Luxury houses race for the real estate

Introduction

Buying properties in key locations is not a new trend in the luxury sector. However, over the past two years there was a huge increase in activity of the large players of the market as brands want to establish their presence in an environment of scarcity and competition. Extraordinary design of the store can attract the customers' attention and give them a unique experience, potentially increasing revenues of luxury houses. Lately, LVMH [PA: LVMH], Kering [PA: KER] and Prada [HK: 1913] have been buying up real estate in New York, Paris and Milan, securing flagship locations for their brands in key fashion hubs all around the world. This distinguishes the largest luxury houses from other groups and puts pressure on competitors to plant their own flags. The race to control these properties has made high-end retail real estate one of the niches where large deals continue to be made, while high borrowing costs and uncertainty have more than halved global real estate transactions and made large sales a rarity. Kering and its main rival LVMH were the buyers in three of Europe's largest five property sales last year, with LVMH's approximately €1bn purchase from investment firm Brookfield on the Champs, Élysées in Paris topping the list. However, Kering's acquisition of via Monte Napoleone 8 in Milan for €1.3bn, announced on the 4th of April 2024, surpasses the previous leader and becomes the largest real estate deal in Europe in the last two years.

Kering's acqusition of Via Monte Napoleone 8

On the 4th of April 2024, a global Luxury group, Kering announced the acquisition of the iconic and historic Milanese building on via Monte Napoleone 8, for approximately €1.3bn, from a subsidiary of Blackstone Property Partners Europe. Located on the most prominent corner of Milan, the 18th century building is developed over five floors with a gross area of 11,800 square meters. The property houses Kering's Saint Laurent store, as well as Prada and the LVMH-owned Cafe Cova, and includes more than 5,000 square meters of retail space, making it one of the largest in via Monte Napoleone. The sale of historic building marks the biggest European property deal in two years and continues the series of large real estate purchases by luxury fashion houses seeking to lock down flagship locations in key global cities. Managing such renowned fashion houses as Gucci, Saint Laurent, Bottega Veneta, Balenciaga, and Alexander McQueen, Kering sees this acquisition as a part of its selective real estate strategy, aimed at securing key locations for its Houses. According to the latest press release: "Kering remains focused on proactively managing its real estate portfolio with the short- to medium-term objective of retaining a stake in its prime assets alongside co-investors in dedicated vehicles".

However, the Milan building is not the first real estate acquisition of Kering. The luxury group announced in January the $963m (€885m) purchase of a building located at 715-717 Fifth Avenue, on the Southeast corner of 56th Street, entering the race with LVMH and Prada for securing location on one of the world's most iconic avenues. Multi-level luxury retail spaces occupy 10,700 square meters and houses Giorgio Armani and Dolce&Gabbana. In spring 2023, Kering also acquired properties on Paris' two most vital high-end shopping streets, at 35 avenue Montaigne (8,300 square-meters) and 235 rue St Honoré (8,000 square-meters), spending €860m and €640m respectively. Both are currently undergoing radical reconstruction, to become major new flagships for two crucial Kering's brands – Saint Laurent and Gucci. Kering plans to open a giant Gucci store on 235 rue St Honoré in 2025, designed by architect Franklin Azzi and modelled on its concept gallery in Piazza della Signoria in Florence. However, the luxury conglomerate put both properties up for sale in June 2023 and pulled the buildings off the market 5 months later, being unable to find buyers willing to pay competitive price in high interest rate environment. The decision to take the two properties off the market comes on the back of Kering's successful £800m bond issue, increasing its financial flexibility and diversifying its funding sources by entering the sterling bond market for the first time ever. In addition to these investments Kering's portfolio includes landmark assets in Tokyo's Omotesando, and the Hôtel de Nocé housing Boucheron's Paris flagship. Although Kering has about 1,800 selling points, it does not intend to acquire many of them: "Kering will only purchase "exceptional" buildings in a limited number of cities if they create value for the group's labels," - Deputy chief executive officer Jean-Marc Duplaix said in February 2024. He also mentioned that the company was exploring partnerships with financial funds to become "more agile" while limiting exposure to real estate.

