2020 - Seizing the Opportunities

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Over 2,000 years ago, Euripedes said, “There is in the worst of fortune, the best of chances for a happy change.”

He wasn’t of course to know of the global financial crisis early in the 21st Century, but his attitude is shared by the distinguished panel of leading investors and occupiers interviewed for this thought provoking report.

Their collective view is that property markets are undergoing a fundamental correction. The financial crisis has been its catalyst, not its cause. The resetting has been brewing for at least 10 years.

In this changing environment, new and exciting opportunities are emerging. To take full advantage of them requires one fundamental change. Our industry can be overly compartmentalised. Improved dialogue between occupiers, owners and investors will be critical. Our hope for this report is to kick-start a constructive and on-going dialogue.

This would indeed represent a “happy change”.

What is keeping our panel awake at night?

Behaviour is determined by what is given attention. So what are the issues currently pre-occupying senior members of the industry?

Ed Jenkins spoke for the whole panel, *“Taking the shopper for granted is really a thing of the past. We forget at our peril that unless shoppers are attracted to the shops and spend money with the retailer, there is no viable retail market. And shoppers are subject to a host of new influences and live in a world significantly different from that of their parents.”*

THE ‘ALWAYS ON’ WORLD

“There is no reason anyone would want a computer in their home”. So said Ken Olsen, President of Digital Equipment Corp, in 1977.

Fast forward to 2010 and technology is now woven into the fabric of all our lives. The pace of change is breath-taking. Myspace and Facebook arrived only in 2004…YouTube in 2005…Twitter in 2008.

Technology is re-shaping the world and also retail. “The networked computer is physically transforming the city faster than did the automobile“, writes US academic Joel Garreau.

Add to basket

Online sales currently account for less than 10% of retail turnover - much more of course in categories like books, music and electrical goods.

The functional benefits of online shopping, convenience and accessibility, are clear. However there are emotional benefits too ~ parcels received can feel more like a present than a purchase. Net-a –Porter is now delivering their black boxes with tissue paper and beautifully wrapped in ribbon to over 1,000 customers every day. The average order is £500.

How big will online get? The panel expects the overall market share of online to increase to between 20% and 30% over the next 10 years.

Internet shoppers in the UK now spend over £5 billion a month.

Last Christmas, spending on the Liberty website increased by 110% over the previous year.

Tesco, already operating online shopping sites in Korea and Ireland, is launching online in China, Poland and the Czech Republic.

This gives rise to issues that are now being tackled

- Retailers are aware that the current multiple delivery system is inefficient and, in a resource constrained environment, unsustainable.
- In a slow growth economy, online sales growth must lead to pressure on turnover generated from shops.

“As a percentage of sales are deflected away from stores and into the online space, or are shared with the online space, the profitability of those stores is going to go down as both margins and volumes decrease in many locations“ (Scott Malkin).

- The “open all hours” access to online will place more pressure on shops. Customers can now buy online whatever they want, from anywhere in the world, whenever they want to. *“Nobody recognises boundaries, so there aren’t any boundaries”* (Crispin Tweddle). Only 10 years ago, many John Lewis stores were shut 2 days a week. Jeremy Collins commented, *“Longer opening hours have been critical to providing high standards of customer service but this has created significant operational challenges and attendant costs.”*
- This will have a further impact on turnover-linked rents. Retailers can attribute online turnover to a specific store, by linking the customer post code to store catchment areas, but most do not. A multi-channel environment also creates problems for retailers who pay sales commission to their staff. However, it is unlikely that most retailers will change how they account for online turnover.

