Showrooming or Norooming?

eCommerce - the impact of on property

cordeasavills

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Key conclusions

- Online spending in the UK is ahead of Europe but Europe is following suit
- Squeezed budgets have altered consumer purchasing behaviour
- Pricing pressures are particularly acute on third party brand retailers
- Retailers with strong own brands and control over distribution will have a greater control over pricing
- Whilst stores remain a place where customers interact, retailers will be forced to reduce occupancy cost leading to portfolio rationalisation
- There is a trend towards Showrooming, "Click and Collect" and mobile commerce
- New technologies will enhance the online shopping experience
- Winning retailers will invest heavily in multi-channel operations at the expense of physical retailers with geographic over-reach
- Winning assets will be in prime locations with destination stores or will be well located dominant schemes
- Poorly located assets or those in lower tier retail centres will be hardest hit
- Distribution - operators will continue to require large sheds for national and regional distribution hubs.
- Demand for smaller satellite distribution centres will support rents and positively impact property and land at the edge of major population centres where supply is tight.
- Re-letting risk for satellite sheds may be lower than for large centralised fulfilment centres.

Commerce to the consumer

Bringing commerce to the consumer is nothing new. From the medieval trans-European pedlars who laid the foundations of the modern day consumer society to the 'ding dong' of the Avon Lady, enterprising salesmen and women have hawked their goods from door to door in search of custom. However, the product range was limited and so was the ability to directly compare prices and quality. The internet solves this by bringing the global market place to the customer's living room.

Traditional high street and in-town shopping centres have already been hit by decades of out-of-town developments as well as the weakening of consumer sentiment since the start of the economic downturn. Increasing taxes across Europe and higher energy and utility bills in many geographies have reduced expendable income. "Squeezed consumers" are increasingly using price comparison sites and purchasing online to maintain their standard of living.

Online purchasing behaviour is expected to remain intact with economic recovery as eCommerce becomes a mainstream retail channel. High streets have been hit by the rise of e-commerce as online retailers have lower fixed cost than physical "bricks and mortar" retailers and consumers go for the lowest cost option. However, the pricing gap with multi-channel retailers continues to narrow.

Price pressure on third party brands retailers

There are severe price pressure for retailers with a high degree of well-known third party brands because it is easy for shoppers to compare prices for example books, music and consumer electronics. Some categories such as pharmacists, DIY, club stores and high volume discounters have been more resistant.

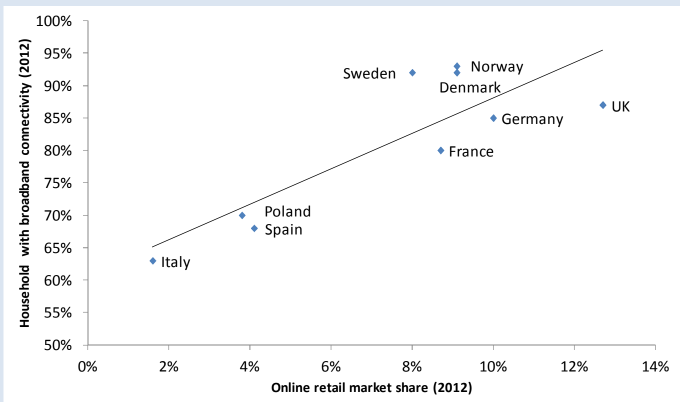
In the luxury sector, retailers have built significant brand equity and benefit from high margin operations. Premium locations add to the brand value and online channels have complemented the store network, improving retail productivity by offering cross selling opportunities. Retailers with strong own-brand products make price comparison more difficult and so limit price erosion and protect margins. Similarly, vertically integrated branded apparel firms can control both manufacturing and distribution of their products, enabling greater control over pricing.

eCommerce North-South European divide

Since 2006/07 growth in internet sales has contributed approximately half of overall UK retail growth. The proportion of online spending is much higher in the UK than it is in Europe, However, online retail is expected to develop throughout Europe with other European countries following a similar trajectory to the UK.