Returning to the recent Milan deal, many real estate experts wonder why Kering agreed to pay such a high price of €1.3bn for the Via Monte Napoleone 8. Indeed, the building was bought by Blackstone as a part of its 2021 acquisition of Reale Compagnia Italiana, a private Italian firm that also owned offices, hotels and residential properties in the city, for which Blackstone paid about €1.1bn. While some analysts consider this deal as a right move for Kering and explain the Group's willingness to pay a premium by the fact that it will allow the company to secure the best location in Milan and to compete with LVMH, others disagree. This acquisition might seem inappropriate in the current situation as Kering recently issued a profit warning, saying it expected sales at Gucci, which accounts for half of group sales and two-thirds of earnings, to decline 20% in the first quarter led by weakening demand in China, its key market. However, the company had €2bn in free cash flow from operations last year, and it considers the purchase of key real estate assets as part of its long-term strategy which will allow to strengthen the exclusivity and elevation of Kering's brands. Regarding the valuation, it is hard to estimate the return on investment as the main gain from this acquisition is associated with intangible assets such as brand recognition and status. Yet if we want to evaluate the deal somehow, we can say that at current Milan market rates, the building could cost about €50m a year to rent, considering the fact that Via Monte Napoleone has the second-highest rent of any shopping street in the world, after Fifth Avenue in New York. This figure combined with the purchasing price of €1.3bn would result in 26 years payback period. Furthermore, given that Kering is not planning to lease its new property but will earn extra revenues and gain brand prestige from this acquisition, the real return on investment might happen to be much higher, depending on the success of the group to create unique experience for the customers in its flagship boutiques. On the other hand, this investment is unlikely to be making anything near current rents from long-term tenants such as high-end LVMH-owned café Cova and huge increase in capital expenditures might be noticeable to Kering, which may explain why the group's real estate strategy also involves seeking co-investors to limit the total amount of capital raised.

LVMH's investment in real estate

LVMH, a titan in the luxury sector, has strategically amplified its brand prestige with careful real estate investments in major luxury hubs like Paris and New York. These strategy moves are deeply rooted in the company's DNA, largely influenced by Bernard Arnault's background in running his family's real-estate development company, and backed by the fact that LVMH's market capitalization has doubled, and its annual sales have grown almost two-thirds since 2019, giving it enormous firepower to buy desirable real estate. These initiatives are not just simple acquisitions, they are central to LVMH's comprehensive strategy, which emphasizes brand enhancement, a technology-driven omnichannel approach, and a focus on experiential luxury. The properties acquired by LVMH are regarded not only as retail spaces, but also as vital long-term strategic assets poised to hedge the threat of losing vital spots on major shopping street if they remain renters, appreciate in value, thereby offering significant financial returns, and further elevating the brand's stature. By owning rather than leasing these iconic properties, LVMH retains complete control over the retail environment and the overall consumer experience it provides, underscoring the company's commitment to integrating its operational goals with its consumer engagement strategies seamlessly.

Indeed, LVMH's strategic approach to real estate investment exemplifies its commitment to reinforcing its brand's presence in the most prestigious luxury retail corridors globally. In Paris, the Champs-Élysées, one of the world's most valuable retail landscapes, showcases this strategy vividly. Here, LVMH has secured significant properties, including the Louis Vuitton flagship at 101 Avenue des Champs-Élysées, purchased for a sum between $770m and $900m. This property, previously leased, underscores a shift in strategy from leasing to owning to establish a more permanent presence. Furthering its dominance, LVMH acquired another major property at 150 Avenue des Champs-Élysées for nearly $1bn, bolstering its portfolio on this iconic avenue and deepening its roots in the luxury retail sector. This philosophy extends to New York's Fifth Avenue, mirroring the Parisian strategy but tailored to the unique dynamics of the American luxury market. The acquisition of the Tiffany & Co. building at 727 Fifth Avenue, following LVMH's acquisition of the brand, marks a strategic enhancement of its real estate holdings and integrates significant retail spaces into its broader operational strategy. LVMH's interest in further expanding its Fifth Avenue portfolio, specifically eyeing 745 Fifth Avenue, is a move that not only aims to cement its position but also sets the stage for competitive positioning among luxury retailers in one of the most high-profile shopping districts in the world. However, this strategy is not without competition as Chanel is also rumored to be eyeing a building on the corner of 58th Street, underscoring the stiff competition that characterizes the real estate race among luxury houses.