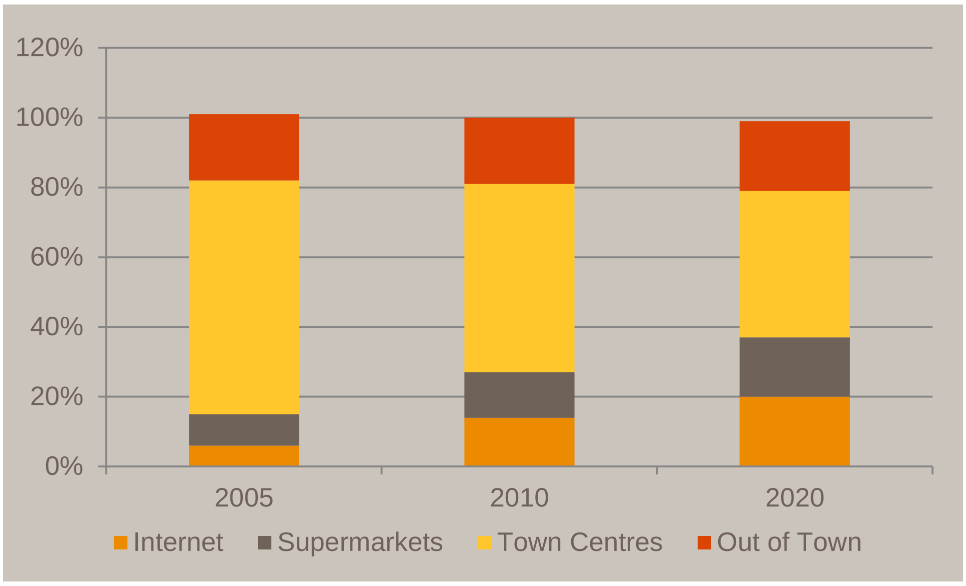
Inditex is now extending the trial launch of Zara online into Austria, Belgium, Ireland, Luxembourg and the Netherlands.

Consumers are now far better informed about both products and world events. No individual retail store can match the breadth of offer available through the web, so a wide product offer is itself no longer sufficient for attracting shoppers. The role of flagship stores, for example in Bond Street, is to showcase the brands to drive sales through other channels as much as through the store itself.

Clicks and Bricks are Complementary

The concept of "online" in isolation is obsolete, particularly with the advent of smart phones and the mobile internet. Where now do bricks end and clicks begin? Jo Staveley pointed out that people can research in the catalogue, try out in a shop and then buy online.

- Multi-channel retailing has increased overall customer spend. The John Lewis experience indicates that customers who use both a store and online spend annually more than double a store-only customer. *"It really is about multi-channel. By the middle of the decade John Lewis Direct will be contributing probably a quarter of our sales"* explained Jeremy Collins.
- In the last 12 months John Lewis Direct has made a huge jump from 35,000 to over 90,000 items online and expects to move to around 220,000 lines during the next few years.
- Far from being a threat to town centre retailing, the internet may prove to be its saviour. The graph shows that the market share of non-food sales attributed to town centres is expected to have declined from 64% in 2005 to 43% in 2020. Town centres have been losing market share primarily to supermarkets and retail parks.



Source: FSP

- The positive relationship between websites and shops will reinforce the role of the town centre outlets.
- Retailers will need carefully to consider the mix of products in their stores to complement their online business. They can offer in-store merchandise with a limited supply that cannot sensibly be offered on-line.
- Enormous changes are taking place in the traditional production cycle for fashion brands. These can only accelerate over the next 10 years. It is already possible for shoppers to order directly from some catwalk fashion shows.

Media goes multi

With so much technology at our fingertips, the watchwords for retailers are immediacy, real-time and transparency. There really is nowhere now to hide.

- News of a positive, or disappointing, in-store experience for one person is quickly spread amongst a whole group on social sites. This can lead to a widespread surge or boycott, unimaginable 10 years ago. How many retailers, restaurateurs or shopping centres are aware of their reviews on social networking sites?
- The arrival of price comparison apps gives shoppers near perfect knowledge, thus reducing the scope for price variations.
- Social media sites are now used by over 28 million people in the UK. Nevertheless, human beings remain innately social animals. We all need real human contact. Teenagers using Facebook, Twitter, Foursquare and Buzz morning, noon and night, still like to meet up with their friends. So one of the challenges for shopping centres over the next 10 years is how to give these customers reasons to visit. Centres are being designed and built that provide space for the community to create and curate and edit for their own needs *"An extension of social networking within a physical space"*. (Beverley Churchill).
- To dedicate space to experience and to relationship building in order to develop the brand is very hard. The property industry generally finds it difficult to value brand and to understand the kind of potential upsides that a good solid brand can bring to a business. You only ever see the benefit when you exit, that's when it's realised. In the meantime, questions are asked such as, "Why would you want to give that space to that brand; why would you want to give away a £3 million asset to that brand for six months to do something else?" Talking of Covent Garden, Beverley Churchill said, *"As the main landlord, I think we definitely have an obligation to make the best of it. But we have to go at the pace that's dictated by the local area trust, the Council, English Heritage, just generally taking people with us on that journey."*
- The retailers are also carefully considering how to maximise the social media opportunities to attract customers and secure their loyalty.
- All this new media stuff is not just for young people. YouGov reports that women aged over 55 are the most likely group to consider an iPad purchase.

