfied investors, tenants, shoppers and municipalities.

Food services: The share of food service outlets in shopping centres in Germany is growing significantly. The food options available are becoming more specialised and appeal to different, clearly-defined target groups in a variety of price and quality segments. Shoppers see food services as value added and a component of quality of stay. They also satisfy the desire for social contact and recreation. In return, operators benefit from higher customer frequency and a longer duration of stay. According to JLL's study *Food & Beverage within Retail Real Estate 2017*, system catering, food stalls and coffee concepts are significantly increasing their share of the German rental market. Food services — which account for between 10 percent and 20 percent of space — have now become a potential anchor tenant in German shopping centres.

Tenant and sector mix: The targeted selection of tenants to ensure a mix of tenants and sectors that is right for the location, distinct and as resistant to online retail as possible is more important than ever for the economic success of a shopping centre. This ensures the neces-

Retail prime yields in Germany's Top Seven cities, 2011–2016 (%)



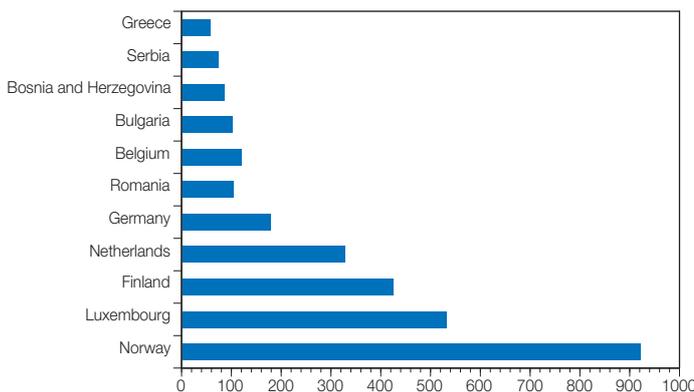
Source: JLL

sary customer frequency and increases the revenue potential for the entire location. In our experience, a balanced combination of international brands, nationally-known retailers and local offerings tailored to the local situation and demand is highly promising. Furthermore, particular emphasis should be placed on a high level of fulfilling local needs, strong integration into the town or city and a recognisable local footing. It is also important that the tenant and sector mix is continuously analysed and optimised as the competition — both from other shops and online — is changing constantly.

Integration of other types of use: In our opinion, opening up shopping centres to other, supplementary uses is an enormous opportunity to enhance the attractiveness of the property and

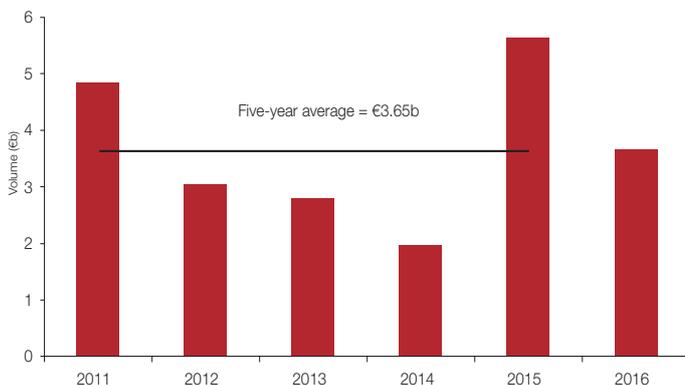
Given the outdated condition of existing shopping centres and the low level of new construction activity, a market shake-out is expected in the next few years.

The range of shopping centre density in Europe (square metres per 1,000 inhabitants)



Source: Cushman & Wakefield

Shopping centre transaction volume in Germany, 2011–2016 (%)



Source: JLL

increase visitor frequency in the long term, and to reach out to different, complementary target groups. If the conditions are right, hotels, children's day-care centres, fitness providers, doctors, services and cinemas are particularly suitable options for integration into shopping centres. Looking at current shopping centre projects in Germany, it is clear that the trend toward the integration of different types of use will be a sustainable trend.

Positioning: For some years, since e-commerce began to make a serious impact, the issues of branding, marketing and positioning have been crucial to bricks-and-mortar retailers and to shopping centres, in particular. Without positioning themselves by focusing their product ranges, shopping centres cannot survive today. The positioning concept takes into account all aspects that make up the operation and management of a shopping centre: a clearly-focused mix of sectors, services and tenants, appealing to specific target groups, leaning toward convenience or an experience, not to mention branding, events, and interior and exterior design.

Good prospects in a challenging environment

Germany is and remains a highly attractive retail market. Retail revenues in 2015 amounted to €471.5 billion, and the trend is rising. Online trading accounted for 8.7 percent of revenues or nearly €40 billion — and its growth rates are down to single digits. The features that set the German shopping centre market apart are low shopping centre density, outdated buildings, market saturation and demanding tenants.

Moving ahead, investors and operators must focus much more on getting existing properties back into shape. Considerable potential for increases in rent and value can be leveraged in value-added properties through refurbishment. In core properties, targeted re-letting can further improve an already good performance. Good money can still be earned with project developments at special locations.

Investors and operators should look very carefully at the overall location: purchasing power, catchment area, the competitive situation, transport links, and not least the demographic and economic development are key to the economic success of an asset. Shopping centre owners and operators will achieve an appropriate rent in the future as well if tenants can generate high revenues and if the factors related to location quality, frequency, tenant mix, positioning and management are right. ♦

Martin Mörl (martin.moerl@prelios.com) is managing director of **Prelios Immobilien Management**, based in Hamburg.