E-Commerce and Retail Property Markets: (When) Should We Panic?

How do Retail Property Investors Respond to the Digital Revolution?
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Presented By:
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E-tailing does not take a very large bite out of retail sales at present . . . [but] investors should not be lulled into believing that store-based retailing will remain untouched. Selected retail categories, stores, and retail shopping centers will be adversely impacted as a result of e-tailing . . . E-tailing will accentuate the vulnerability of poorly located, poorly anchored, and poorly configured retail centers, especially power centers and second and third-tier malls.

-- **RREEF Strategic Outlook**: “Online Retailing and its Potential Impact on Shopping Center Sales”

**August 1999**

*Source: US Census Bureau and RREEF Real Estate Research as of June 2012.*
E-commerce and Retail Property Markets – October 17, 2012

Internet Retailing in Context: E-Commerce vs. All Retail Sales

- E-commerce sales up more than 12-fold since 1999, compared to barely 50% for retail sales overall.
- Online sales growing at consistent 40 bps of market share annually

Source: US Census Bureau and RREEF Real Estate Research as of June 2012.
Internet Retailing in Context: “Core” vs. “Non-core” Goods (1)

- Overall e-commerce share ≈ 5.5%
- Online penetration rate almost doubles to 10.5% in “core” categories, excluding goods shoppers rarely buy online:
  - products with low value relative to shopping costs (building materials);
  - expensive items for which on-site assessment is crucial (automobiles and diamonds);
  - less expensive items for which personal selection is still important (produce at a grocery store); and,
  - products purchased frequently in small quantities or values (personal-care items).

On-line Sales as Share of All Retail Sales - 2007 vs. 2011

Source: US Census Bureau, RREEF Real Estate Research as of June 2012.
Internet Retailing in Context: “Core” vs. “Non-core” Goods (2)

- Books, clothing, electronics, furnishings all quickly migrating online
- Autos, groceries, personal care, and building materials still safe

**On-line Sales as Share of All Retail Sales - 2007 vs. 2011**

- **Still safe (for now)**: Books, clothing, electronics, furnishings
- **Going, going, gone**: Autos, groceries, personal care, building materials

Source: US Census Bureau, RREEF Real Estate Research as of June 2012.
E-Commerce Sales and Trends

E-commerce dominated by just a few key retail segments

- Four “core” retail categories account for almost 2/3 (66%) of all e-commerce sales.
- The most dominant segments are also the fastest growing -- most up by more than 50% since 2007.

**E-Commerce Sales in 2011**

- Electronics & appliances*
- Apparel & accessories*
- Hobbies*
- Furniture & furnishings*
- Miscellaneous retail
- Health & personal care
- Food and beverage
- Auto-Related

**E-Commerce Sales Growth, 2007-2011**

* “Core” online sales categories
Source: US Census Bureau and RREEF Real Estate Research as of June 2012.
Approaching escape velocity

Online share of retail sales now surging

**E-Commerce as Share of All Retailing 1999-2020F**

- **Surging smartphone and tablet ownership / usage**
- Expanding usage among all consumer groups
- Showrooming
- Three words: value, convenience, selection
- **Virtual products** (downloads vs. CDs / DVDs / books)
- Consumer ease with online purchasing and payments
- **Strong support from physical retailers**
- Significant tech investments enhancing the online shopping experience and facilitating transactions
- Product and price transparency

Source: US Census Bureau and RREEF Real Estate Research as of June 2012.
E-commerce is much more than “Pure-Play” Retailers

- Retail chains are capturing a significant share of e-commerce
- 17 of top 25 online retailers have significant physical store networks (“multi-channel retailers”)
- Huge technology investments by multi-channel retailers

#### Total vs. e-Commerce Sales Growth at Key Retail Chains
**Compound Annual Growth Rates 2006-11**

*For illustrative purposes only.*

*Source: RetailSails.com, company filings, RREEF Real Estate Research as of June 2012.*
Device Ownership and Usage

Technology is transforming consumer behavior and retailer business models.

- Smartphone and tablet usage is surging across virtually all demographic groups
  - almost half (46%) of American adults own a smartphone (+11 percentage points 5/11-2/12)
  - rates higher among key groups: young, college-educated, HHs with incomes > $75,000
  - tablet ownership almost doubled in the last six months of 2011 (pre new iPad!)
  - iPad users now account for two-thirds of all mobile shoppers, driving 90% of all m-commerce

Smartphone Ownership, Key Demographic Groups, 2011-2012

The New Retail Mantra: Fewer and Smaller Stores

After decades of relentless growth, chains are shrinking store sizes

Retail Space, Store Growth, and Store Size
1983-2011 (Year 1983 = 100)

- Retail GLA has far outpaced store growth, yielding sharply larger store sizes – up 46% since 1983
- Historical size growth reflects:
  - larger store = more market share?
  - greater growth in suburban and exurban markets
  - shift in sales from local “mom and pop” retailers and toward warehouses, discounters, and other big-boxes
- 2011 is inflection point:
  - retailer focus on profitability over market share
  - efficiency gains from driving sales online
  - new retailing strategies
  - infill over greenfield store locations

