A brave new world of retail

How will technology change the real estate market?

by Richard Gwilliam, Head of Research at M&G Real Estate

Retail has changed beyond all recognition in the past two decades. Globally, ever more consumers are doing at least some of their shopping online, and they increasingly use portable or handheld devices to do so. They are cost-conscious and, at the same time, keen to experiment with new technologies and gadgets.

What does that mean for the future of traditional stores — and those who own them? It would be naïve to expect that all stores will survive the technology revolution in their current format. But we believe that it would be equally naïve to sound the death knell for physical retail emporiums.

To thrive in this brave new world, stores will need to offer experience, ease and customization. Those retailers and investors who are most able and willing to adapt to the changing needs and desires of consumers — both in the short and long term — will be rewarded with higher sales and higher returns on property.

Near-term challenge: the many faces of online retail

We do not see e-tailing as a threat to property, but as a necessary evolution of an additional purchasing channel. Overall, it will reduce global net demand for physical stores, but we think the impact will not be as dramatic as many market participants believe.

Easily digitized traditional retailers (such as those selling books, music or films) were among the early technological losers, resulting in some notable bankruptcies. Online shopping with home delivery has also affected physical stores. Arguably, however, much of that switch has already taken place, particularly in countries with high internet penetration.

Retailers can adapt to the changing consumer demands by accentuating the "experience" aspect of shopping. Retailers can increase footfall by providing leisure activities in-store — from serving coffee to hosting events and even overnight camping.

Another route is through offering convenience. The latest, rapidly growing trend is for "Click & Collect" shopping, where products are ordered online and picked up in person. For consumers, it offers lower costs than online delivery and also the convenience of choosing when and where to collect. For retailers, it has the advantage of being more "shop-neutral" than home-delivered online shopping, with collections often taking place in stores (though lockers and drive-in collection hubs are also used). This trend is changing the desired format of shopping places as well as creating opportunities for strategic partnerships between stores to serve as collection hubs.

Merado Daikai, Kobe, Japan

A conveniently located neighborhood shopping center, with a strong focus on food retail.

The popularity of Click & Collect in the United Kingdom — one of the first adopters of this trend — has meant that online deliveries directly to the consumer actually declined marginally over the past five years, in contrast to the astounding growth of e-tailing overall.

Who will survive the online revolution

Retailer characteristics	Examples
Goods that people like to see/touch and that are not easily digitized	Food/groceries; clothes; big-ticket items
Competing on criteria other than just price	Luxury stores; independent retailers with strong USP
Convenient location	Public transport links; free and ample parking
Leisure/experience offering	Eating and drinking venues; cinema and other leisure activities; in-store events; personalized service

The healthier global economy also bodes well for the retail sector as a whole. The cyclical downturn — caused by the global financial crisis and the ensuing recession in many countries — has also been an important factor responsible for the retailer administrations of recent years. Growth is now recovering, so, while some retailers will continue to fall prey to the changing consumer demands, we expect that a number of the closing stores will be replaced with new ones, including new formats.

Landlords will need to consider showrooms, pop-up stores, and Click & Collect depots. While these new bricks-and-mortar requirements may be a little different from traditional stores, demand for them results from e-tailing and the wider multichannel offer, rather than being challenged by it. In many cases, occupiers may want more flexible leases and, although not widely used at the moment, some type of turnover-linked rents.

Overall, we expect technology in the retail sphere to intensify competition and polarization. As a result, only places that create a reason for consumers to visit them can thrive. Investors need to bear this in mind when considering their property portfolios and positioning their retail assets.

Gascoigne Road industrial unit, London, U.K.

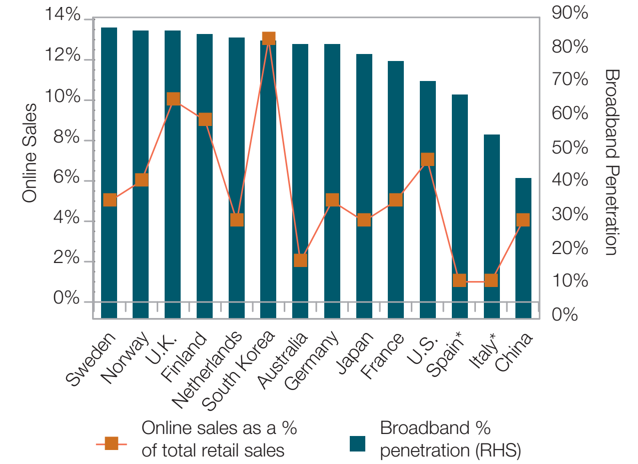
A well-specified asset in East London, serving as the main distribution for a major men's clothing company and serving both its network of stores and online customer base.

