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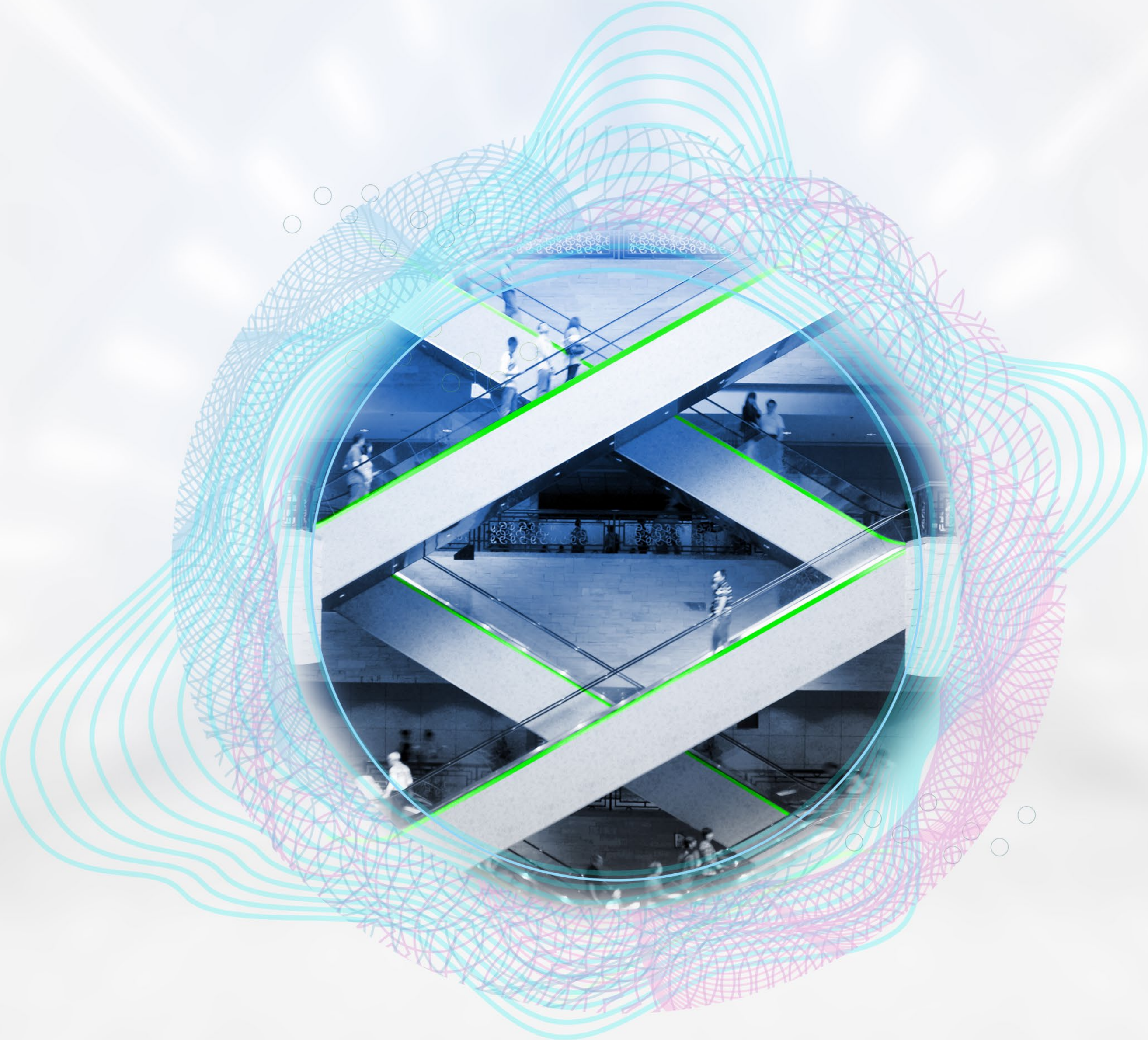

The future of shopping: Creating customer value with retail real estate

How owners and retailers can partner to transform shopping experience

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Contents

Changing consumer behaviors create opportunity

EVEN BEFORE THE pandemic, shopping centers and retailers were facing many challenges: The rise of e-commerce, shrinking foot traffic, and changing consumer shopping preferences threatened a way of shopping that existed for decades.[1] COVID-19 accelerated these trends, and created a more digital-centric consumer who expects frictionless transactions, personalized experiences, and elevated conveniences. These new purchase drivers highlight the need for shopping mall transformation, but also create unique opportunities for the industry.