NEW YORK, LONDON, PARIS, MUNICH…..

The world is getting smaller. The globalisation of the retail supply chain has been very high profile. It has led to 15 years of clothing price deflation and scandals about factory working conditions.

Less recognised is the impact of retailer globalisation. Lindsay Page said, *"There will be more pressure to be international because you won't be getting growth out of your home market. If anything, people will be consuming less. So if you're going to get more growth, you will have to go into new markets".* In the last 2 years, Ted Baker has opened no shops in the UK, but is opening 10 shops this year *"from Santa Monica to Sydney"*.

- The developing markets, particularly China and India, are going to exert enormous influence on brand identity, authenticity, supply and distribution. Retailers can grow their business in emerging markets in sites at lower cost

In Europe there are just 35 cities with over 1m people. There will be over 200 in China by 2020.

Tesco is now one of the largest developers in Europe with a £35 billion portfolio. The company also plans to open more retail space during the next 5 years in China than it currently has trading in the UK.

"In India there are 20 million people joining the workforce every year, with around 10 million mobile phones being sold every month" Clem Constantine.

- The continued validity of a UK Property Return is questionable. The 2 influences on return i.e. yield and rent, will be more and more dominated by global factors. It was overseas investment that last year drove the rebound in prices. If rent is derived from tenants whose income comes mostly from outside the UK, is that a UK return? It may be denominated in pounds, but that is as far as it goes.
- If retailers and investors are trading globally, there will be exciting opportunities for more landlords to extend the reach of their relationships and experience outside the UK.
- International expansion is always risky. However, on-line sales provide a relatively cheap way to test the water before opening physical stores.
- The effect of globalisation on shoppers is to raise awareness of global issues such as climate change and carbon footprint. At least some of our panel foresaw this might lead people from being consumers to conservers. Bill Hughes spoke about, *"a confluence of events, with the green agenda, global warming, Government and regulatory activity such as CRC (Carbon Reduction Commitment) coming together with the age of austerity induced by the financial crisis, to create a moment of significant change."*

MONEY, MONEY, MONEY…

By no means were all our panel persuaded that the financial crisis has fully arrived. Quantitative easing and continued governmental expenditure have so far disguised the full impact. Ironically, the property industry, more reliant on transactions than most, may have had an early taste of recession.

Across UK society in general, the impact has been more anticipated than experienced. However, the promised cuts in UK Government expenditure may precipitate a change. Andrew Jones noted that when looking at assets, one factor to be considered is the proportion of public sector employment in the catchment. *"Historically we used to think that high proportions of public sector employment meant the asset would be immune to the pressures of a recession. This time round, it's quite the reverse".*

The distinction between London and the rest of the country, particularly the North, is beginning to show up in terms of vacancy rates and retailer performance. The gap seems likely to widen.

The growth of UK sales density (total retail sales divided by total retail space) averaged about 3% a year in the late 1990's.

This contrasts with 2000 to 2005, when annual growth of overall UK sales density annual growth averaged about 1.5%.

More recently, from 2005 to 2010, there has been no overall growth in sales density.

Our panel all agreed that the UK is entering a period of, at best, subdued consumer demand. The time of exuberant spending and over-leveraged consumers is giving way to a time of living within one's means. This comes on top of an over-supply of retail space.

Over-supply has been caused by the addition of new retail space, weak retail sales and growth of on-line sales. So the outlook for overall rental growth (which at the macro level is directly related to growth of sales densities) is limited.

What are the panel seeing as the implications of all this?

