

E-tailing & the impact on distribution warehouses

April 2013



SUMMARY

■ E-tailing continues to grow at pace within the UK, with record percentages of total retail sales now coming from online. To combat this change, the traditional 'high street' retailers are being forced to reconfigure their supply chains to cater for this new era of multi-channel retailing.

■ This report identifies the current and future trends in e-tailing and how the inevitable changes will impact upon the distribution warehouse sector and its future growth.

■ Savills commissioned Transport Intelligence to undertake an in-depth analysis of the online retail sector, including face-to-face interviews

with retailers to understand issues including the points at which retailers are 'triggered' into expanding their warehouse facilities, as well as, their preferences both in terms of location and configuration of the space.

■ From the research and analysis, Savills believe that warehouse take-up, by retailers only, will total 50 million sq ft over the next five years and that is 21% up on take up in the last five years. 13 million sq ft of this future take-up will be within e-tailing specific property, driven by online sales.

■ With specific needs from retailers and a shortage of stock, there will be a bias towards more pre-letting in

the UK and an increased reliance on development sites.

■ This paper summarises a larger and more comprehensive report from the interviews and the survey. Hence the bullet point style of this overview. To obtain a copy of the full report, please contact Richard Sullivan or Steven Lang.

.....
 "E-tailing will help drive a new era of demand for warehouse space... although one size will not fit all" Richard Sullivan, National Head of Industrial & Logistics

➔ **The market today**

■ On-line retail sales are roughly 10% of total retail sales today and are expected to double over the next decade. The knock on effect for the logistics market will be significant and demand for distribution warehouses will be driven increasingly by the needs of the e-tailing market.

■ The Transport Intelligence/Savills research targeted the key players in the e-tailing market and was purposely aimed at the occupiers of distribution warehouses. A detailed interview process and a wider survey were completed.

■ Transport Intelligence's expertise lies within the logistics process and has enabled Savills to have a clearer understanding of the key factors affecting property within the e-tailing sector.

■ The businesses interviewed included the 'traditional' retailers such as supermarkets and department stores as well as retailers that rely much more heavily on the online consumer market.

■ The other main group of respondents was 'logistics providers', including express parcel companies and 'e-fulfilment' players that include Amazon, Norbert Dentressangle and iForce.

■ Graph 1 illustrates the increasing sales growth expected for the next 12 months from the survey/interviews.

■ A quarter of retailers expect e-tailing growth to increase by a further 25% during the next 12 months, compared to 20% of logistic providers.

■ As shown in Graph 2, there are varying

levels of e-tailing related sales. Although interestingly, nearly 40% of retailers have less than 5% classified as e-tailing and this demonstrates there is room for significant growth within their e-tailing businesses.

■ The majority of respondents operate one warehouse (Graph 3). At the other end of the scale, 9% operate between 11 and 100 warehouses at present.

The players

■ The analysis has been split between the retailers and the logistic providers.

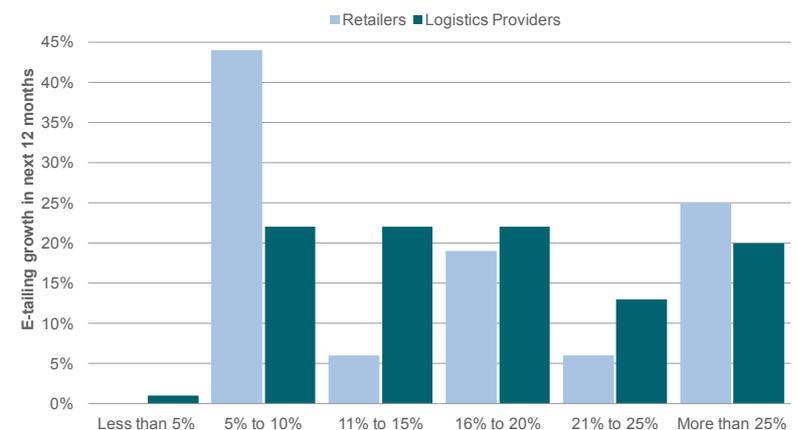
■ 20% of the retailers operate from a dedicated e-fulfilment centre at present, compared to 36% of logistic providers. It is unsurprising that more retailers operate a multi-channel facility, but investment in dedicated e-fulfilment will increase in the future.

