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Outlet Centers Rise to the Top During Recession

Vacancy, Leasing and Retail Sales Trends Show Outlet Centers are a Force to be Reckoned with in Retail Real Estate

While most of the nation's shopping centers and malls struggle to hold onto tenants and deal with increasing vacancy during this recession, landlords and leasing agents for the country's outlet center have enjoyed continually tight vacancy rates during this time, and many have also seen improvement over the last six months.

According to CoStar Property Analytics, outlet center vacancy hit a high of 5.56% at the end of first quarter 2009. Since then, the shopping center category is the only one to put togethr two consecutive quarters of declining vacancy this year. Currently, the outlet center vacancy rate stands at 5.12%, far outshining the 8% - 10% average vacancy rates currently found in the lifestyle, power, community and neighborhood shopping centers categories (click to see chart at end of article).

According to a CoStar Property Analytics statistical forecast, outlet center vacancy could return to its lower, pre-recession level of less than 4% by the end of second quarter 2010.

One major contributing factor to this low vacancy is the level of positive net absorption within this category. Outlet center net absorption amounted to 1.1% of the category's total square footage so far this year, which is a much higher level than other shopping center types -- power centers have absorbed .8%, followed by lifestyle centers (.6%), neighborhood centers (-.1%), community centers (-.2%), and malls (-.3%).

The nation's top outlet center landlords are also reporting steady leasing activity and lower vacancy at their outlet centers.

Simon Property Group (NYSE:SPG) operates the country's largest outlet center portfolio through its Chelsea Premium Outlet Centers division. During second quarter 2009, this segment performed much better than the REIT's mall portfolio. Specifically, Chelsea's outlet center occupancy came in at 97%, which compares to 90.9% occupancy at Simon's malls.

Tanger Outlet Centers, the country's second-largest outlet center owner with 31 centers totaling 9.2 million square feet, reported that its average occupancy rate improved 120 basis points over first quarter to 94.7% in second quarter. Company CEO, Steven Tanger attributed this strong rate to steady leasing activity, as well as being fortunate that its portfolio was not hit hard by store closures -- something most shopping center landlords have suffered. Tanger estimated that of the "few bankruptcies" Tanger's tenants had this year, only 25% of the stores ended up going dark and re-leasing has gone well.

This September, Value Retail News ("VRN") released its annual State of the Outlet Industry report, which found that, during 2008, 1,454 net new outlet stores opened, bringing the total units in operation to 12,924, which represents a strong 12.6% growth rate over the course of a recession year that included mass store closures. Also according to VRN, the average outlet center store is 4,702 square feet and pays $23 per square foot in rent.

With 21 outlet centers across the country, Baltimore-based Prime Retail is the third-largest outlet center owner in the nation. Prime has had continued success in signing new leases at its outlet centers during 2009. Karen Fluharty, a senior vice president at Prime, said 35 new tenants were signed in its most recent quarter alone.

Retailers signing on to Prime's centers this year include: 2b bebe, 7 for All Mankind (2), Aeropostale, American Apparel, Banana Republic, Bare Escentuals, Body Central, Carters, Children's Place, Coldwater Creek, Columbia Sportswear (2), Converse, Dooney & Bourke, Ecco, Ed Hardy (2), Escada (4), Etro (3), Factory Brand Shoes, Gap Outlet, Gucci, Gymboree, J. Crew, Lacoste (3), Le Tigre, Mandarina Duck/Francesco Biasia, Love Culture, Loro Piana, Michael Kors (2), Osh Kosh, Perfumania, PacSun, Rainbow, Reebok / Rockport (2), St. John, Talbots, Tory Burch, Under Armour (2), Vans, Vince, Yankee Candle, and more.

According to an August VRN report, tenants recently moving into Chelsea Premium Outlet Centers include 7 for All Mankind, Balenciaga, Brunello Cucinelli, David Yurman, Ed Hardy, Etro, Giuseppe Zanotti, Gucci, Jimmy Choo, Joe's Jeans, La Perla, M Missoni, Oliver Peoples, Ted Baker, Thomas Pink, Tory Burch, Y-3, and more.

