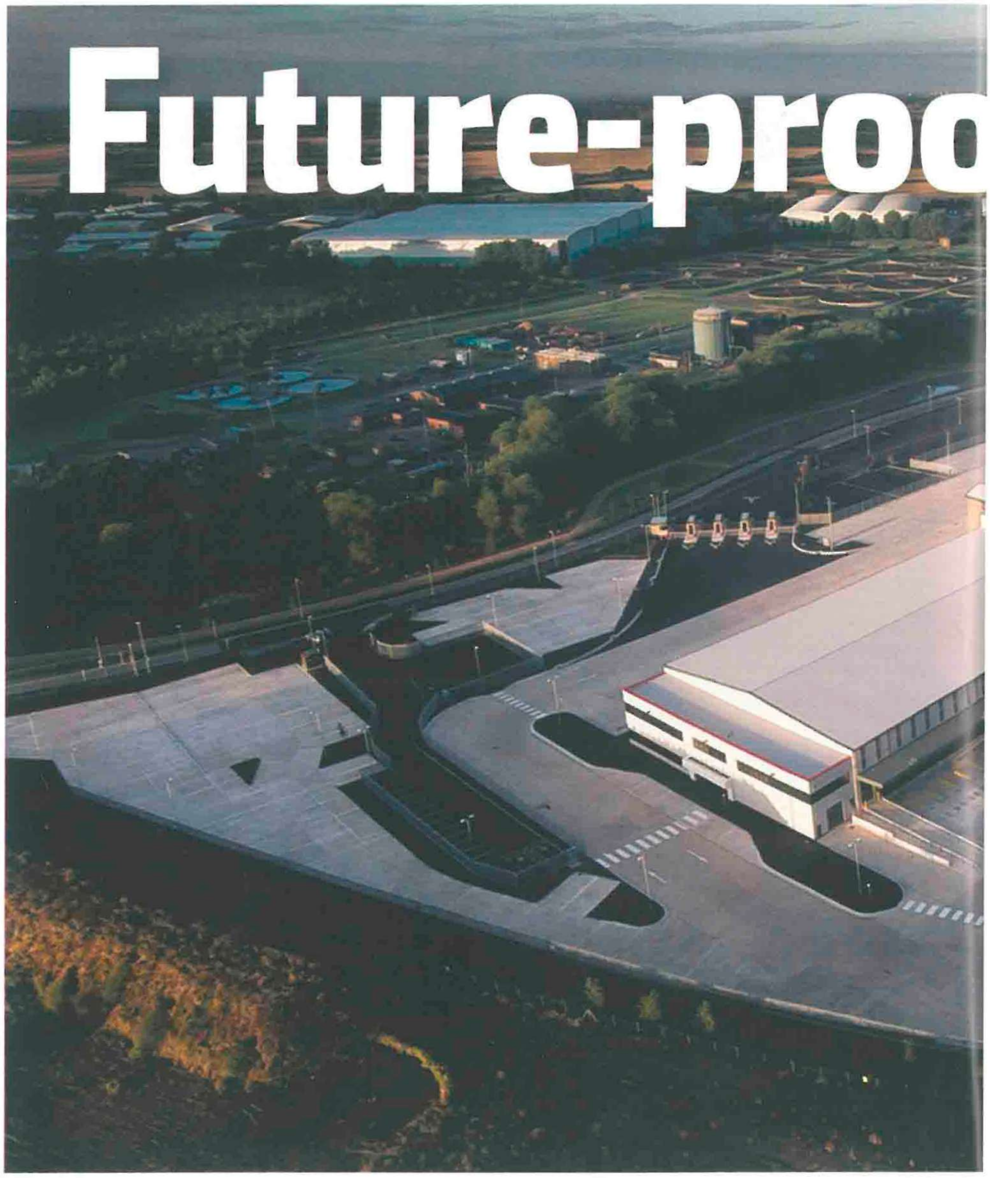
Future-proo



A multi-disciplinary think tank recently criticised the property industry for being too slow to deliver much-needed distribution space. Could a new flexible approach to building be the answer? **Mark Faithfull** reports

Even without the wealth of facts and figures that support the mounting urgency for ecommerce distribution space – whether that is fulfilment for pure-plays or multichannel operators – it hardly requires a genius to work out that storage, shipping and delivery infrastructure is a crucial pinch point.

As retailers continue to work through the optimum method for distribution, whether it is dedicated channels or, as is becoming more common, fulfilment for all channels, the need for appropriately located and sized logistics buildings has become critical.