Store sizes finally start to fall in 2011

Source: CoStar (Retail GLA), Bureau of Census (Stores), RREEF Real Estate Research as of December 2011.
New Store Paradigms: Finding the Right Footprint

National chains are shrinking their store sizes:
- shrinking prototypes
- introducing niche stores designed for a specific location or strategy
- smaller store concepts growing faster than full-size stores

Source: RetailSails, company reports, RREEF Real Estate Research as of June 2012.
The New Retail Mantra: Fewer and Smaller Stores

The Shrinking Office Products Store

Office Depot Store Prototypes

- Before 2011
  - Average Warehouse Store: 27,000 SF
- 2011
  - Average Prototype: 15,000 – 18,000 SF
  - Urban Format 5,000 SF

Office Depot is downsizing warehouse stores to 15K – 18K sf, and is developing smaller 5K sf prototype ideally for urban areas.

Officemax Store Prototypes

- 2006
  - Average Prototype: 23,000 SF
- 2007
  - Average Prototype: 13,000 – 18,000 SF
  - Ink Paper Scissors 1,500 – 2,000 SF

Smaller store prototypes contain about 2,000 of the most popular items of full-size OfficeMax store.

Staples Dover Store Prototype

- Pre-2010 Prototype: 24,000 SF
- 2011 Prototype: 18,000 SF
  - New Suburban 14,600 sf; New Urban 10,000 SF

Staples reduced "Dover" prototype size from 24K to 18K sf over time. New urban requirements are now about10K sf, while suburban footprints are 14.6K sf.

Source: RetailSails, company reports, RREEF Real Estate Research as of June 2012.
Key Conclusions

Retailing Trends

- **Fewer and smaller** stores
  - national chains in **fewer markets**
  - **smaller prototypes** and more urban niche stores
  - located **closer to shoppers**

- E-commerce will grab much **larger share** of retail market
  - consumers prefer online convenience, selection, and pricing
  - retailers drive more sales online
  - **technology** enables easier, faster shopping, greater **product and pricing transparency**

- Growing **redundancy** of shopping centers in secondary locations

- **Stores are not obsolete**
  - **community crossroads**: the original social network
  - logistical **delivery constraints**: “click & deliver” vs. “click & collect”
  - (some) people still like to shop
Key Conclusions

Implications for Retailers and Shopping Centers

- Successful centers and shopping districts will have more, smaller stores
  - smaller stores allow more retailers into same amount of space → more exciting and diverse retail environments
  - higher sales volumes will drive higher rents

- The best malls and high-street districts will attract larger flagship stores as extension of branding

- Commodity retailing and secondary locations will suffer
  - e-commerce (and related trends) to double the number of obsolete centers within a decade
  - tough for physical retailers to compete with pure-play retailers on efficiency, convenience, selection
  - big box and power centers need new strategic purpose
Chicken Little Revisited

**August 1999**

**Early Conclusions**

*E-tailing does not take a very large bite out of retail sales at present . . . [but] investors should not be lulled into believing that store-based retailing will remain untouched. Selected retail categories, stores, and retail shopping centers will be adversely impacted as a result of e-tailing . . . E-tailing will accentuate the vulnerability of poorly located, poorly anchored, and poorly configured retail centers, especially power centers and second and third-tier malls.*

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**The Losers**

- commodity retailing and secondary locations
- big box and power centers

**The Winners**

- luxury retailers focused on service and unique products
- discount and value retailers that can compete with online retailers on price and convenience
- well-located grocery-anchored centers with service and food tenants less vulnerable to online sales
- retailers, retail centers, and urban shopping districts that offer consumers distinct, compelling experiences
**Biography**

**Andrew J. Nelson, Director, Research**

Mr. Nelson is currently a Director in RREEF Real Estate's Research group, based in San Francisco. He joined the firm in July 2006 with more than 20 years of advisory and industry experience in the areas of real property development, use and investment. Mr. Nelson is the retail property specialist for the Research team, and also serves on RREEF Real Estate's Sustainability Council, where he leads global research on sustainable investment practices. Among other industry involvement, he serves on the North American Research Task Force for the International Council of Shopping Centers (ICSC), the Research Advisory Committee of the US Green Building Council (USGBC), and on the editorial board of the Journal of Sustainable Real Estate. Prior to joining RREEF, he was vice president of HOK's Advance Strategies group, where he was national practice leader of the real estate strategy service line. Previously he held leadership positions with Deloitte & Touche's real estate consulting practice, the US Department of Housing and Urban Development, and with Sedway & Associates, as well as managing a construction finance program for the World Bank in Russia. He earned a Master of City and Regional Planning Degree from the Kennedy School of Government at Harvard University and a BA in Economics from Harpur College at the State University of New York in Binghamton.

*For more information*

**Bricks and Clicks: Rethinking Retail Real Estate in the E-commerce Era**

Andrew Nelson and Ana Leon, RREEF Real Estate Research, Strategic Outlook #84, July 2012
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