Pandemic-related shutdowns accelerated the bankruptcy filings of more than 50 retailers in 2020.[2] This led to higher vacancies, which reduced property values and real estate owners' profitability.[3] The vacancy rate in regional malls rose 170 basis points year on year (YoY) in 1Q21, to 11.4%.[4] The pandemic also forced more consumers online, creating additional demand for omnichannel services that offer consumers various ways to shop, receive, and return items. But, importantly, even during the pandemic, e-commerce sales represented only 14% of overall retail sales[5]—signaling the importance of integrating store-level inventory within the digital supply chain.

Combined, these factors will likely require retail real estate owners to adopt a more holistic view of the "jobs to be done" in retail spaces. It is no longer enough to offer the physical space for consumers to find goods; retailers should entice consumers with a more enriching experience that fosters a sense of community. Large online retail platforms have gained share by understanding and adapting to changing consumer preferences.[6] How can retail real estate owners best respond to this challenge? How can they better exploit their unique position to create a more personal connection with consumers?

We believe retail real estate owners can play a pivotal role meeting consumers where they want to be. To successfully respond to this changing retail environment, owners can focus on three strategic priorities:

1. Recast the role of the shopping center to serve multiple purposes
2. Drive greater customization in the tenant mix
3. Develop a new leasing model that captures the value derived from new business models

But to do all of these well, retailers and retail real estate owners should work together in new and fundamental ways.

Certain shopping preferences will likely stick

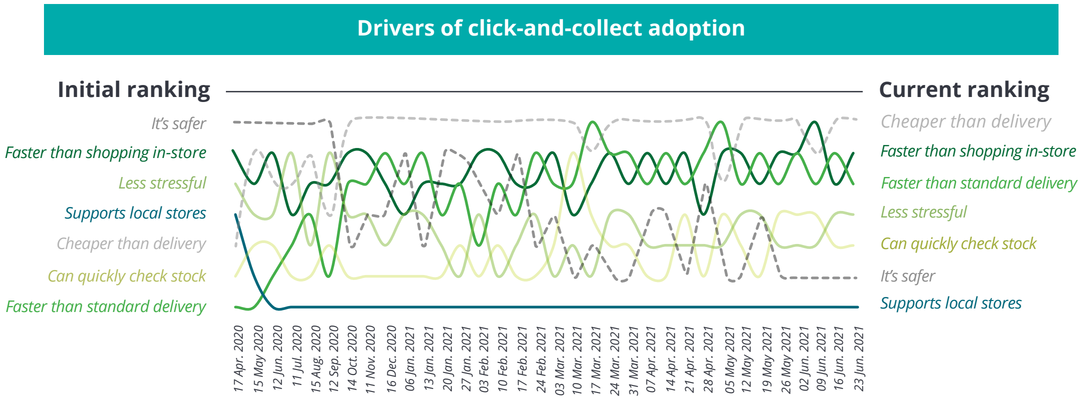
POSTPANDEMIC, CONSUMERS MAY never shop the way they once did. Which behaviors are most likely here to stay?

Recent data from Deloitte's Global State of the Consumer tracker shows that consumers are getting back to public life. But the data also indicates that some behavior, like the "at-home economy," continues. Consumers say they plan to work more from home than they did before the pandemic, so they expect to cook more and shop more from home for the foreseeable future. This preference to stay closer to home could create opportunities for shopping centers. Are there ways they can serve as community centers, where consumers could easily access experiences and events? Or could physical spaces be redeveloped into distributed work locations, hoteling for hybrid/remote workers, and even housing?