■ The 'trigger' point for a dedicated e-fulfilment centre is the key statistic. For the retailers, when the space required is between 10-25,000 sq ft, then a dedicated centre is adopted, on average.

■ A discussion with one major e-fulfiller for small/medium retailers said that warehouses range between 20,000-60,000 sq ft. They also said that the 'tipping point' for a new dedicated e-fulfilment centre, assuming a standard parcel size, is 200,000 on-line orders.

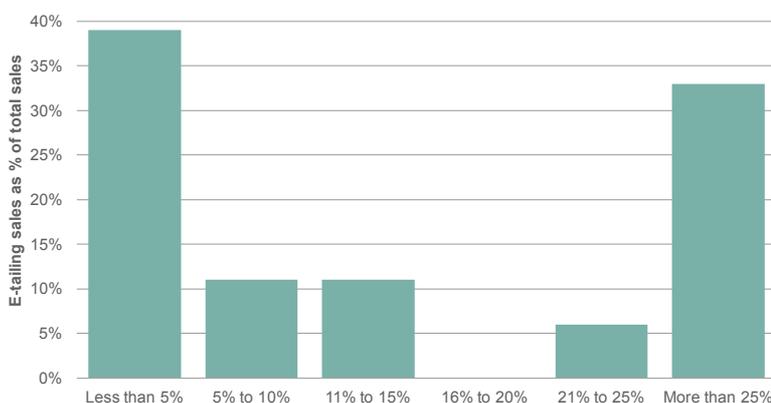
■ The 20-60,000 sq ft range mentioned above does not sound a significant amount of space, but should be put into the context of the fact that three-quarters of retailers currently operate from 10,000 sq ft or less. It is not all about the big retailers in this growth market.

GRAPH 1 **E-tailing sales growth predictions for next 12 months**



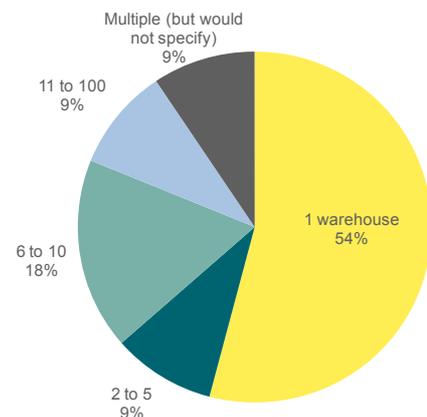
Graph source: Transport Intelligence / Savills

GRAPH 2 **Retailers' e-tailing sales proportions**



Graph source: Transport Intelligence / Savills

GRAPH 3 **Respondents' current warehouse portfolio**



Graph source: Transport Intelligence / Savills

➔ ■ The question for the property market is how can this type of space be catered for? Savills view is that there will be an increase demand on more 'traditional' industrial estates close to, or within, urban centres. These offer good security and can be more cost effective for smaller companies.

■ Within older industrial estates, there is a potential to 'breathe new life' into warehouses that could be viewed as redundant, particularly in close proximity to towns and cities. Indeed, this view is supported by the speculation of Amazon establishing a 'satellite' depot of 75,000 sq ft in Croydon. This will support their large warehouse network around the country with further requirements out amounting to 3 million sq ft.