Lower use of eCommerce in Southern European countries has been attributed to:

- Less extensive broadband availability
- A greater use of cash payment
- Lower levels of catalogue / home-shopping
- The reluctance of customers to pay for delivery charges



Source: Eurostat, Centre for Retailing Research, Cordea Savills

e-Commerce the impact on retail property

As the volume of internet sales grows this will further impact retailer margins and will reduce demand for space - reducing sales per unit area and profitability of physical stores. Bricks-and-mortar will take on a different role as the retail landscape evolves. Retailers will be forced to reduce their overall occupancy costs and store portfolios will change significantly as rationalisation takes place. The number of stores will reduce and there will be a shift to larger stores displaying a wider range of point of sale products. Primary locations with destination stores will continue to prosper at the expense of secondary locations.

At present very few retailers offer genuine destination stores (Apple, Abercrombie). Most retailers rely on passing footfall. We expect to see a greater differentiation between unexciting 'maintenance shopping' for necessities and 'leisure shopping' in dominant venues such as the Westfield shopping centres in London (and soon opening in Milan). However, stores will remain a place where customers interact with the retail brand as part of a multi-channel environment of in-store ordering and staff expertise.

Standard store based retail will continue to offer a tactile shopping experience fulfilling the 'instantaneous gratification' and social aspects of physical shopping as well as acting as community meeting place. The store continue to provide an opportunity for retailers to sell complementary products which is sometimes more difficult to achieve online.

Multi-channel retails are fighting back with an enhanced customer experience and using there own stores to showroom the e-Commerce divisions of their operations.

Growth of "Showrooming", Click and Collect and M commerce

"Showrooming" is where customers visit stores to evaluate goods, then compare the prices and buy online either in store, or at home or on their phones. Stores are a channel to touch and to try goods and a place for pick-up and delivery. Consumers who are wary of using credit cards (more common in Southern European markets where online payment is underdeveloped) can reserve online and use in-store terminals (in showrooms) for payment.

"Click and collect" services have proved popular with UK and French consumers

- They provide convenient, free next day in-store delivery
- They can resolve failed delivery problems
- Customers avoid paying shipping costs for return/exchange items
- In France free drive-through collection services are proving to be popular (e.g. Auchan hypermarkets).

Increased use of mobile commerce tactics using mobile optimised sites or smartphone apps. For example geofencing, where customers are targeted as they enter the vicinity of stores, will help embed Showrooming into consumer shopping habits. Mobile and tablet advertising spend will grow dramatically driving growth of M commerce. However, technology investment is displacing capital for investment in physical stores and there is a risk that stores will be seen as a "public good" - they benefit everyone but nobody is willing to pay for them.

Winning retailers/strategies

- Larger operators who invest heavily in infrastructure that supports a coherent and flexible e-commerce or multi-channel platform will outperform. These retailers:
    - Use all channels to communicate with their customers
    - Have a large customer database offering a single view of customers who may move frequently between physical, online and mobile channels (Tesco, Sainsbury)
    - Have the right balance within their property portfolio
- Operators who can maintain sales volumes with a smaller portfolio - either smaller stores or fewer, larger 'flagship' stores displaying a wider range of products
- High margin operators - e.g. luxury retailers
- Retailers with strong own-brand products / vertically integrated - can control distribution and pricing
- Specialist stores, pharmacists, home improvement
- Club stores and high volume discounters
- Convenience store supplying prepared foods. Multi-brand retailers who can consolidate brands under one roof

Struggling retailers/strategies

- Low margin operators will struggle to afford to provide a differentiated shopping experience
- High degree of well-known third party brands where price competition is fierce
    - Electronics
    - Books
    - Music
    - Travel
- Unexciting 'maintenance shopping' for necessities
- Retailers whose strategies have not adapted sufficiently from historical geographical expansion to extending brand reach and increase sales. They put market share ahead of profitability in the hope of reaching scale and dominance in their sectors. These strategies are no longer appropriate for the evolving e-Commerce environment.
- These retailers need to adapt to survive by rationalising their store footprint, repairing their balance sheets and restoring profitability

Third-parties a threat / opportunity

Third-party marketplaces such as Ebay (3P), Amazon (1P+3P) are enlarging and non-store retailers with a significant share of the e-commerce market are now looking for a physical presence. Both Amazon, through "lockers", and eBay, through pop-up showrooms, are exploring bricks-and-mortar operations.