And that pressure for new warehouse space as ecommerce sales accelerate could soon become even worse in light of claims by an industrial logistics think tank that the lack of space will be compounded further if developers do not adopt a new approach to building.

The think tank, consisting of property agent Colliers International, Total Logistics (since acquired by Accenture Retail), UMC Architects and KAM Project Consultants, argues in its report that the traditional approach to developing warehouses needs to change to be more strategic, with logistics properties lending themselves to easy expansion.

Steven Mitchell, Colliers International industrial and logistics director, explains: "Online sales are growing exponentially and already there is not enough warehouse to stock and transport goods to meet demand. This is partially because there has been very little development in the past five years and partially because ecommerce is a new and emerging trade so we are slowly becoming more sophisticated in our predictions for future growth."

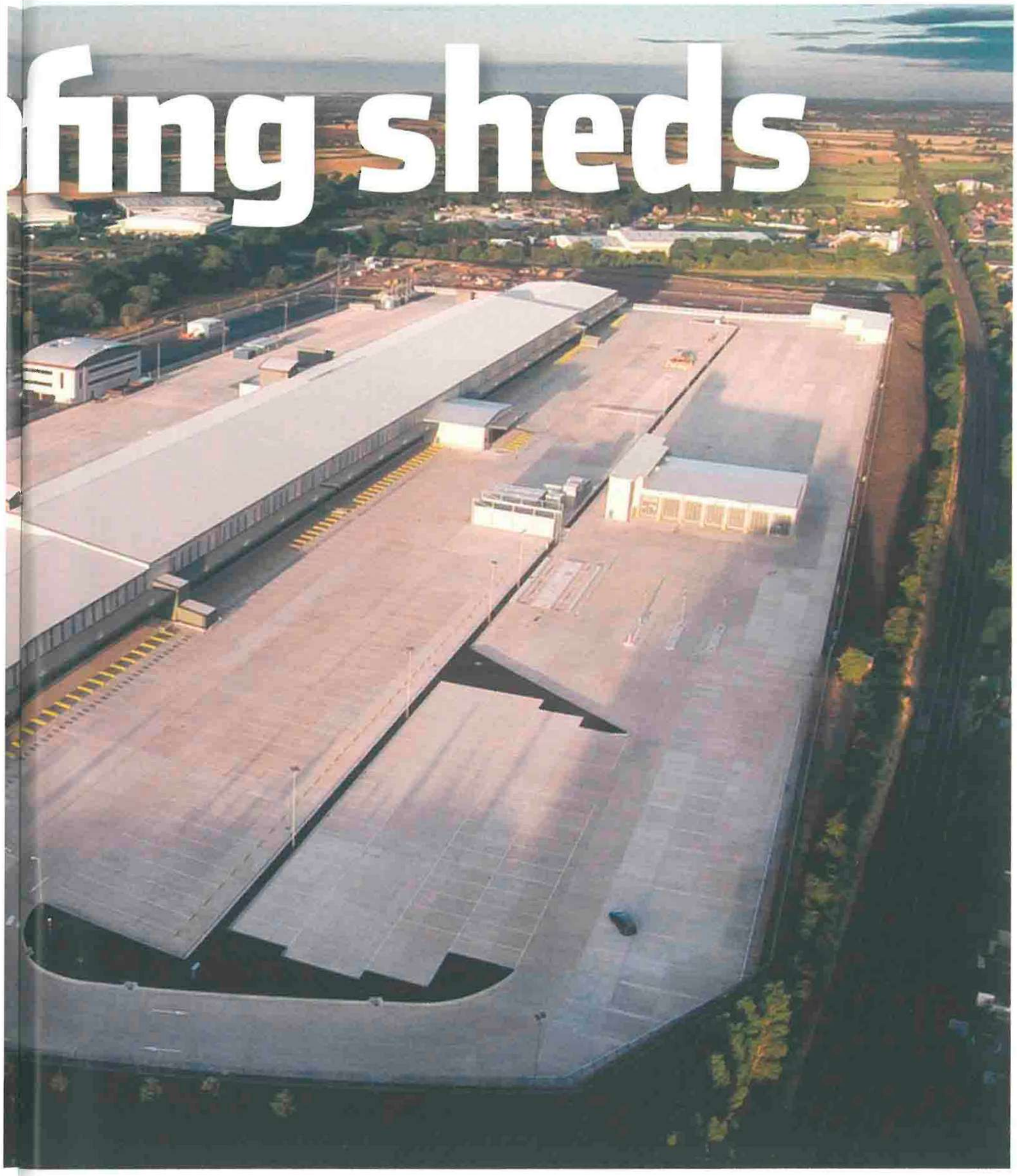
The report cites the ongoing surge in online volumes and the provision required to house stock and to distribute goods, concluding that warehouses need to increase in volume. But there is one big drawback – as it presently stands it takes an average of 12 to 18 months to develop, procure and deliver a new 100,000 sq ft space. By the time it has been constructed, it already is at capacity and cannot meet demand, the think tank says. Large-scale Grade A warehouses of more than 100,000 sq ft are extremely constrained, with less than a 10-month supply available throughout the UK, according to Colliers' research. The Northeast of England, Southwest Golden Triangle and Wales have no Grade A supply of big sheds, while Scotland, the West Midlands, East England and London are all approaching no availability.