Another major consumer behavior that has increased lately is the use of digital click and collect platforms such as buy online, pick up in store (BOPIS), buy online, pick up in locker (BOPIL), and curbside pickup. Concern over health and safety during the pandemic drove people of all generations to try these services. As consumers adapted to pandemic life, the catalyst for these specific shopping methods shifted away from safety concerns to perceived affordability and speed (figure 1). Given that convenience is a growing purchase driver for consumers, we see this preference sticking even after the pandemic subsides.

FIGURE 1

The popularity of click-and-collect is driven by affordability and speed



Note: N=1,000.
Source: Deloitte Global State of the Consumer Tracker, 2020–21.

Retail real estate owners should embrace these consumer shopping preferences; they highlight the value retailers that have a brick-and-mortar presence with integrated omnichannel capabilities can bring. This is one key advantage brick-and-mortar retailers have over large online retailers, which lack the physical infrastructure to offer same-day services in many markets.

The at-home economy trend may also be altering the frequency of shopping trips. Our analysis found that even before the vaccine rollout, retail trips, especially to mass merchants, home improvement stores, and grocery stores, had recovered by the end of 2020.[7] We also found larger basket sizes, implying consumers have been buying more on each trip.[8]

But once retailers have lured consumers back to their locations with experiences and new convenience formats, how can they keep them coming back longer term?

Leveraging cross-shopping as a differentiator

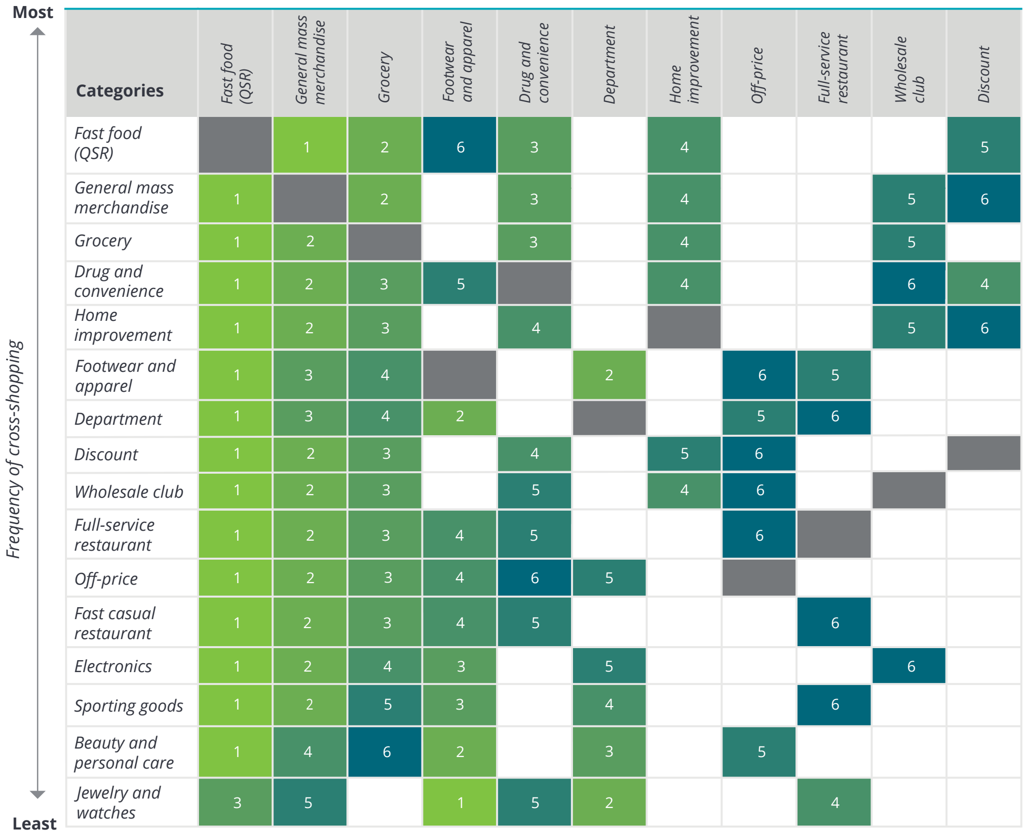
RETAILERS AND RETAIL real estate owners understand that a successful shopping center requires categories and brands that complement one another. We believe cross-shopping relationships will become an even more important consideration when planning retailer locations. Having a shared customer base, rather than a more traditional, one-size-fits-all shopping center layout, can boost overall consumer traffic and spending.