- The position on rental levels at the macro level is of course not valid for individual locations. The best 100 locations have gradually taken an increasing market share over recent years. Sales densities in these locations have grown, resulting in continued retailer competition for space. By the same token, investor interest in the Prime and Super Prime locations will keep the yields low. Ed Jenkins anticipated an increase in JVs. *"Super Prime centres just don't get traded. There might have to be a reassessment of the balance between having the control or not having exposure to the assets if you insist on having control."*
- In Secondary locations there will be opportunities for active management which can identify and exploit its particular advantages
- The outlook for other locations is less positive and it is likely that in many cases, uses alternate to retail will need to be found
- Of the c £200bn of property assets held by banks, perhaps £40-£60 billion will not be fit for purpose.
- There will be a significant impact on the market of vast swathes of relatively under-managed, depreciating real estate will have a significant impact on the market. Banks don't usually have the resources or the set-up for the intensive management required
- The current absence of banks as a source of capital has created a huge gap which the institutions are in no position to fill. There is therefore a serious shortfall of capital for development
- The limited possibilities for new development in the immediate future put a much greater emphasis on working existing assets more intensively. Where there is development, it is likely that the buildings will be less heavily specified and they will be more easily adapted for different configurations
- In a difficult market, there is a new obligation for landlords to work constructively with their occupiers, to create the best possible trading environment. Bill Hughes commented, *"There is a focus upon getting people here (at Legal and General Property) to understand how retailers operate".* Ed Jenkins noted, *"The idea of maximising turnover for the retailer to maximise your rent is not something that most UK landlords have really got their head around yet."*
- Private landlords, unlike the institutions, are increasingly entering joint ventures with their tenants.
- The shorter leases, turnover-based rents and break clauses are all creating problems for valuers. One result, again amongst private landlords, is to focus on income. David Pearl's view of shorter, more flexible leases is, *"It might lower the value of your investment but my real interest is in rental income because that's what pays the wages."*
- The reduction of public expenditure and the changes to the planning regime are expected to create short term stasis. In the longer term, the localisation of

planning is anticipated to create a greater presumption in favour of development. The problems such a change will create for institutions with a nation-wide portfolio, in terms of keeping abreast of the distinctive planning regime in every planning authority, are daunting

THE MAN ON THE STREET

Staying younger, older

The demographic change of most interest to the panel is the ageing of the UK population. The age statistics are not in dispute, but the implications for shoppers and retailers are less clear.

Undoubtedly more of us are going to be living longer. Many of us will live way beyond our “3 score years and 10” For some of our panel this was felt to potentially depress spending. If older people are either non-productive or in savings mode, the effect will be to reduce GDP growth. It has been estimated that the population age profile now, compared with 20 years ago, will reduce annual GDP growth by around 0.5%. If the trend GDP was to be between 2.2% and 2.5%, this could reduce potential annual GDP growth by around 20%.

Older people are not necessarily attracted by the hustle and bustle of a big regional shopping mall. The success of Springfields Outlet Centre, adjacent to the Festival Gardens at Spalding, suggests that there is a market amongst older people still to be exploited

But set against this, is the way that “60 is the new 40, “50 is the new 30”. People are living younger, more aspirational, more branded lifestyles much later into life. This has created a real issue for the traditional older brands, but is an exciting opportunity for companies that can stretch into this sector.

From consuming to conserving?

The age of austerity will become reality .There will be a significant reduction in retail spend, both in value and volume. And consumers will move towards becoming conservers.

I think we are in the process of a significant evolutionary, if not revolutionary, change in behaviour.” (Bill Hughes).

- Sustainability, global warming and carbon footprints, having been pushed down the agenda by the financial crisis, will definitely be high on the agenda by 2020. But how quickly behaviour will change is more debatable. Currently, these issues are more prominent for companies and children than for adult shoppers.
- How does fast fashion - where everything is replaced every 6 weeks, fit with sustainability? Will this become an increasing challenge as children - now much more aware of the sustainability issues -become tomorrow’s shoppers?
- If there is to be a long slog out of this recession it is likely that shoppers will be more conscious of durability. So the sofa will need to last for 5/10 years but it will be refreshed with different coverings or cushions.
- Whether the next generation will have the same mind-set remains to be seen. They have largely been insulated from the realities of the recession. Social

issues such as product provenance, child labour in the Far East, carbon footprint and product air miles may be for them greater influences on product selection.
- Refurbishment of shop fits, rather than just new build, is being considered more often.
- Landlords are wrestling with complex new regulations on construction.
- By 2050 there is likely to be widespread international and domestic conflict over oil, water supplies and other resources. A significant moment is imminent when global warming, carbon footprint, air miles and consumption will all be interlinked. Non-renewable, resource depleting usage will be under far more scrutiny.
- Shoppers are already showing that re-cycling, re-using, re-covering are important to them. There will be a confluence of the green agenda with regulatory activity such as on the disposal of electrical goods. Shoppers will increasingly understand their own carbon footprint.
- Peak Oil in 2012/ 2014 will drive us away from a carbon economy. There will be far more emphasis on car sharing and public transport initiatives, including designated spaces for vehicles with alternative power. Both retailers and shopping centres will provide sophisticated home delivery.

RETAILING

In the middle of the road you'll get run over

More than 30 years ago, Suzy Menkes, then fashion correspondent for The Times, predicted the demise of the middle market. She was right. Premium brands and value retailers have gained market share at the expense of the middle market.