Real estate companies are also entering the third-party space, acting as aggregators for example Intu Properties plc, owner of the Trafford Centre and Lakeside shopping centres in the UK, is creating a national brand for its centres and launching a retail website (Intu.co.uk) allowing customers to buy from a variety of retailers in one transaction as if they were in a shopping mall.

Future trends

New entrants or companies with international expansion plans will use a small number of large 'flagship' stores, to highlight the breadth and depth of their range, whilst their websites will be used to service areas not covered by the smaller store base. New technologies will enhance online shopping:

- Virtual dressing rooms and fashion feedback apps
- Virtual stores and virtual shelves on subways
- Social networking sites which may be used to generate online sales leads
- Flash sale websites and limited time discounts websites (e.g. Groupon)

Online shopping will become more of a leisure activity with an increased entertainment factor.

Overview of the impact of eCommerce on distribution warehouses in the UK

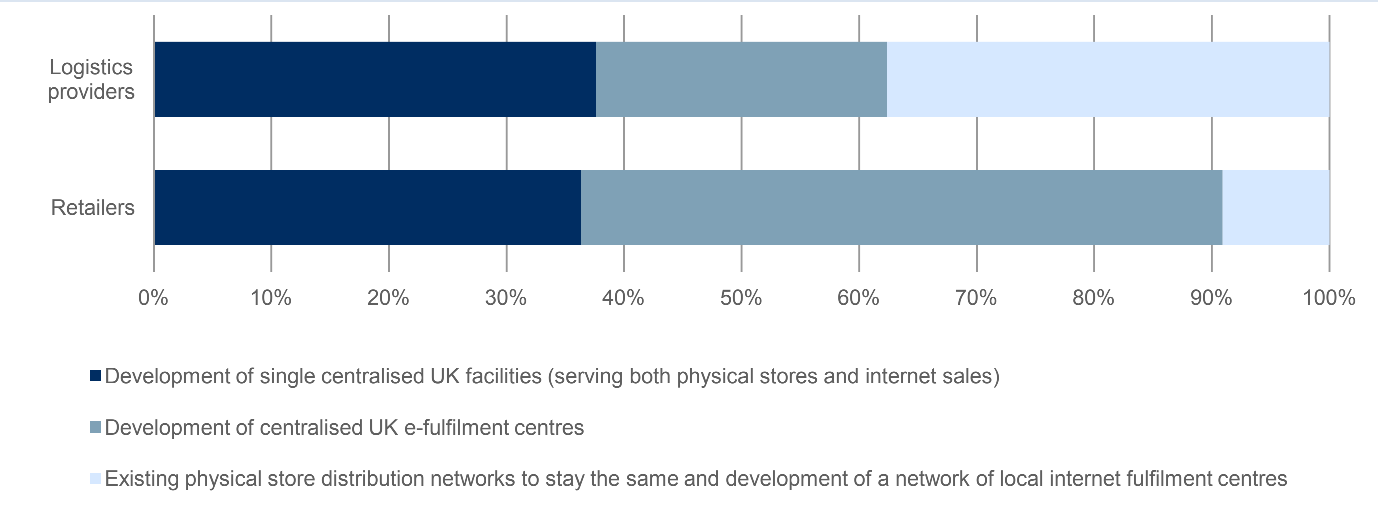
A key differentiator for retailers is delivery timing and customer tolerance of erroneous orders is diminishing. As such eCommerce is having a profound effect on logistic networks. eCommerce and multi-channel operations require delivery to more and varied destination points. The resulting dispersion of pick up and destination points requires substantial investment in fulfilment infrastructure and significant changes to the configuration of the supply chain, which will include a wider range of logistic properties to overcome the 'last mile' problem.