Tanger said it signed leases with 23 retailers this year that have never before operated outlet stores in its portfolio, including Aerie, Bally, BCBG, Dooney and Bourke, Petit Bateau, QVC, Talbots, and more. Prime said retailers new to its portfolio include Bare Escentuals (beauty), Ed Hardy (tattoo art apparel), FaÇonnable (men's and women's apparel), Judith Ripka (jewelry), Love Culture (trendy apparel), Vince (men's and women's apparel), and more.

Other tenants signing leases with Tanger this year include Aeropostale, Bali, Easy Spirit, Hartmann Luggage, It's Sugar, Kenneth Cole, Yankee Candle, and more. Using its database, CoStar found a few more tenants signing new leases at outlet centers this year, including Bass, Brighton, Bruno Magli, Charlotte Russe, Chico's, Diesel, DKNY, Esprit, Hurley, Lane Bryant, Le Creuset, Michael Brandon, New Balance, Papaya, Robert Wayne, Rue 21, Solstice, Tommy Bahama, True Religion, Van Heusen, and Zumiez.

Aside from these existing active outlet center players, Steven Tanger said that several high-profile retailers are considering entering the outlet channel. VRN confirmed this, reporting that 27 new chains were added to its 2009 outlet retailer directory. Victoria's Secret was named the "best newcomer" by the industry journal -- other new additions include American Eagle, Billabong, Eccoci, Ghirardelli, Hugo Boss, Hurley, Kensie, Marciano, Pendleton, Shade, Soma, Volcom, Zoo York, and more.

So why are most retailers holding on to their outlet center stores, with many actively expanding and some even breaking into the off-price retailing space?

"There has been a lot of momentum for us and we are pleased that retailers have continued to see the outlet channel as viable in their distribution strategies," said Fluharty. "What we're seeing is that as these brands expand their presence or maintain their existing full price presence, they recognize that need for an outlet channel," she added.

Steven Tanger pointed out that excess inventory at retailers' full price stores is "backing up" and the companies are in need of a profitable sales channel to clear that merchandise. Tanger said its low cost of occupancy across its portfolio, as well as good retailer sales, helps retailers produce store profitability.

According to VRN, the average outlet retailer brought in $301 in sales per square foot during 2008, down only slightly from $305 the prior year. Tanger's retail sales per square foot came in at $335 in second quarter 2009, representing a 1.8% improvement over last quarter, but 2.9% decrease over second quarter 2008. Meanwhile, Simon's outlet center retailers produced sales of $493 per square foot during second quarter, which compares to $442 per square foot at Simon's malls. CEO David Simon commented that while Chelsea's second quarter sales were down 3% over last year, "the sales decrease was less significant" in the outlet platform as compared to the company's malls.

According to inflation-adjusted data released by the International Council of Shopping Centers on September 23, retail shopping by tourists (a key driver of outlet center shopping) amounted to $96.9 billion in the U.S. during second quarter 2009, which is down 5.3% over the same period last year.

However, tourist shopping has performed better than general retail sales -- according to the Census Bureau's Sept. 15 release, second quarter U.S. retail sales were down 8.5% over the same period in 2008.

VF Corp (NYSE:VFC) is one of the largest operators in the outlet space with brands including Lucy, 7 for All Mankind, Vans, Wrangler, Lee, Nautica, North Face, and more. VF is on track to open at least 70 stores this year, which is down only slightly from intentions the retailer stated in 2008 to open 75 to 100 outlet stores annually over the next five years.

VF chairman and CEO, Eric Wiseman, said that VF's outlet stores are performing "consistently well" in terms of sales, a trend he said many of its outlet competitors are experiencing. "People are looking for value, so they’re shopping in the outlet centers and our outlet stores." In contrast, Wiseman said it's been "a struggle" selling merchandise at the company's premium-priced stores.

Phillips Van-Heusen (NYSE:PVH) is one of the largest retailers in the outlet sector -- its core brands include Calvin Klein, Van Heusen, Izod, Bass and Arrow. During second quarter, the retailer's comp sales for outlet stores, while down compared to the year prior, came in significantly above expectations.

The retailer's chairman and CEO, Emanuel Chirico, commented that lower gas prices have worked in favor of outlet centers this year, as operators bank on shoppers driving significant distances to their centers.