- The tougher market makes a more focused offer necessary. This will drive the existing polarisation of the market between a more cost effective operation and understanding the definition of quality, value and experience
- Retailers need to mean something valuable to their customers. This is the essence of being a brand and is independent of price position or exclusivity.
- The centre operator who really knows and understands his shoppers can then introduce his retailers to them, knowing what his shoppers want. This is a service that goes well beyond simply providing suitable retail space.
- Historically, many retailers have provided customer service on their own terms. The transition over the next 10 years will be an increasing recognition of the importance of being convenient, relevant, and engaging on terms set by customers.
- The discussion is now about the use of space for services that might add value to the product. Customer service is not just how to serve customers, but what services should be offered to them. So perhaps the beauty department is not just about selling bottles of perfume and lipsticks and nail varnish. It may be to provide a complete beauty service.
- The internet is already improving the knowledge of customers. During the next few years all retailers will have to match price, because the internet will enforce it. Competition will then turn on quality ~ of the overall experience and the product itself. The perception of quality and durability will become far more important over the next 10 years.
- On the other hand, the new Shoe Galleries in Selfridges (bigger than the Turbine Hall at Tate Modern) is the largest shoe department in the world, with over 5,000 pairs across 150 labels. Perhaps size alone can be compelling.

This leaner, meaner world will create more clearly defined winners and losers.

Creating a sense of place

With a largely US perspective, Marvin Traub, the New York retail visionary, writes, *"In recent years, shopping centres have seen declining market share and loss of traffic. I believe that the approach to shopping centres will need to be redefined over time."*

- In the UK a significant number of retailers decline to trade from shopping centres. Some because they believe their customers are not comfortable shopping there. Others are deterred by the current rent review system, thus challenging the valuation method for retail property.
- Shopping centres, like retailers, thrive when they have a distinctive brand. Those delivering a clear set of relevant values and benefits to their customers, both shoppers and retailers, will continue to do best.
- This is not easy to achieve. Lindsay Page*, "I've been to hundreds of shopping centres all around the world, and they are fundamentally the same however much everyone says, this is new, and this is better and this is whatever. Some are older than others, but they are fundamentally the same and functional."*
- Much of the space initially developed in China and India has been less disciplined and coherent than in the UK or US. Leading UK investors, together with their advisors, are increasingly involved in creating new centres across the world.
- All shopping centres now compete with the internet and other channels. Property owners are looking very carefully at the traditional 'anchors' in new developments. Westfield Stratford will be the largest urban shopping centre in Europe when it opens. There will be traditional anchors but also a real focus on boutique shops and independent retailers.
- It is essential for high streets and centres to create a 'sense of place', so that shopping is part of an overall experience.
- Property owners and developers will have to spend more, and work harder, over the next 10 years *"Grade A shopping centres will be determined by sales densities and rents will go up in Grade A centres, but I don't think that is very good news for the B or C centres",* (Scott Malkin).

Improving owner and occupier relationships

The panel was unanimous that the single most powerful change required in the industry is talking, listening and engagement directly between landlords and occupiers.

- Too many landlords, in the words of Martin Moore, "forget that we're actually in a service industry. We have to offer the right product at the right price in the right place. And once the deal is dealt, we've then got to continue to offer great service and value for money to try to keep those relationships flowing beyond the periodic tenancy terminations."
- Detailed discussions took place at the highest level in the midst of the crisis on monthly rents and service charges. "We have a better understanding now of some of the issues that retailers face and their business models. I would also like to think that retailers better understand their landlords' models too" (Ed Jenkins).

- All felt that this should be an on-going dialogue, not just when there is a problem or a negotiation required.

And the issues this dialogue should be focusing on to maximize opportunities over the next decade?

