

INVESTING IN RETAIL IS THE NEXT TREND



International retailers see Germany as the number one target for international expansion plans. In a survey carried out at November's MAPIC Conference, 47% of international retailers stated that Germany is included in their future expansion plans.

With slow economic recovery expected across the world, major retailers are expected to focus on the countries with high consumer spending, a mature retail culture and with the capacity for significant organic growth. Germany ticks all three boxes and those European retailers not currently trading in Germany are looking to follow the lead taken by the likes of TK Maxx and Primark to launch their brands. Other global brands such as McDonalds and KFC are gearing up for a large growth and development push while German retailers are also seeing low rents as an opportunity to expand rapidly at home.

Germany has always been a tough retail market to crack for international retailers. Research suggests that Germans are at the top of the list when it comes to selecting value-for-money products in comparison to other European countries. This attitude is directly linked to the thriving discount retail market in Germany and could explain why there is reluctance among leading retailers such as Tesco to enter the market and why Wal-Mart and Marks and Spencer failed in the country.

Between 2000 and 2008, the market share of discount supermarkets increased significantly, while the market share of specialist shops, department stores, supermarkets and mail order companies all fell. The retail environment in Germany is primarily within the inner cities rather than in out-of-town locations, which are very much the second choice where German preferences are concerned. This explains the changes that have occurred in the German retail landscape with out-of-town and inner city retail developments challenging the traditional markets of the High Street and department stores.

“Germany has always been a tough retail market to crack for international retailers and the recent high profile crashes of two major German retailers indicates that the market remains difficult.”

The economy

Following the remarkable downturn of the German economy in 2008/9 the outlook for 2010 is expected to be brighter although the economic recovery is rather weak and GDP expected to grow at just 1.3%. Reduced working hours have helped to compensate for the effects of the recession, but despite this, unemployment is expected to go on rising from its current 7.7%. The levels of unemployment vary widely across the country with the South less affected than the West and North and the highest unemployment rates in Eastern Germany.

With the German budget deficit expected to reach new heights in 2010, additional measures to support consumption are unlikely at the moment. One positive item for consumers is that inflation is likely to remain at a fairly low level and finish the year at 0.3%. In comparison to other economies Germany represents a stable marketplace and the outlook for Germany is positive.

German business confidence, as measured by the Ifo index, rose to 93.9 in November, its highest reading since August last year. Germany came out of technical recession in the 2nd quarter of 2009 and has sustained its recovery. The figures for the 3 months to September show that GDP has continued to rise, by 0.7% in the 3rd quarter of 2009.

So how can international retailers, developers and investors prepare themselves for market entry or network expansion? Is the market really shaping up with the retail landscape?

“Germany represents a stable marketplace. It came out of recession in the 2nd quarter of 2009 GDP is expected to grow in 2010 and business confidence is at its highest in over a year.”

Retail sales at a glance

The table below indicates sales in October 2009 compared to October 2008

Item	Year on Year % movement
Food, drink and Tabacco	(-1.7)
Textiles, clothing, footwear and leather goods	5.2
Furnishings and home appliances	0.8
Other retail (e.g. books, jewellery)	(-2.0)
Cosmetics and Pharmaceutical	(-0.7)
Internet and mail order	(-6.3)

German retail landscape

International Retailers looking for expansion in Germany will find that the German cities Düsseldorf, Munich, Hamburg, Stuttgart and Berlin have high point-of-sale retail turnovers and the states of Baden-Wurttemberg and North Rhine-Westphalia are faring particularly well in comparison to other German states. However, retailers need to take on board the lessons from the difficulties that major domestic retailers have recently faced, as well as the failure of previous market entries such as Hertie, Karstadt, Woolworth, Sinn & Leffers and Wehmeyer.

Poor property and network development strategies have played contributory roles in the failure of the retailers to successfully implement their expansions plans. When devising a market entry or network expansion strategy therefore, it is essential for international retailers to understand the various types of retail locations and their differentiators, in terms of quality standards, to ensure alignment between Brand Statement and Location.

Inner towns and city retail landscape

Traditional Shopping Centres

Traditional Shopping centres can be divided into Neighbourhood and Regional Centres:

Neighbourhood Centres in the main have a limited reach and provide mainly convenience goods as well as additional services.

Regional Centres offer a full range, including numerous retailers, service providers and restaurants. Key tenants are supermarkets and department stores.

Compared to other retail facilities Neighbourhood and Regional Centres are generally of a lower standard of quality; with construction costs averaging at around €850/m².