Growth to date has been largely supported by existing infrastructure but future growth will need higher-specification logistic buildings that can handle greater levels of automation. These may differ from the majority of current built stock in terms of size, configuration and specification, for example high throughput, cross-docking capabilities. However, this will represent additional net demand for new operations and should not adversely affect demand for existing modern stock in the medium term.

There is no one model that firms are adopting but there is a trend towards centralised fulfilment centres supported by a larger number of local satellite distribution centres. Operators will continue to require large sheds to act as national and regional hubs for storage and distribution: major e-tailers typically need warehouses of at least 500,000 sq ft and grocers are looking to expand fulfilment centres and 'dark stores'. However, rapid delivery necessitates proximity to multiple delivery destinations and parcel delivery networks. This will drive demand for smaller satellite warehouses (trend towards 100,000 sq ft, with mezzanine and ancillary space for packing and returns, good security, a large number of loading docks and cross-docking facilities) that are located near to final delivery destinations, typically at the edge of major urban areas where there is also access to labour.

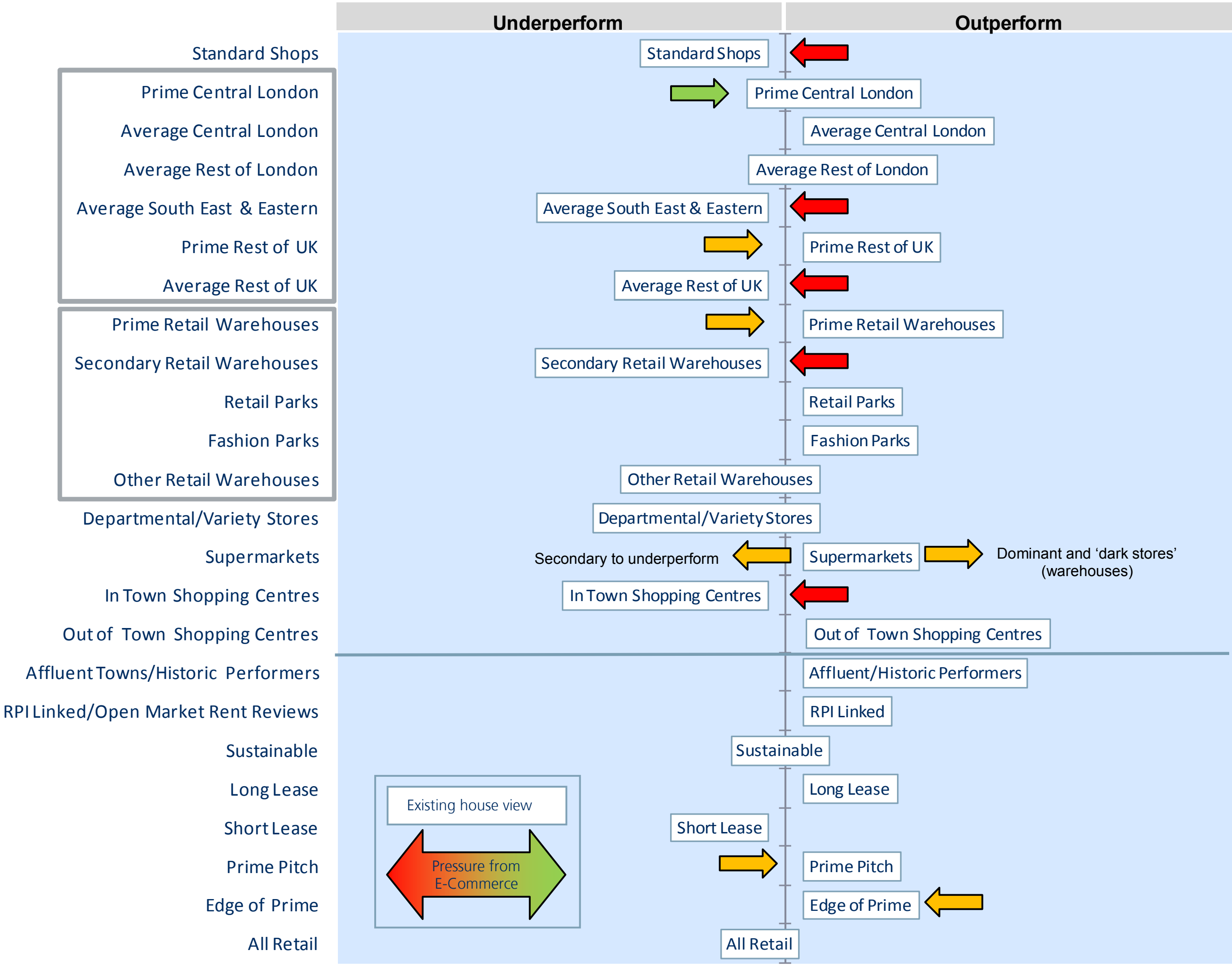
There is increasing investment demand for large lot-size prime properties, but this is increasingly reflected in higher prices for more liquid prime assets. We believe demand for smaller lot-size satellite distribution centres will support rents and impact on property and land prices in the vicinity of major population centres where supply is tight. Moreover, re-letting risk may be lower for satellite sheds than for large centralised fulfilment centres.