"A traditional retail replenishment warehouse may expect to grow by 5% each year," says Mitchell. "If from project inception to occupation it takes three years, then the facility would require capacity for an extra 16% today and after five years' occupation need approximately 50% more capacity than today. On the same timescale an ecommerce business with a 30% annual growth rate would move in with over double the business size and need capacity for eight times business activity by the eighth year since inception."

However, Savills director of industrials Graham Brown says that, while it is easy to blame property developers for not keeping pace, recent history has played a part in the current imbalance. "Ecommerce is growing ferociously now but that follows a lean patch after 2008 when a lot of developers were left with empty property on their hands," he points out.

"It took a long time for those properties to fill up and, until that happened, the developers stopped adding new space. Now there is more and more demand, but even then many retailers have specific requirements and it is difficult to justify the development without retailer commitment. A couple of years ago a speculative 100,000 sq ft development would be snapped up. Now you need to be much braver to develop such a scheme and what developers do not want is to be left with a white elephant on their hands."

Lucy Larkin, managing director in Accenture's Retail practice in the UK, which recently acquired Total Logistics, says: "Consumers' expectations to shop using any channel they choose and still get fast and reliable delivery



fing sheds

Five easy ways to equip sheds for the future

Add **floor slabs** to accommodate **mezzanine installations**

Increase building **height** to allow for **mezzanine floors**

Add **sprinkler and utility** expansion **pipes**

Have space for **deeper yard depth** to allow for **future dock expansion**

Buy **additional land** to enable future yard and warehouse **expansion**

poses logistical and financial challenges for retailers. In this environment, it becomes critical for retailers to transform their supply chain models to enable a more real-time, digitally enabled service."

Flexible approach

Given that space constraints for new sheds will always be an issue in the UK, retail operations need to become more flexible in their approach and, in the case of store-based retailers, better at leveraging their existing assets, according to Andrew Kirkwood, regional vice-president, EMEA, at JDA.

"Clearly it makes a lot of sense for retailers to use their stores, not just their distribution centres," he says. "We're seeing a lot of work in this area and it makes a lot more sense than treating stock separately. This extends to distribution centres that now frequently support multiple channels rather than being allocated to one channel."

Martin Brickell, Total Logistics director, says a viable solution would be to design ↘

Optimising stores

The need for bespoke space is particularly evident in the grocery market, yet, even with the advent of dark stores and online distribution hubs, the market remains volatile. And, as Asda boss Andy Clarke pointed out at the World Retail Congress in Rome earlier this year, online expansion has been relatively recent.

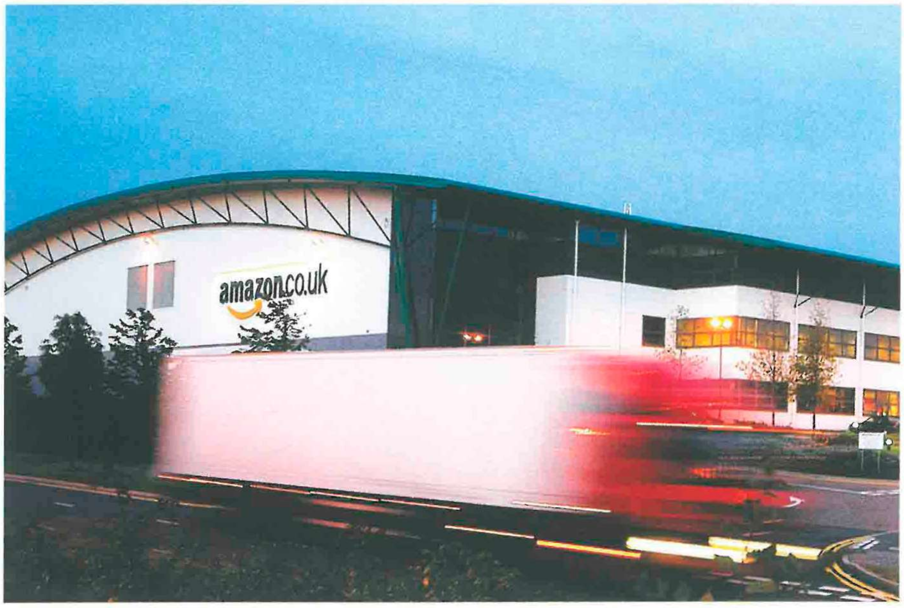
"Our online business represents around 10% of all orders but, even though we've been offering online for 18 years, the growth has only come in the past few years," he said.