Shopping Galleries are an extension of inner-city commercial areas and supplement existing pedestrian streets. Tenants are most likely to be small-scale retailers, gastronomy and service providers with an upscale range. Shopping Arcades/Galleries tend to have a central location and high standards of architecture and general fit-out, with construction costs averaging at around €1,370/m².

The out of town retail landscape

Retail Parks ('Fachmarktzentren'): have a different tenant structure and are dominated by the major retailers including electronics, shoes, fashion, DIY and supermarkets which act as customer magnets. Design is functional and of limited quality, steel portal framed buildings with industrialised type cladding predominate and construction costs reflect this, being fairly low around €775/m².

Factory Outlet Centres: The design standards for Factory Outlet Centres in Germany are much higher than in many other countries where the goods provided are generally seen as cheap end-of-line ranges at bargain prices - with architecture to match. In Germany, in contrast, Factory Outlets are designed to ensure a unique shopping experience and are often laid out to provide a 'village' effect. Design standards vary considerably but are considerably higher than retail parks with construction costs averaging at around €1,500/m².

Off-Price Centres are closely related to Factory Outlet Centres in terms of the goods sold. Tenants are traditional retailers, selling branded goods with a significant discount on a self-service basis, but the location will usually be premium sites in pedestrian areas where the opportunity is taken to refurbish vacant buildings.

The developer market

Prime rents in Germany remain stable with good quality refurbished space commanding higher rents while prime yields are showing some marginal upward movement in the short term. Demand is now shifting to the inner city areas, as tenants are increasingly risk averse and choose to focus on high street retail and shopping centres; both of which have a high tenant base. While demand for retail space has not increased there is approx. 700,000 m² of retail space currently under construction up to 2010.

In the 1st quarter of 2009 prime high street retail rents varied between €210 and €240 per m² per month in most Western cities, peaking at €280 in Munich; rents in the former East Germany cities were considerably cheaper with prices down to €95 per m² in Dresden. Rental yields have risen and are generally between 4.15% and 5.75%. Retail parks and shopping centres have the highest yields and in the city centres of Frankfurt and Dusseldorf yields for retail property have both increased by approximately 10 base points while Hamburg remains stable for top property yields and Munich has shown the strongest rise. Prime retail warehouse rents for the 1st quarter of 2009 are as indicated below with yields on average approximately 7.6% higher than in 1st quarter of 2008.

“Demand is now shifting to the inner city areas, as tenants are choosing to focus on high street retail and shopping centres.”

Conclusion

Despite a decline in European retail spending, shopping centres in Germany are providing opportunities in the retail sector. Business confidence is high, recovery is under way and private consumer spending is also increasing. Shopping centres have seen a huge surge in Germany since the 1990s and the country is often seen as the most attractive country in Europe in which to develop a shopping centre. Shopping centres form the core investment profile of many property funds as they often have long leases and high occupancy rates, which make them less volatile as investments.

The basic message for international retailers interested in Germany is that the market offers a wide variety of different possibilities; retail unit types vary from Retail Parks at the lower end of quality to Galleries and Outlet Centres at the top end. The insolvency in 2009, of retail chains Karstadt and Hertie with a combined loss of around 180 department stores, has created an opportunity for retailers to enter this market. These stores are often vacant and only require fitting out, which makes them attractive possibilities for retail activity. As construction costs are expected to be almost stable in the near future the cost risk seems to be manageable from that point of view.

The outlook for 2010 is positive; business confidence is strong; Germany is seen as an international target for retail; prime retail rents remain stable and prime yields are showing upward movement. What more of a reason does one require to expand in Germany?

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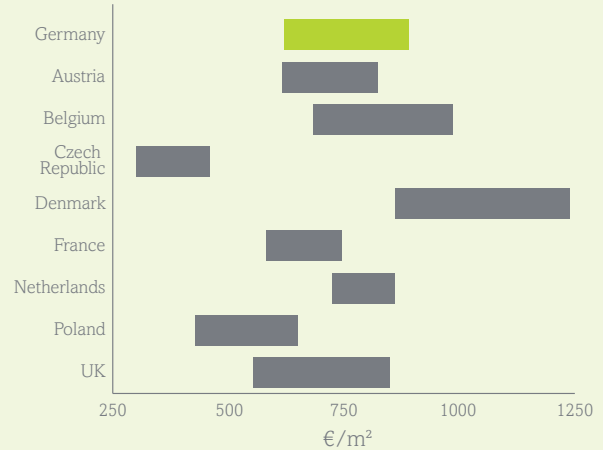
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Retail Park Costs in Europe (Construction Costs €/m²)



Retail Benchmark Costs - Germany (Construction Costs €/m²)