- The form of leases, to which the polarisation of the market is highly relevant.
- In prime locations, the existing lease structure is likely to persist. The system of 5 year rent reviews is confrontational, time consuming and expensive. The perceived defects deter some retailers from taking space in shopping centres but as long as there is sufficient demand to fill the space, the system is expected to continue.
- Detailed discussion to link rents to an index with a cap and collar. RPI was the index most often mentioned, but one respondent made the case for linking rent to changes in footfall, if shops are to become primarily showrooms, with purchases made increasingly on-line.
- The partnership business model run by Value Retail is more akin to a department store than a shopping centre- The brands can be relocated, changed in size or replaced. This requires hands-on work and detailed knowledge of retailing.
- There will continue to be a distinction between institutional investors and property entrepreneurs. The role of the institutions is quite rightly to match their liabilities, their obligations to pay pensions or insurance claims, with their income streams. Prime and Super Prime centres can offer this reliable income stream. However shopping centres that are businesses, rather than investments, will be more appropriate for property companies than institutions.
- John Milligan took the view that, *"If you control enough of a city, you can then start to do things in tenant mix terms and make things happen that no one individual can do. So people buying up estates and the growth of an estate again, I can see that happening, where you can then build a community at the end of the day.*"
- Martin Moore spoke in similar terms. *"Fragmentation is our weakness. Fragmentation of engagement; fragmentation of representation; fragmentation of ownership. You can see a huge difference in the ambience and performance between Oxford Street and Regent Street. And why is that? One reason must be that Regent Street is controlled and managed, and Oxford Street is under competing, fragmented ownerships."*

Redefining the retail experience

100 years ago, Gordon Selfridge used his store to offer 'theatre' and an unforgettable experience. At the same time, Spedan Lewis was offering a breadth of product and great service with price taken out of the equation.

Both retail models have stood the test of time. However, both "experience" and "service" need to be redefined in the internet age.

What is now the right balance of space for product, and for services that might add value to that product? How will values and perception of quality and durability evolve over the next 10 years? Will the next generation of shoppers have the same values as the current generation?

- The experience of the recent recession was that after the initial panic, shoppers quickly shifted back from sole focus on price, to price and quality being the issues. ..
- There will be far more hospitality in shopping destinations. Going shopping will be more about an experience and being with your friends and less about, "I'm going out to buy a sofa."
- Different formats for different locations. The grocers have shown skill and flexibility; from Tesco Extra to Tesco Express; and Waitrose in motorway service stations, standalone and Food and Home stores. Fashion retailers are now catching up - with pop-up shops and mobile retail units.
- REI in Seattle is a retailer devoting time and space to allow people to try out their product in as real an environment as possible. Their main flagship store has something like 900 sq m of space devoted to the experiential. Closer to home, National Geographic with its cold room for testing cold weather gear, is another example of pushing the boundaries of experience

Focus on communities

- Shopping centres will become more locally relevant, providing a place where people can find out about, and get basic training for, the jobs that are locally available.
- The traditional role of the landlord is to create an environment attractive to shoppers - car parking, toilets, cash point facilities and catering. Once shoppers are present, it is the job of the retailer to entice them into their shop.
- The traditional view gives no credence to improving the relationship between owners and the local community. Martin Moore's view is, *"that whole community stakeholder engagement thing is really important. Shopping centres are, by definition, at the heart of the community. And they need to offer a range of services to the community they're supporting, more than just the shopping experience. It will be a very interesting ten years for sure."*
- Traditionally, department stores have been the anchors for shopping centres. Although they command a decreasing market share, no satisfactory alternative anchors have been established. Supermarkets, multiplex and restaurants may drive footfall, but not significant fashion spend.
- As shopping centres cease to be single use locations and are integrated into their community, the variety of occupiers will increase. These may include pick up and drop-off points for on-line shoppers, or the provision of a creative exhibition space for temporary use by brands or community members to tell their stories. The facilities that are complementary to the retailers will depend on the nature of the community.
- There is likely to be a shift in land use away from conventional retail space. When jobs and money are short, planners will favour development that creates a relationship between economic, social and community development. It is possible that along with the new localism, planning may become more positive and proactive, rather than constraining and restrictive.

"We spend more time focusing on consumer trends and what people are doing, then we try to match our product to the people. We are very, very focused on creating spaces where people will be inspired to shop." (John Milligan).

- Liverpool One is a great example of a project creating a step change for a city - allowing two halves of the city to re-engage. With the waterfront visible from the city centre for the first time, suddenly the historic city raison d'etre was obvious.

In parallel, through the Year of Culture programme, schools and communities began to understand what made their city great. A real sense of pride in their city has been created.

THE LAST WORD

Our objective has been to identify the opportunities over the next 10 years that will secure the best returns. It is increasingly apparent that this objective can best, perhaps only, be achieved if the stakeholders work more closely together. The role of other participants in the industry is to facilitate this closer relationship.

Dialogue may not sound revolutionary, but our panel was unanimous in seeing this as the biggest opportunity of all. And this needs to be an on-going dialogue, not just when there is a problem or negotiation required

Martin Moore sums up the collective view: “Talking, listening and engaging, are the most powerful things we could and should be doing differently”.

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