How will the distribution model change? Variety of logistics models - no one solution



Source: Savills Research 'E-tailing & the impact on distribution warehouses'

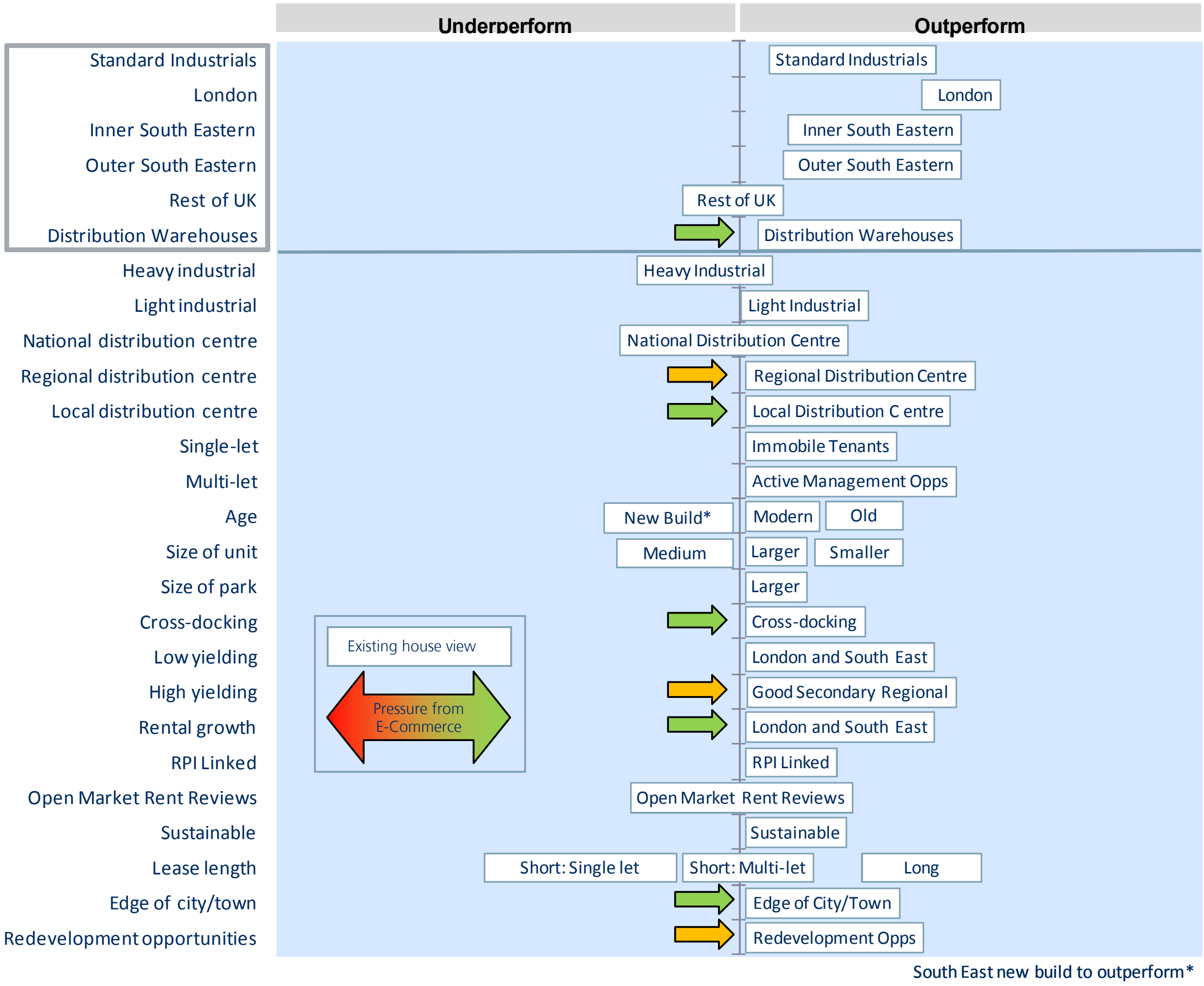
E-Commerce impact on retail sector – overall negative pressures, except on prime/dominate stores



