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AVIVA INVESTORS THE FUTURE OF RETAIL WAREHOUSING BY JONATHAN BAYFIELD

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JONATHAN BAYFIELD

SENIOR RESEARCH ANALYST,
GLOBAL REAL ESTATE

Main responsibilities

Jonathan manages Aviva Investors' Real Estate Research Team thought leadership and insight program. He is also responsible for developing a house view on the attractiveness of specific UK and Irish property sectors and investment strategy for our UK and Ireland focussed real estate funds.

Experience and qualifications

Prior to joining Aviva Investors, Jonathan worked in JLL's Retail Research and Consulting team, in the UK and Europe. Jonathan holds an MSc in Real Estate from University of Reading's College of Estate Management and a BSc in Geography from University College London. He is a member of the SPR, Revo and the ICSC.

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INTRODUCTION

This paper explores the structural pressures facing the retail sector and the implications for the future of retail warehousing.

First, we review the most pertinent trends unfolding in the retail sector:

- Store-based retailing will decline considerably.
- Fewer and smaller stores will be needed.
- Stores will become a platform for discovery, engagement and experience.

Second, we identify that there will be winners and losers in the retail sector throughout the UK. The likely route for sustained investment performance in retail warehousing will be locations that offer experience-led, high engagement retailing. There are only a small number of retail parks that have destination credentials. However, most parks are characterised by low-engagement retailing and face an uncertain future over the long term.

Finally, we conclude with the strategic implications for investors in this sector:

- Unique places that encourage long dwell times will be the safest investments. Rental growth is likely to be muted, except in a few locations.
- Landlords must have knowledge of the overall demographic catchments, so that they can respond to on-going changes in occupier requirements.
- Current income profiles are only likely to be sustainable in the short to medium term.



1. THE FUTURE OF RETAILING

In our recent report on *'The future of retailing and retail estate – what lies in store?'*, we concluded that shoppers' expectations are being radically altered:

- Technology has raised the bar on product information, price comparisons, instant customer support and varied delivery options.
- E-commerce has jettisoned many issues related to physical retailing. These include but are not limited to: transport and time costs, issues finding products and lack of customer support.

Physical stores are struggling to match these expectations.

The growth of e-commerce has significantly changed consumer expectation levels, particularly in relation to convenience, personalisation and service. Physical stores should offer an experience that rivals or betters what buyers can find online. Historically, cost, choice and convenience have been the key to consumer gratification. But now the vibrancy of an environment and its experiential qualities have become more and more important. As a result, retailers will only want to promote brands in the most attractive locations with the strongest sales densities.

Not all products lend themselves to creating an experience.

Low-engagement products are typically routine purchases where speed, efficiency and price are the chief concerns. For such products, "auto-replenishment" will become the norm.

High-engagement products, by contrast, are those which offer the potential for an interactive, tactile and personalised customer experience. Stores can offer a touch point with customers in a distinctive way in comparison to online shopping or social media. Stores hold the potential to be a space for discovery, engagement and interaction with brands.

The report made three conclusions, which are relevant to all types of physical retailing.

- **Store-based retail sales will decline significantly.** This will be driven by further e-commerce penetration, particularly for low-engagement products. The UK's considerable mature retail stock, muted household income growth and a lower proportion of consumer spending going towards retail sales, also support this view.
- **Fewer and smaller stores are likely to be needed.** Some high engagement stores will be larger, particularly flagship stores. But the majority of low-engagement retailing is set to move to online channels, stores will therefore be smaller on average.
- **The role of stores is set to change significantly;** smaller stores will become platforms for discovery, engagement, experience and interaction. They will form part of a multi-channel strategy for many retailers that will see a blurring of online and offline retail formats.

2. SUCCESSFUL RETAIL PARKS OF THE FUTURE

Clearly, there will be winners and losers across retail types throughout the UK. The likely route for sustained investment performance in retail warehousing will be locations that offer experience-led, high engagement retailing.

Destinational Retailing: brand-enhancing centres

Historically retail parks' USP was car-led convenience. In the future, car ownership will decrease as regulation and cost will limit the use of petrol. Car sharing and taxis will become the norm. As a result, retail parks will struggle to compete with e-commerce, auto replenishment and auto fulfilment. Most parks are characterised by low engagement retailing and are not places people would choose to spend their free time. The majority of retail parks are therefore challenged.

In the future, successful retail parks will significantly broaden their offer to create destination appeal. As occupiers deploy multi-channel strategies, they will continue to locate in places with high footfall and the potential to enhance brands. Unique places that have destination qualities and offer engaging experiences will be the safest investments.