Prada's investment in real estate

Mirroring the general race for real estate, Prada's is doubling down on its retail strategy, with planned investments of €1bn over the next five years, including approximately 130 renovation and relocation projects that account for ~80% of Retail capex. Furthermore, the Italian luxury brand's real estate investments, especially in New York City, reflect a nuanced approach to integrating experiential retail with luxury shopping. The purchase of a significant building in Manhattan, which has housed Prada's flagship store since 1997, is a prime example of their strategy. This property, valued at $425m, not only signifies Prada's long-term commitment to its historical retail location but also highlights the importance of landmark real estate in luxury retail branding. Such locations attract a high volume of foot traffic and maintain high visibility in key markets .

Following the trend of the high-end industry, the Hong Kong-listed Italian luxury group's investments are aimed at creating more than just shopping locations; they are about crafting experiences. The concept of experiential shopping is at the heart of Patrizio Bertelli's strategy, where the physical space is designed to offer customers a blend of fashion, art, and culture. This approach is expected to cater to the luxury consumer's desire for unique and immersive shopping experiences. Integrating elements like the catering by Marchesi 1824 pastry shop and cultural exhibitions curated by Fondazione Prada, these spaces are intended to provide an elevated, holistic experience that enhances customer engagement and brand loyalty .

Prada's real estate strategy also reflects a long-term vision for sustainability and growth. By owning their properties, Prada ensures more control over the brand environment and can better adapt to the ever-evolving consumer needs without the constraints and costs typically characterizing by leasing arrangements. This ownership allows for a more consistent and controlled deployment of brand strategy across its locations, ensuring that each store embodies the essence of Prada's luxury ethos.

Branded residences

Aside from luxury fashion brands expanding their commercial real estate portfolios over the recent years, many have begun to venture into the world of residential real estate by partnering with property developers to create branded residences. These residential complexes embody the fashion brand's ethos, culture and legacy. By incorporating the brand's namesake and signature designs into these residences, each brand is able to craft properties that offer immersive experiences and exude luxury and exclusivity. Through the development of branded residences, luxury brands have transitioned into becoming synonymous with ultra-luxe housing that offers a stable stream of revenues and enhanced brand prestige. Indeed, according to a global real estate company Savills, the number of branded residences has soared by 160% over the past decade. This tally is expected to double globally by 2030, with Miami and Dubai driving this trend and becoming hotspots for luxury housing complexes.

Armani was one of the first luxury houses which decided to capitalise on both cities. In June 2019, it opened The Residences by Armani/Casa, a luxury highrise in Miami's Sunny Isles Beach, a prime example of Armani's transition from fashion into the luxury real estate space. Armani's first real estate project in the United States, their stamp on the complex is apparent in the common areas such as the private lounge, cigar room and movie theatre. Recently, Armani has announced plans to build the Armani Beach Residences on the infamous Palm Jumeirah Island, in partnership with UAE developer Arada. This branded residence will be designed by the award-winning architect Tadao Ando and is projected to be completed by 2026. The Armani Beach Residences will be priced 63% higher, per square foot, than other residences on the island. For instance, two-bedroom residences will start from around $5.9m.

Bulgari has also committed to residential real estate, building the Bulgari Lighthouse in Dubai in partnership with renowned architectural firm Antonio Citterio Patricia Viel. The project consists of 31 penthouses, with four to five bedrooms, and a three-floor 'Sky Villa' atop the entire building. The 13,000-square foot villa was sold for $112m in February 2023, becoming the city's most expensive apartment at the time. Over the first half of 2023, the residence sold 20 units for a grand total of $583m. The complex is surrounded by Mediterranean gardens, a 50-meter swimming pool and the exclusive Bulgari Yacht Club – these amenities provide residents with a life of luxury right on their doorstep.

Missoni and Fendi have also opened their own branded residences in Miami. Missoni Baia is a 57-story complex featuring with a 24-hour concierge, pet spa and gym with views of Miami bay. In addition, the interiors of the building were designed under the direction of Missoni, featuring the Italian house's distinctive colour palette and patterns. Fendi Château Residences is a 12-story complex with 58 oceanfront residences and penthouses ranging in price from $5m to $22m, and each residence features are fitted with a Fendi Casa kitchen with custom Fendi Casa cabinets and Gaggenau appliances. Interestingly, apart from its exploits in Miami, Fendi has also invested in constructing a branded residence in Marbella, which could become a similar centre for such luxury complexes. The Italian fashion house collaborated with Sierra Blanca Estates, a Marbella-based developer, to launch Epic Marbella in 2023, the first branded residence on the Mediterranean coast. Situated on a 48,000-square metre property, the complex features 56 apartments and duplexes designed and furnished by Fendi Casa. Moreover, the communal areas also feature Fendi Casa designs and furniture.