Our analysis below shows that in 2020, quick service restaurants saw the most amount of cross-shopping, followed by mass merchandisers such as Walmart and Target, and grocery stores (figure 2). Discretionary items, such as sporting goods, beauty, and jewelry, appear to benefit from proximity to the footwear and apparel category.

FIGURE 2

General mass merchandisers and grocery stores are among the highest contributors to cross-shopping

Top cross-shopping by category: 🟩 1 🟩 2 🟩 3 🟩 4 🟩 5 🟦 6



Categories	*Fast food (QSR)*	*General mass merchandise*	*Grocery*	*Footwear and apparel*	*Drug and convenience*	*Department*	*Home improvement*	*Off-price*	*Full-service restaurant*	*Wholesale club*	*Discount*
Fast food (QSR)	▨	1	2	6	3		4				5
General mass merchandise	1	▨	2		3		4			5	6
Grocery	1	2	▨		3		4			5	
Drug and convenience	1	2	3	5	▨		4			6	4
Home improvement	1	2	3		4		▨			5	6
Footwear and apparel	1	3	4	▨		2		6	5		
Department	1	3	4	2		▨		5	6		
Discount	1	2	3		4		5	6			▨
Wholesale club	1	2	3		5		4	6		▨	
Full-service restaurant	1	2	3	4	5			6	▨		
Off-price	1	2	3	4	6	5		▨			
Fast casual restaurant	1	2	3	4	5				6		
Electronics	1	2	4	3		5				6	
Sporting goods	1	2	5	3		4			6		
Beauty and personal care	1	4	6	2		3		5			
Jewelry and watches	3	5		1	5	2			4		

Sources: Deloitte Insight IQ data; Deloitte analysis.

Understanding online and offline behavior changes across geographies

WHILE THE PANDEMIC inevitably increased online spending at the cost of physical trips,[9] the level of impact varied significantly depending on region/geography. This makes it imperative for retailers and retail real estate owners to localize strategies.

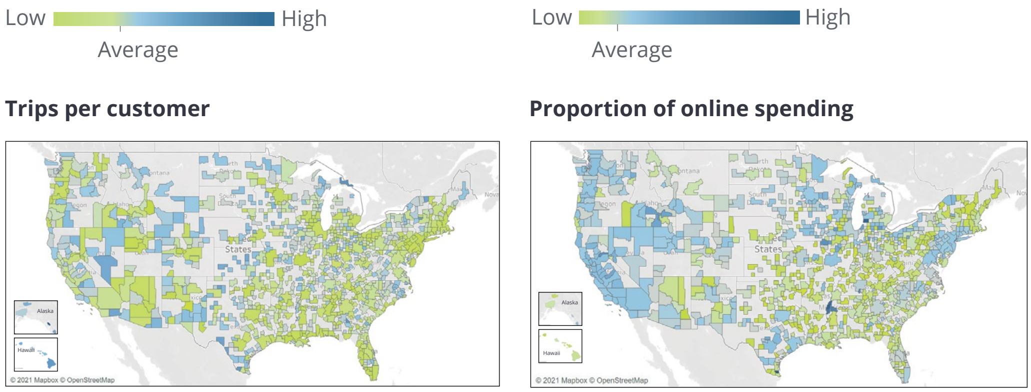
Our illustrative geospatial analysis shows diverse trends across key US markets, based on retail trips per customer and proportion of online spending from February 2020 to December 2020 (figure 3).