New occupiers will broaden appeal

New types of tenant will be needed. A retailing offer which aligns to the catchment demographics will boost customer appeal and engagement. Traditionally, retail park occupiers have sold electronic and/or bulky goods. These sectors have a higher exposure to online retailing. Occupiers will need to sell high engagement products with the potential to offer interactive and personalised experiences. DIY and home improvement retailers may need to embrace technology, incorporating virtual reality to offer a more personalised experience. Increased and improved leisure and food and beverage provision, or even the fusion of retail and leisure

parks, will also become more normal. Retail parks are characterised by low land costs and large amounts of space. Therefore unique physical experiences like 'competitive socialising', including golf and climbing walls, and other dynamic activities may take space.

Scale is vitally important

Scale is critical when looking to create a strong retail and leisure destination. Greater scale implies more consumer choice and a wider offer. As our previous report highlighted, there will be a bias towards the major cities and regional shopping destinations. Smaller retail locations generally will struggle to establish themselves as destinations for high-engagement retailing. Landlords of retail parks must have large adaptable sites to compete with strong centres in cities and regional shopping centres.

Awareness of wider catchment crucial

In recent years, many fashion operators have migrated from town centres to retail parks. Retailers have consolidated stores and also benefitted from lower occupancy costs. Crucially, landlords must understand specific catchments so they have sight of the overall retail landscape. A clear understanding of the local demographic is also important. This will allow investors to take advantage of changing occupier requirements. Real estate is a local asset class in which deep expertise gives investors a competitive advantage.

Considerable opportunity for repositioning

The majority of parks are currently underdeveloped in terms of experiential retailing. This suggests a significant opportunity for repositioning. Landlords must ensure that retail line-ups are both compelling and fresh in order to keep shoppers returning. As a result, some may even have to totally re-configure as current space does not match requirements. Varied two-sided street retailing centres instantly create a

more attractive destination; refashioning a 'town centre offer' in an edge of town location. Adaptability of site is a key requirement to effect such changes.

Understanding the prospects for the catchment are also important

As with any retailing location, fundamentals are vitally important. The economic strength of the catchment, including growth of the population and labour force, can help to gauge likely investment performance. New developments and extensions in a location's competing markets may see a decrease in shopper populations as competing venues attract a greater share of activity. Landlords must be aware of this before making investment decisions.

Redevelopment of smaller compromised sites

Historically, easy car access and free parking provided retail parks with a convenience factor that was difficult to replicate. This clearly is of less prominence given the continued growth in e-commerce. One redevelopment model might be a hybrid pick-up and delivery retail centre. Incorporating drive-throughs, pick-up lockers, smaller traditional stores, as well as a last-mile fulfilment facility.

Redevelopment in affluent areas with high land values

Other redevelopments in the residential and/or offices sector could be considered on appropriate sites. The aim would be to deliver a more rounded mixed-use scheme, with the retail component likely consisting of traditional convenience stores and food and beverage operators. Clearly land values will be the driver of this strategy for landlords. Currently this will only be possible in London and the South East.

3. STRATEGIC IMPLICATIONS FOR INVESTORS

- To be successful in the long term, retail parks will have to significantly broaden their offer to create destination appeal. As occupiers deploy multi-channel strategies, they will continue to locate in places with high footfall and the potential to enhance brands. Coupled with a weakening depth of occupiers, rental growth is likely to be muted, except for a few locations. Unique places that have destination qualities and offer engaging experiences at scale, thus encouraging long dwell times, will be the safest investments.
- Real estate is a local asset class in which access to information gives investors a competitive advantage. Investors with the greatest city level expertise are therefore the best positioned to create value through asset management and by sourcing the most attractive buying and selling opportunities. By developing deep expertise, retail real estate investors position themselves to make the large conviction calls that are required for sustained investment out-performance. Landlords must understand the overall demographic catchments, so that they can respond to changing occupier requirements.
- Total returns for many retail warehouses in the UK currently look relatively high compared to other parts of the market. We believe income is only likely to be sustainable in the short to medium term. Well-let, well-located schemes should continue to deliver strong income returns. But longer-term sales will leak online to in-town locations and to super-regional malls. The reduction in the relative importance of convenience means investing in many retail parks may be imprudent.



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CONTACT US AT :

Aviva Investors
St Helen's, 1 Undershaft
London EC3P 3DQ

www.avivainvestors.com