Now that we have covered some of the branded residences that have been opened by luxury fashion houses in recent years, we must ask ourselves: what is the rationale behind all of this? The goal isn't just to build luxurious properties but to "merge the DNA of the developer and the DNA of the brand through architectural and interior design to offer a unique experience to clients" according to Sierra Blanca executive director Carlos Rodriguez. Both the developer and the fashion brand gain financially from these collaborations as they bring unique value to the properties and attract a specific clientele willing to pay a premium for branded residences. The willingness to pay almost absurd prices for these residences is due to the fact that the brand's name serves as a guarantee of excellence and attention to detail. Hence, the developer benefits from higher real estate prices - on average, luxury residences command a 30% premium compared to similar properties in the same location. Despite such an influx of branded residences over the past decade, it is unlikely that French fashion houses will join the race to design their own. According to Thomai Serdari, a luxury marketing strategist and professor at NYU Stern, French brands are bound to a tradition of haute couture that focuses mainly on fashion. On the other hand, Italian houses are often led by a single visionary - Gianni Versace and Giorgio Armani for example. Hence, they are more concerned with overall aesthetics, enabling them to apply their design on other lifestyle areas.

Not only Luxury houses are expanding their real estate portfolios

Not only are luxury houses expanding their real estate portfolio and profiting from the real estate market, but various fast-food chains also generate a large portion of their revenue through franchising. McDonald's [NYSE: MCD] is a prime example of this business model, where they make money by leveraging their fast-food products to franchisees who lease properties owned by McDonald's. Former McDonald's CEO Harry J. Sonneborn is famously quoted as saying: "We are not technically in the food business. We are in the real estate business". As of Q3 2023, there are approximately 41,200 McDonald's locations, operating in more than 100 countries. Yet, the company itself only operates about 2,100 establishments with the rest being franchises. The McDonald's business model differs from the standard model of franchising in the sense that instead of generating revenue through selling supplies to franchisees or demanding large royalties, they bought the properties and leased them out at large markups. This business model is much like a subscription, where the subscriber (the franchisee) pays the corporation a fixed amount every month. In addition to the regular income generated from rent, the corporation takes a percentage of each franchise's gross sales.

The size of McDonald's real estate portfolio can be seen in the company's 2023 balance sheet, where property and equipment are valued at approximately $43.6bln. Moreover, of McDonald's $25.5bn of revenue in 2023, $15.5bn came from franchised restaurants (as reported in the 2023 10-K). We can see the importance of McDonald's franchising model and how crucial it is to the profitability of the company. The advantage of the model under which McDonald's operates is that their revenue streams (rent and royalty income) are stable and predictable. Moreover, operating costs are much lower for franchises than those of company-operated locations, enabling an easier path to profitability. According to analysts, 82% of profit generated by franchises is kept by McDonald's compared to the 16% from company-operated locations. In conclusion, one could say that McDonald's is more of a real-estate empire than a food one.

Conclusion

In conclusion, the main reason behind the luxury houses' race for the real estate is their willingness to secure the best location for their brands. Major players on the market fear that if they do not buy their flagship store from the landlord, one of their competitors will do so and then force them to leave the highly desirable place. Moreover, it is a great time for luxury houses to buy real estate because they have a financial edge over traditional property investors, which comes from the cheaper borrowing on the corporate bond market than what others would pay for a commercial mortgage. According to analysts, spending and investment in luxury brands' stores has risen from 6% of their sales in 2019 to 9% in 2023, with European luxury brands spending more than $9bn on boutiques on the world's major shopping streets since the beginning of 2023. Currently, Chanel and LVMH continue to search for luxury properties in New York, while Kering is planning to spend about 10% of its expected sales in 2024 on real estate. Although some experts wonder if spending huge sums on real estate is the best use of the company's capital, it might be the best way for Kering to compete with LVMH. Overall, while some brands continue to acquire the key locations for their boutiques, others develop their brand further through designing residential housing. And this trend is not going to stop anytime soon as fierce competition in the fashion industry makes luxury brands search for new ways to attract clients' attention and earn their loyalty.

TAGS: Real Estate, Luxury Houses, Flagship Store, Kering, LVMH, Prada, Armani, Bulgari, Fendi