We divided the US markets into four groups based on their performance across the two parameters. Most of the largest markets, such as New York, Los Angeles, Chicago, Houston, and Miami, experienced below average retail trips and above average share of online spending. In these markets, doubling down on servicing the e-commerce ecosystem while using retail store spaces strategically for fulfillments and other services may be the best strategy.

Other markets among the top 50 metro statistical areas (MSAs), such as Boston, Detroit, Pittsburgh, and Columbus, Ohio, were below average on both parameters. For these markets, exploring alternative uses, such as repurposing spaces for fulfillment, may be the better play.

FIGURE 3

Physical trips and online spending vary by markets



Markets are highlighted with reference to average trips per customer.

Markets are highlighted with reference to average proportion of online spends.

Notes: The map includes metropolitan and micropolitan statistical areas. The markets for which the proportion of online spending was not available have been excluded from the map.
Sources: Deloitte Insight IQ data; Deloitte analysis.

Below the top 50 MSAs, some of the smaller markets, such as the Research Triangle in North Carolina and some of the smaller cities in California, such as Bakersfield and Stockton, were above average on both aspects. This suggests that retailers and retail real estate owners at these shopping centers should focus on enhancing experiential retail as well as developing omnichannel capabilities. Finally, markets such as Honolulu, Hawaii, Erie, Pennsylvania, and Columbus, Georgia saw above average growth in retail trips and below average share of online spending. Owners and retailers in these markets should consider retrofitting existing properties and expanding their physical presence.

Ultimately, these analyses show that retail strategies should be curated and customized at the shopping center level, and informed by local consumer behavior and buying habits in their respective trade areas. Furthermore, they highlight how retailers and shopping center owners should learn from buying habits during the pandemic and use that knowledge to their mutual advantage. Retailers should adopt a more holistic approach to their real estate. They should reconsider how they treat stores, not just by the type of merchandise customers buy, but by the way they shop and how they intend to shop for other areas of their wallet share.

Moving from landlord to partner

MANY RETAILERS AND retail real estate owners made do with existing spaces as they entered 2020. But now, to prepare for the postpandemic shopping world, how can owners and retailers design new environments or retrofit old ones with new intent and purpose?

The pandemic has exacerbated friction between owners and retailers. Over time, the transactional nature of many of these relationships has created a disconnect in expectations and responsibility for different aspects of the business. Retailers often regarded owners as their landlords instead of as partners or collaborators. Requests for pandemic-related rent concessions have strained some relationships even further.

As they work to rebuild traffic, retailers and retail real estate owners are experimenting with digital experiences. However, they don't always understand each other's business models, which limits the possibility to implement scalable experiential solutions that benefit everyone. Clearly, the dynamics between owners and retailers should shift to more of a partnership model because intimate coordination and collaboration will likely be necessary to succeed in the next era of retailing.

Ultimately, retail real estate owners can evolve their tenant mix and service offerings to become multipurpose lifestyle centers that enable community experiences. As urbanites fled large cities during the pandemic, smaller cities and suburbs have been revitalized, and some mall owners will benefit.[10] In these areas, shopping centers can serve the needs of their communities by taking on the role of the "town square," enabling retailers and retail real estate owners to address the needs of the consumer in ways that online competitors cannot. To help facilitate this trend, retail real estate owners could offer retailers additional fulfillment infrastructure, location and shopper intelligence, an enhanced digital presence, and a targeted tenant mix based upon cross-shopping trends.

Creating value by innovating together

BY THINKING MORE like a service provider and less like a space provider, retail real estate owners have an opportunity to redesign the value proposition of shopping centers. They can enhance the value of their properties by identifying opportunities to provide digital and physical services to retailers and consumers. Optimally, the marketing and finance teams of retailers and retail real estate owners should move beyond the traditional financial and leasing transaction relationship and forge a symbiotic relationship where they target and serve consumers together.

