

M&G Real Estate

Around the world in retail

The retail sector is undergoing significant change and evolution globally. Across our key investment regions in Asia, Europe and the United Kingdom, common cyclical and structural drivers shape the retail story, with retailers facing the challenge of adapting to a new age where online retail is dominating sales and consumers expect an integrated shopping experience across channels. However, each of these markets has varying levels of online retail penetration, with South Korea having the second-highest rate after the United Kingdom. Indeed, in the five developed Asia Pacific (APAC) markets of Japan, Hong Kong, South Korea, Singapore and Australia, we remain positive on retail, despite headwinds from e-commerce growth, as several supportive fundamentals, particularly prevalent in the APAC region, underpin the sector.

Growing incomes and sustained population growth drive consumption

Population growth provides the retail sector with a sustained domestic consumer base that requires goods and services. In the key gateway cities of Tokyo, Hong Kong, Singapore and Sydney, steady population growth looks set to continue. Three-quarters of a billion people are expected to be added to Asia's population by 2050.¹ Such population growth is driving strong and rapid urbanization in key cities, increasing the depth of local markets and demand for real estate. Almost two-thirds of Asia's population is expected to be urban by 2050.² As population growth continues, so too does the growth of domestic consumers' disposable income, while tourism also has a huge influence upon retail. With significant volumes of outbound tourists, Chinese consumers are particularly important to the APAC retail sector.

Experience, convenience and transparency are top consumer priorities

APAC's positive macro fundamentals are driving retailers' sentiment toward space expansion, evidenced by the fact that the developed APAC markets continue to attract interest from international retailers. According to CBRE,³ these five markets and China

were international retailers' top preferred markets for expansion in the region in 2017, probably due to their proven sales success and strong tourism appeal.

However, with the growth of e-commerce, consumers now have more shopping options and greater price transparency, and they no longer expect retail to merely fulfil their consumption needs. Instead, the process and experience of shopping play a more integral role in attracting and maintaining footfall. Retail landlords, therefore, need to implement strategies that improve consumers' shopping experience and convenience.

Favorable macro fundamentals underpin retail in Europe

In Europe, too, economic growth continues to create a positive backdrop for the retail sector. Continuing urbanization means that by 2050, 80 percent of Europeans are expected to live in urban areas, creating an increasing base of people with consumption needs in densely populated areas, which underpins retail provision.⁴ Another positive macro driver for Europe is its leading position as the largest inbound-tourism market globally. Our optimism is toward prime retail in dense, well-connected cities, such as Paris, Copenhagen and Milan, that attract affluent international consumers or retail in dominant regional centers, which are much more resilient to potential store closures, given the captive local catchment and convenience attraction. In France, for example, one of the most significant retail innovations has been the rise of Click & Drive grocery outlets, aimed at increasing convenience and creating a seamless consumer experience.

Physical stores need to build resilience against the rise of e-commerce

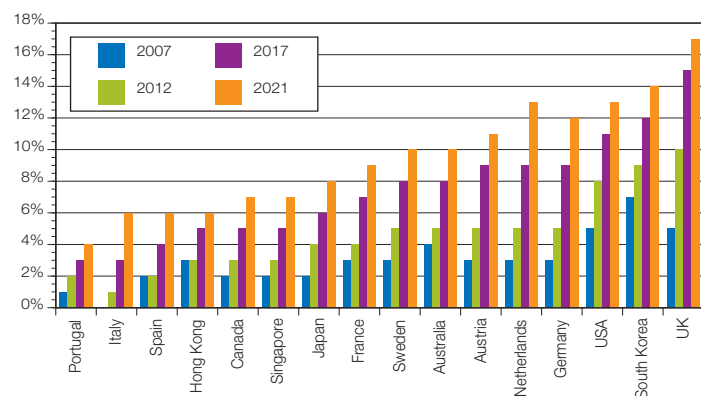
In terms of global e-commerce growth, Europe overall remains a laggard compared with the United Kingdom and the United States. This could spell bad news for some retail, particularly for retailers and landlords that fail to adapt to changing consumer preferences or those lacking a strong catchment.

The physical store will remain an important consumer touchpoint. Footfall is likely to be maintained through both experience- and convenience-led retail, with the boundary between online and offline increasingly blurred through omni-channel sales. With Europeans now spending a greater proportion of their income on "experiences," retailers and landlords have been adapting, with the proportion of lifestyle, food and beverage (F&B), and entertainment tenants across schemes increasing in Europe, as well as in Asia.