Retail House View agreed Q3 2012, e-Commerce tactical moves agreed at Q1 2013

Winning retail assets/locations	Struggling retail assets/locations
▪ Institutional-quality property is generally healthier ▪ The best retail space will benefit as customers and retailers migrate to superior centres ○ Major high streets, dominant shopping centres, dominant supermarkets and 'dark stores' (warehouses) ▪ Primary locations which offer genuine destination stores (Apple, Abercrombie) and 'leisure shopping' with an increased entertainment factor to drive footfall (e.g. Westfield) ▪ Retailers will continue to focus on urban markets and centrally located stores ▪ Renewed emphasis on local / convenience formats ▪ Well located retail warehouse and retail parks with good fundamentals (location, dominant or with little competition) where rents are still relatively cheap compared to the high street. Ample parking is needed for click and collect and/or drive through facilities.	Portfolio rationalisation will result in the closure of many underperforming stores – many retailers will abandon tertiary and some secondary markets leading to increased vacancy in lower tier retail centres ▪ Secondary/tertiary high street retail will struggle as consumers choose the lower cost option ▪ Poorly located, inferior shopping centres will be hit hardest – particularly those removed from daytime working populations ▪ Smaller retailers and big-box out of town stores designed to support non-food sales may face a more difficult transition. There is a risk that secondary retail warehouse let to low margin operators will be hit hard ▪ As more consumers purchase staples online and from discounters they will supplement this with less regular visits to supermarkets. ○ Supermarkets where there is competition or limited catchment will suffer as sales per unit area declines

E-Commerce impact on industrial sector - overall positive pressures on distribution warehouses



Industrial House View agreed Q1 2013, e-Commerce tactical moves agreed at Q1 2013

Smaller satellite distribution centres	Large national /regional distribution centres
Increasing occupier demand for satellite distribution centres ▪ Support rents and impact property / land prices close to major cities/towns where supply is tight ▪ Lower re-letting risk may be lower for satellite sheds	Increasing investment demand for large lot-size prime properties ▪ However, this is increasingly reflected in higher prices ▪ Higher re-letting risk for large centralised fulfilment centres

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