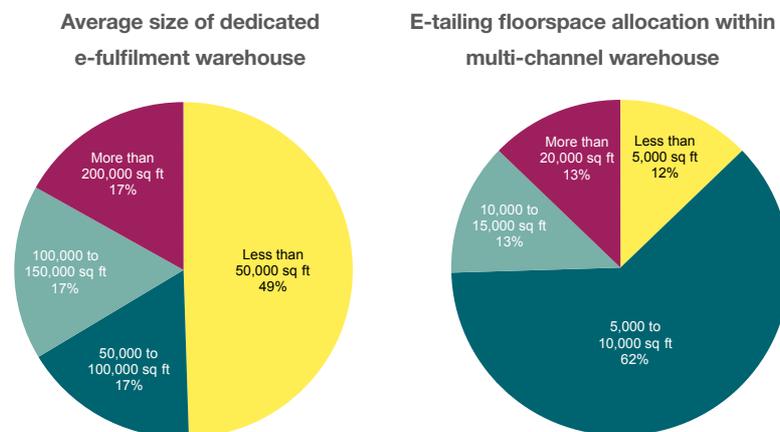
■ The interesting strategies that have emerged are related to the final delivery to the customer ('last mile'). 'Dark stores' have generally dominated the headlines, where the warehouse function replicates a supermarket store, without the frills or customers. 'Pick and pack' functions are very efficient from this type of operation. Tesco have six 'dark stores', including one in the pipeline. As well as being in Park Royal, Waitrose e-tailing warehouse is planned in Croydon of approximately 80,000 sq ft.

■ One of the pioneers of the fulfilment sector in the UK, Ocado, have announced the imminent opening of a £210 million centre near Tamworth, West Midlands. Stock has been received and live customer orders processed. Recently, there have also been discussions between Ocado and Wm Morrison, UK's 4th largest supermarket, regarding its UK e-tailing expansion.

■ 'Click & collect' has grown in importance for major retailers, including Argos and, more recently, John Lewis. The logistic providers are expanding their operations in this area including UPS launching Access Point with 1,500 collection locations by mid-2013 and CollectPlus (PayPoint/Yodel) with 4,700 local corner shop collection points. These are yet another link in the UK e-tailing logistics market.

■ For the logistic providers, some companies have grown significantly during the past few years and leaders in the e-tailing sector have emerged.

GRAPH 4
E-tailing floorspace for retailers



Graph source: Savills

■ One to watch, is iForce, who employ around 600 staff and occupy 1.1 million sq ft of warehouses. Key clients include John Lewis Direct, Cath Kidston and Tesco. iForce offer innovative processes and technologies for the e-tailing world. A key question is how the outsourced e-tailing providers will expand in the future.

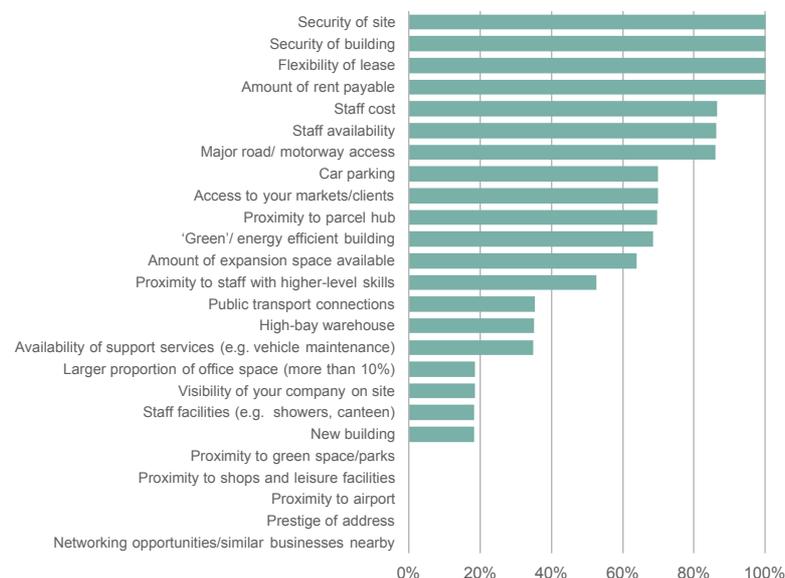
■ As shown in Graph 4 above, the smaller warehouse dominates for retailers. Even within a multi-channel warehouse, the floorspace allocated, for the majority, is quite small. This will grow in the future and emerge as smaller warehouse requirements, as we have seen in the recent past.

What do occupiers want?

■ Graph 5 below presents a Savills survey response to the preferences for future warehouse property features, irrespective of whether they are for e-tailing or not. The percentage represents the proportion that placed a 'high' importance on the factor.