International retailers focus on strategic prime-pitch locations

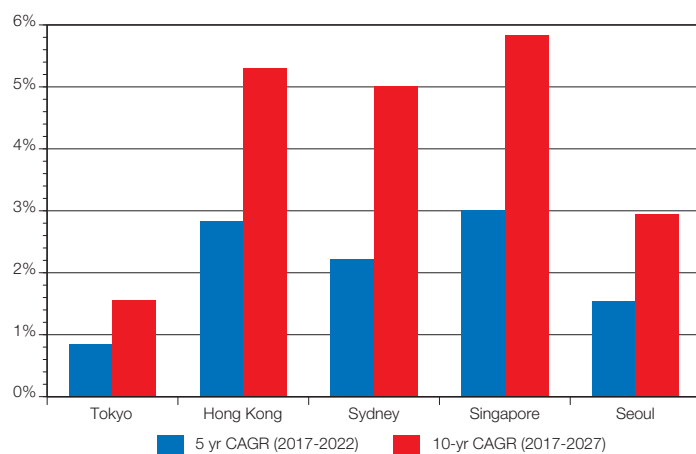
Across Europe, the rate of retailers' physical expansion has slowed, with consolidation of portfolios into fewer, but larger, flagship stores in key cities. Meanwhile, international retailers

Online Retail Value as a % of Total Retail Value



Source: GlobalData 2017

Real Income CAGR



Sources: M&G Real Estate, Oxford Economics January 2018

have been concentrating their physical presence in strategic prime-pitch locations.

Retail is a fast-evolving and flexible sector that will need to adapt to remain resilient and meet the changing demands of the consumer. Nowhere else is this more apparent than in U.K. retail, which faces not only the challenge of losing market share to online and rising cost pressures against consumers that are reaching “peak stuff,” but also large store portfolios.

As a result, fewer retailers are opening new stores and are instead choosing to “right-size” to keep costs down. They are also increasingly sharing store space through more concessions, enabling them to drive income and reduce their net operating costs.

Resilient performance from U.K. core retail

In the United Kingdom, well-positioned retail assets have continued to attract occupiers, generating stronger performance for core property. E-commerce continues to grow in this mature market, and physical retail will inevitably undergo a transformation, challenging older and larger space in weaker towns. We remain positive on more dominant locations that continue to see population and employment growth and have “destination” potential. Such locations have been more resilient to store closures.

Staying flexible is a crucial ingredient of success as retailers transform stores

As we analyze retail globally, it is clear that in virtually all markets, regardless of their own particular drivers, maintaining flexibility is key as the requirements for stores change. Large tertiary and secondary assets may not have a future as solely retail. The repurposing of stores to mixed-use can create opportunities to maximize income from assets, as demonstrated by Lidl, which plans to increase its involvement in mixed-use schemes to include offices, hotels, student accommodation and flats. In addition, the adoption of omni-channel retailing is a growing trend, alongside technological integration, targeted marketing and place-making strategies, which are used to attract, engage and retain consumers and tenants.

For shopping malls in Asia, for example, our preferred investment scenario is a management strategy (i.e., purchase of partial stakes), where we can work with established operators with market knowledge and the resources to maximize asset performance. Super-regional shopping malls and high-street retail in prime areas, attracting both locals and tourists, are among our favored investment assets, alongside large, suburban shopping malls in growing catchment areas, close to residential development and served by strong transport links.

In an era of structural change within the sector, investment strategy and active asset management will be equally important to remain resilient to potential headwinds. Providing consumers with a seamless shopping experience, by integrating both online and offline channels, will be a key driver of success. Active asset management initiatives, which facilitate meeting both occupier and consumer requirements, will be crucial to driving footfall and ultimately capturing strong and stable property returns in this sector. And with some key differences among the regions — and among individual locations — a proactive approach to asset management remains the most critical driver of success.

¹United Nations, World Urbanization Prospects, the 2017 Revision ²United Nations ³CBRE's *How active are retailers in APAC?* report, 2017 ⁴United Nations, 2015

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Richard Gwilliam is responsible for the overall direction of property research within M&G Real Estate, including analysis of the U.K. and global property markets, formation of in-house views, determination of strategy for the funds, and bespoke in-depth research projects. He has 13 years of analysis and research experience within real estate investment.

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