In a broad outlet channel view, Chirico said, "The outlet environment is doing somewhat better, clearly much better than specialty retail. The trends and traffic are better." Fluharty said that at Prime, "shopper traffic is definitely up from 2008." Tanger said its comparable shopper traffic is up 1.2% this year over last.

David Simon said shopper traffic and outlet center sales are keeping up because "the consumer continues to seek value in these economic times." On this point, however, will shoppers continue to seek value by shopping at outlets once the recession is over?

Fluharty says yes. "Fundamentally, there has been a large consumer flight to value, with quality and brand names remaining a key driver. The market share the outlet channel has gained from consumers looking to make smarter choices will remain regardless of the economic climate. As a consumer, if you've been able to purchase the brands you know and love at a 40% discount, it's very hard mentally to go back to paying full price just because your money's back and the recession is over."

Anticipating further tenant demand in the category, Simon, Tanger and Prime as well as a number of other developers in the channel, have continued with new outlet center projects.

During 2009, Simon weighted its new development and expansion projects to the outlet center category. In April, the company opened a 220,000-square-foot expansion to The Promenade at Camarillo Premium Outlets in Camarillo, California, bringing the outlet center's total square footage to 674,000. In July, the company opened the 225,000-square-foot first phase of Ami Premium Outlets in Japan. In August, Simon opened its 51st outlet center in Cincinnati, Ohio -- the 400,000-square-foot Cincinnati Premium Outlets. Simon expects the Saks Off Fifth-anchored center to be 85% occupied by the end of this year, which is pretty strong for a new center in these economic times.

Currently, Simon has only one project classified as "on the horizon" in its entire development portfolio -- and it's an outlet center. Chelsea is currently in the pre-development and pre-leasing stages for Merrimack Premium Outlets, located just off Exit 10 of the Frederick Everett Turnpike in the Nashua, NH area. Situated upon 170 acres, the $100 million, 447,000-square-foot outlet center is planned to have 120 stores. A phase two expansion and 200-room hotel are also penciled on the drawing board. Tenants have yet to be announced for the development, which is projected to open in 2011.

Tanger opened the 682,000-square-foot first phase of its Deer Park Outlet Center in Long Island on October 23, 2008, a time Steven Tanger dubs the "dead center of the eye of the perfect storm, as far as the economic crisis is concerned." While the center stood at 80% occupancy at the end of June, Tanger said "traffic is very robust" and building each week, which the center's tenants are seeing reflected in their sales.

Tanger has a 350,000-square-foot outlet center located on 58 acres along I-85 in Mebane, North Carolina in its pipeline that as of the end of July, had about 57% of its square footage either leased or in negotiation. While the company's typical plan is to break ground once 50% of leases are signed and non-appealable permits are in place (both have happened on this center), Tanger said, "based on the economic environment, I was uncomfortable closing on the property and proceeding." The company has now instituted a stricter requirement to reach 75% leased or under negotiation before it breaks ground.

Prime Retail completed four major expansion projects at its Orlando, Puerto Rico, St. Augustine, and Williamsburg outlet centers during 2008 and the company also has two new development projects in the pipeline:

Prime Outlets Grand Prairie: Located on I-20 between Dallas and Fort Worth, Fluharty reports the 450,000-square-foot outlet center, anchored by Neiman Marcus Last Call and Saks Fifth Ave Off 5th, is over 50% leased with tenants including Adidas, BCBG, Brooks Brothers, Cole Haan, Columbia Sportswear, Dooney & Bourke, Guess, Hugo Boss, LOFT, Michael Kors, Reebok, Tommy Hilfiger, and more. The center's phase one grand opening is targeted for May 2011.
Prime Outlets Livermore Valley: Located on I-580 at Atel Charro and Fallon Roads, about 36 miles east of San Francisco, Fluharty reports this 450,000-square-foot center is also more than 50% leased. Anchored by Neiman Marcus Last Call and Barney's New York, the center's lineup of outlet retailers includes Adidas, Ann Taylor, Banana Republic, BCBG, Brooks Brothers, Coach, Columbia Sportswear, Gap, Hugo Boss, J. Crew, Michael Stars, Tommy Hilfiger, and True religion, among others. The center's phase one grand opening is targeted for July 2011.