■ Security is a major issue for the retailers. Lease flexibility and cost are of equal importance, which comes as no surprise. The more interesting result is the lower importance on the high-bay and new buildings. These issues are covered in more detail within the larger report, which accompanies ➔

GRAPH 5
E-tailing retailers' preferences



Graph source: Transport Intelligence / Savills

→ this paper.

■ Graph 6 shows the relative importance of key factors in locating a distribution warehouse for e-tailing.

■ The percentages represent the proportion of respondents that assigned a 'high' level of importance. As with other surveys done in the past, there are not any surprises in the top rated factors. Occupational costs and labour are key.

■ However, it is more interesting to see that logistic providers place a higher importance on 'higher skilled' workers. This is due to the IT intensity of their warehouses. However, Savills do not expect a significant change in locational requirements going forward as a result.

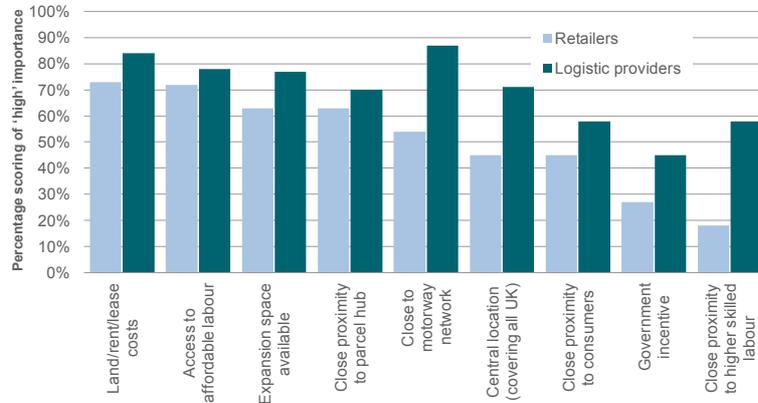
Outsource or not?

■ The results from the research show that third-party logistic (3PL) providers have adopted the attitude that their e-tailer customers will follow their traditional 'high street' counterparts. However, 18 of the top 20 e-tailers in the UK operate their distribution centres in-house.

■ From the extensive industry interviews, the systems required for e-tail operations are very different from those in the traditional retail market. One view from the interviews is that, so far, the 3PLs have not invested in developing bespoke solutions. Instead, smaller, specialist, companies are emerging, targeting the unique demands of e-tailers.

GRAPH 6

What factors are most important for locating an e-tailing distribution centre?



Graph source: Transport Intelligence / Savills

Changing distribution model

■ Savills review of the top 150 retailers shows that 10 are pure internet, with sales around £6 billion. Twenty-seven do not sell on the internet, mainly value retailers and smaller grocer groups. The remaining 113 are both 'bricks & mortar', i.e. have a high street/shopping centre presence and e-tailing operations.

■ The physical 'high street' presence today will continue to evolve and e-tailing will complement the in-store offering. However, retailers must ensure that stock and product choice remains as comprehensive on the 'high street'.

■ Graph 7 below shows two views of how the distribution model will change. Most logistic providers

expect existing physical stores to stay and smaller warehouse fulfilment centres to emerge. This would favour 'click & collect'. Retailers expect that centralised UK e-fulfilment centres will emerge, perhaps the same larger warehouses that they are used to.

■ From a property perspective, the continuation of a centralised model reinforces the need to maintain a supply of the largest warehouses and development sites.

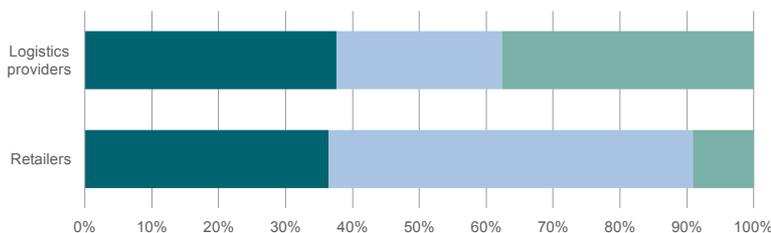
Where to locate?

■ The East Midlands emerged as a clear favourite in terms of locating a future warehouse. 43% suggested this as their preferred location. Greater London was the first choice for 17%.