Retailers and retail real estate owners can partner up to meet a common goal: elevating the shopping experience. They can start by creating frictionless transactions, using smarter technologies and innovations to provide a safe and customized shopping experience. Some of this is already happening: Brookfield partnered with Fit:Match, a 3D, AI-powered technology startup that takes quick body measurements and provides recommendations from different brands to enable a contactless apparel shopping experience.[11] And athleisure brand Lululemon has added workout space and cafés to its stores, giving shoppers additional reasons beyond clothes shopping to keep coming back.[12]

Since consumers increasingly prefer to browse or shop online, retail real estate owners should enhance their online presence and provide customers with a seamless and consistent BOPIS experience. The shopping center's website and mobile app could not only offer information on activities and events, stores and brands, and services and membership rewards, it could also allow consumers to shop online. Miami-based shopping mall Bal Harbour Shops launched its own website where consumers can browse and buy products from any of its retail tenants. Consumers can even book appointments directly with brands for a personal shopping experience.[13]

Retailers and retail real estate owners can partner up to meet a common goal: elevating the shopping experience.

Consumers should be able to browse products online, place orders, and choose whether they want to pick up their order or have it delivered. Retail real estate owners could then provide the necessary infrastructure so retailers can provide added conveniences such as click-and-collect, buy online ship from store (BOSFS) and curbside returns.

Reworking the tenant mix

As more consumer data becomes available, retailers and retail real estate owners can use consumer behavior analytics to determine the appropriate tenant mix for each location. As our cross-shopping analysis above shows, it's not about the shopping center having the "best tenants," but the ones that complement each other and maximize foot traffic and sales.

One key issue retail real estate owners face today is increased anchor tenant vacancies. There are approximately 750 anchor vacancies in the United States, largely in class B and class C malls.[14] As many traditional anchor tenants, such as department stores, rationalize their store counts, both owners and retailers have a chance to rethink what it means to be an anchor, and whether anchors are even needed to meet the demands of the existing tenant mix and shopper behavior. Our analysis shows retail categories such as a grocery stores, which have performed well during the pandemic and have a high cross-shopping propensity with other retailers, could replace struggling anchors.

> **It's not about the shopping center having the "best tenants," but the ones that complement each other and maximize foot traffic and sales.**

Retail real estate owners could also bring in nonretail tenants to anchor their properties. Anticipating a strong recovery in tourism, Simon Property Group added a hotel to its Sawgrass Mills Mall in Florida this year.[15] Other unique anchors include bowling alleys or sports-related venues. In Greensburg, Pennsylvania, CBL Properties replaced a former anchor department store with a casino to help build a mix of entertainment, dining, and shopping experiences.[16] Some owners are in talks with health care tenants as well.[17]

Getting creative with leasing

HISTORICALLY, RETAILERS AND retail real estate owners have worked on a fixed lease rental model.[18] However, the acceleration in online sales and pandemic-related closures have increased cost pressures, and fixed leases have made a difficult situation even worse for many retailers.[19]

Given the current state of retail and a focus on an omnichannel model, owners and tenants should work together to align interests and share business risks. Owners could rework the provision of overage rent and deploy a hybrid rent model, which includes both fixed and variable components. With a fixed minimum base rent, owners could have a consistent cash flow that would reflect the inherent value of the space, while a sales-based, variable payment component could reflect the additional value owners could earn by providing consumers with curated experiences. A lower fixed payment could offer retailers relief during times of declining performance, and improve tenant retention, while the sales-based variable could help align the interests of both parties to maximize foot traffic and sales. But retailers and retail real estate owners should reach a consensus on what constitutes a sale if they used this hybrid model, which is a complex question in an omnichannel environment.[20]

Leading into a brighter future

One thing is clear: To maximize success and capitalize on the new era of retail, retailers and real estate owners should work together. As partners, they can collaborate to find ways to use technologies and analytical tools to monitor and respond to consumer preferences and offer new and engaging customer experiences. And they can develop seamless shopping experiences to consumers across offline and online channels. Consumer spending is ramping up again,[21] and it's clear that retailers and real estate owners can make each other better—and more valuable. Recognizing and capitalizing on this symbiotic relationship and their shared North Star—creating exceptional customer experiences and delivering customer value—can provide both with a path to future growth.

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