Long-term challenge: 3D printing

One technology that has the potential to alter the way we think about manufacturing, retailing and real estate is 3D printing (also known as "additive manufacturing" because it adds successive layers of material under computer control to create the final shape). The technology first emerged in the 1980s, but has only recently become quicker, cheaper and more flexible.

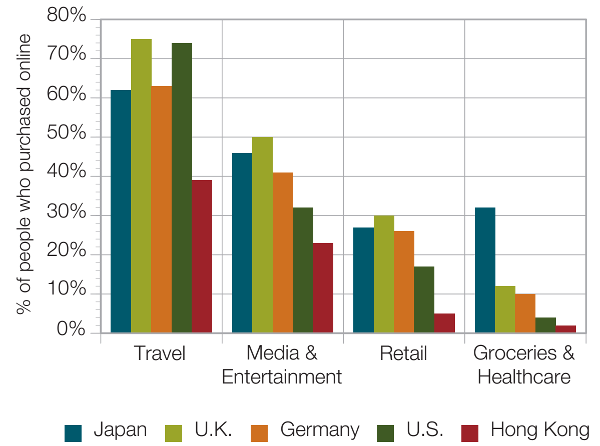
We expect the short-term impacts of 3D printing to be limited, but, looking a decade or more into the future, we see it materially affecting the manufacturing, retail and real estate worlds.

Broadband penetration and online share of retail sales



Sources: Eurostat, IHS,; Euromonitor, Cushman & Wakefield; data as of 2012
**Online sales % of total retail sales for Spain and Italy are 2011 approximations*

Preferences in online goods purchases



Source: Google, Consumer Barometer

Investment Opportunities

- Properties that are integral to a retailer's multichannel offer, which include leisure facilities and are in convenient locations
- Modern logistics (including in China and the rest of Asia)
- E-tail facilities in the U.K., Germany, France and Sweden

Some manufacturers have already started using 3D printing, and certain traditional production lines could face significant decline in the future. Retailers primarily use the technology at present to enhance the in-store experience, by allowing people to customize and 3D-print products. It is also used for spare product parts. Looking ahead, retailers may be able to provide fully customized products in-store for consumers.

That could lead to lower demand for manufacturing space, but certain locations might actually benefit by onshoring — moving industrial processes back to the home market. This trend, which has already been observed in the United States and Europe, reverses some of the offshoring that occurred during the past few decades.

If personal 3D printers gain widespread use, they could reduce the need for retail and logistics space because people would be able to print their purchased items after buying them online. This scenario seems a long way away, however, and manufacturing and retail physical space will still be required, albeit in different forms.

Finally, with actual houses having already been 3D-printed in Amsterdam, additive manufacturing could play a significant role in the cost, speed and flexibility of property design and construction.

Skeptics cite the lower quality of finishing, the reduced durability, the limitations in materials that can be used and — most importantly — the inability of 3D printers to mass produce. Although these are genuine concerns, technology is evolving quickly. Furthermore, history offers many examples of long-term technological impacts being underestimated. As Bill Gates said in his 1996 autobiography: "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction."

Investment implications

On the occupier side, investors should focus more on adaptive retailers that do not simply perceive online as an additional individual revenue stream, but embrace it as part of a multichannel package in order to provide a complete offer to their customers.

Retailers that value the leisure and experiential side — including investing in R&D, experimenting with 3D printing, marketing via online channels or even collaborating with start-ups — should be sought after. Retailers that are bound to be replaced by technological innovations in the future and those that fail to adapt to the changing shopping habits are most likely to suffer.

Investors, for their part, can play a significant role by collaborating with occupiers to enhance their assets' capacity to support multichannel use. Space configuration to suit "showrooming," mobile applications, free WiFi or the use of more technologies, such as iBeacons and geocoding, can help assets fit into the modern retail landscape.

For assets that are unlikely to benefit from the evolving retail landscapes, investors should consider alternative uses — be it residential, leisure, offices or even a Click & Collect hub.

Conclusion

As retail technology evolves there will, of course, be winners and losers. The losers have been well-documented, with a fair amount of traditional retail "bricks and mortar" space having suffered already.

However, we see the other side of the coin as well, with physical space working together with technologies and, in many cases, expanding and benefitting from it.

Everybody will be affected, so retailers and investors should already be looking at how they can future-proof their business and their investments. ■

Company Overview

M&G Real Estate is one of the top 25 real estate fund managers in the world by assets under management. It has over £21.4 billion ($33.4 billion) invested in a broad spread of properties across Europe, North America and the Asia Pacific region (as of Dec. 31, 2014). M&G Real Estate offers institutional investors a range of commingled strategies, as well as segregated-mandate and joint-venture opportunities, with a focus on generating long-term income-driven returns through prudent asset selection and active management.

CORPORATE CONTACT
Placement Agent:
John F. C. Parsons, Managing Director
MacGregor Global Investments
+1 312-274-6800 | jparsons@macgregorinvestments.com