■ Labour availability, proximity to customer base and parcel hubs are →

GRAPH 7

How will the distribution model change?

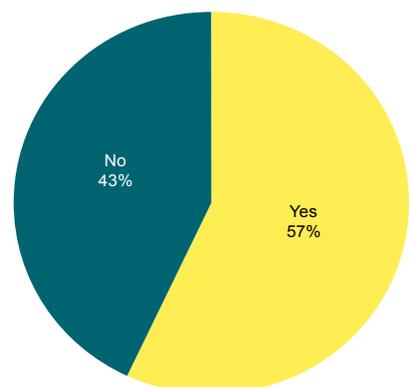


- Development of single centralised UK facilities (serving both physical stores and internet sales)
- Development of centralised UK e-fulfilment centres
- Existing physical store distribution networks to stay the same and development of a network of local internet fulfilment centres

Graph source: Transport Intelligence / Savills

GRAPH 8

Have retailers considered a dedicated e-fulfilment centre in the near future?



Graph source: Transport Intelligence / Savills

→ all obvious locational factors for the e-tailing function. However, Savills don't believe that any of these key factors would necessarily constrain many UK locations and occupiers remain relatively footloose.

- Other factors that are of 'high' importance to retailers include the security of site/building, flexibility of the lease, rent and staff costs.

Warehouse specification

- For the e-tailer, nearly half (49%) of dedicated e-fulfilment warehouses are less than 50,000 sq ft. This compares to 31% for logistic providers.

- Within a multi-channel warehouse, 62% of retailers allocated 5-10,000 sq ft to e-tailing. As mentioned earlier, the majority of e-tailers establish a dedicated centre when this level reaches 10-25,000 sq ft.

- Will we see the revival of a modern e-tailing industrial estate? Could there be an asset management play on older industrial sites to provide secure, smaller, low-rise warehouses on the edge of town/city centres. Plenty of this stock exists today and is likely to be under-priced!

- Finally, the occupiers were asked what additional rent they would pay for the 'ideal' warehouse for their e-tailing

futures. The short answer, nothing. Developers/owners beware. Providing the right product will reduce voids, but they shouldn't be overly specified so that rental levels are above market rate.

- More information regarding the specification of warehouses is included within the main report. Please see contacts below for a copy. ■

Savills Industrial & Logistics Agency

Market-leading leasing, sales and investment advice to occupiers, developers and investors.

Getting more and better value from industrial property requires accurate, up-to-date research and a high level of commercial awareness. Our industrial experts make use of our national network and dedicated research team to offer both. We offer extensive market knowledge across the UK and bring a wealth of experience to deliver innovative solutions for our clients. With teams in all the main regional cities we provide market leading services.

OUTLOOK

How will the market evolve?

- The replacement of the high street with warehouses/home delivery is an extreme view and unlikely. 'Click & collect' will maintain high street and out-of-town presence. Overall, the warehouse will have an increasingly important role going forward within retailers' supply chains.

- There will be an increasing number of players in the e-tailing market. Savills expect at least one new entrant to the market to compete with Amazon. Can we see eBay or Google warehouses on the horizon?

- Dealing with returns is key for all aspects of the supply chain. Minimising costs, waste and maintaining customer satisfaction all need to be considered simultaneously. Logistic providers will support this function, but will require appropriate warehouses, including location and specification.

- The large retailers and logistic providers will continue to drive the market, in terms of the demand for retail-related distribution warehouses. However, the niche logistic providers need to be monitored by the property industry. Savills have also reviewed, and researched, those retailers that are expected to drive the market going forward.

Please contact us for further information



Richard Sullivan
National Head of
Industrial & Logistics
+44 (0)20 7409 8125
rsullivan@savills.com



Steven Lang
Director - Commercial
Research
+44 (0)20 7409 8738
slang@savills.com



Robert Taylor
Analyst - Commercial
Research
+44 (0)20 7409 8768
rtaylor@savills.com



Joel Ray
Head of Consultancy
+44 (0)1666 519910

Savills plc

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 200 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.