Clarke focused on what he sees as the importance of getting stores 'right', which means optimising the layout and assortment for off- and online ordering. "Getting the core right is crucial," he said.

So what is the answer? Robin Phillips, omnichannel and development director of Boots, agreed with Clarke at the World Retail Congress and said that, although Boots,

"with a mature store portfolio, will not be opening many new stores", the retailer will be optimising those shops around experience and fulfilment.

"The customer really does want a relevant, useful, seamless experience across channels," he stressed.



Businesses such as Amazon are seeking smaller distribution centres closer to delivery points

warehouses with flexible, future-proofing expansion facilities such as higher eaves to add mezzanine levels, sprinkler and utility expansion pipes and additional land to extend on.

Brickell says: "In order to retain occupiers for longer periods it is important for developers to help tenants meet their business needs, meaning the traditional approach to building a square shed is gone and strategic development is the future."

Brown agrees that flexibility is key, first around mezzanine capability, and also in allowing space on development land to add capacity. But he says there is a danger that tenants want to "have their cake and eat it", because the nature of what they want is also changing.

"A couple of years ago you could have built a mega shed [500,000 sq ft] and been pretty certain that Amazon would have taken it, but now even Amazon is looking for smaller distribution centres closer to delivery points," he says. "In addition, you have delivery specialists such as DPD that need more and more vehicle space on a plot, so the building size relative to the development site is going down. It's a changing market and not one size fits all."

Brickell adds: "Flexible warehouse designs need to be incorporated into new warehouses from today in order to see the life of the asset extend in future years to meet rising volumes and consumer demand."

He continues: "While there may be additional development costs today to implement these provisions, it is a worthwhile investment and a less expensive alternative to building completely new warehouses. It will also help secure tenancies for longer periods if occupiers know their space can be expanded as their business grows."

Even with such approaches, Kirkwood believes there is likely to be an imbalance "for some considerable time" and, like Brown, he says optimisation of what is available is critical given the current situation.

"We need to look at space productivity, at labour rates, at automation," he says. "But I think the industry has been very focused on the customer-side of the digital age and not focused enough on what can be done at the back-end. I don't think this is as optimised as it should be."

The reality, then, is that the pipeline is unlikely to accelerate at the pace the market requires. Instead, retailers and third-party logistics suppliers will have to be inventive, optimising all their real estate to assist with fulfilment, improving operating systems and being more flexible about the diversity of distribution properties they use.

"I believe that the property developers are trying to respond," says Brown. "But constructing a building takes time and, while new build comes online, so too some of the older stock will need refurbishment. There will continue to be a shortage of up and ready distribution space."

Investment in UK warehousing

The rising demand for logistics property has inevitably attracted big investors into the UK market. Blackstone Real Estate Partners Europe IV recently acquired nearly 6.5 million sq ft of logistics assets in the UK for its European logistics company, Logicor, from a joint venture between funds managed by Oaktree Capital Management and Anglesea Capital.

The portfolio of 16 warehouse properties is located in core logistics markets close to urban centres, including Birmingham, Leeds and Oxford, leased to a diverse range of tenants such as Arcadia, B&Q, The Co-Operative, Debenhams and Unipart.

TH Real Estate secured a new £400m debt financing on behalf of its circa £1.1bn flagship UK Retail Warehouse Fund to expand its acquisition programme. Meanwhile, both Goodman and IDI Gazeley UK are among those most active in developing new space, the latter with three build-to-suit projects with John Lewis.

The most recent was a 638,000 sq ft distribution centre at Magna Park, Milton Keynes. Dino Rocos, operations director at John Lewis, says: "As customers' shopping habits evolve, so too does our operational business model. The new distribution centre will enable us to respond better, react and fulfil omnichannel shopping experiences, be it via phone, tablet, desktop or visiting a shop. For the supply chain this means improving availability."

Similarly, specialists such as LondonMetric have been drawn from the retail parks market towards logistics. Chief executive Andrew Jones says: "As an investor it seems right to be moving into a market that is clearly expanding and out of a far more challenging retail environment."