ASDA & DECATHLON

Expect the unexpected

High-profile mergers and a growing trend of brand tie-ups are the latest steps in a paradigm shift in retail, which, as **Ben Cooper** reports, is having profound effects on the property landscape

It wasn't that long ago that to suggest Sainsbury's might buy out Argos, that Tesco and Arcadia might form an alliance, and that Amazon would be getting into bed with Morrisons would have got you some very incredulous looks. But the catchphrase for retailing over the past two years seems to be, expect the unexpected.

The thinking behind big retail mergers and brand tie-ups is usually clear. Carphone Warehouse and Dixons, for example, was an obvious match with hindsight. Tesco has space it can't offload; Sir Philip Green has publicly said he wants to reduce Arcadia's standalone store portfolio: cue the deal to put Dorothy Perkins, Evans and Burton concessions in the grocer's excess space.

With any merger or alliance, when store and supply chain costs and operations end up being duplicated, usually real estate rationalisations follow. So with Sainsbury's boss Mike Coupe predicting this trend to continue, that "different forms of alliances, different combinations of business, will form over time", what does it all mean for the property market? Could the new era of the unexpected becoming the expected mean a net loss for the real estate economy?

For the sort of "imaginative solutions" Coupe said will be offered to these modern retail challenges, reads a whole string of intriguing developments: Morrisons' deal with Amazon involves providing the etailer with physical points of sale; the acquisition and imminent name-change of Homebase by Wesfarmers; French sports giant Decathlon taking concession space in Asda.

But Professor Alan Braithwaite, founder and chairman of real estate consultancy LCP Consulting, says that it's not just changing shopper habits but wider property problems that are driving new solutions.

He says: "The big story is that retail is ↘

grossly over spaced, and the cost of retail real estate is exclusive and too high. Retailers are facing declining profits and increasing costs, such as business rates, which will lead to them exiting stores. As the whole world switches to digital these costs will be under sustained pressure for at least 15 years. We will see mergers and acquisition being a big part of it and also more CVAs as another big factor."

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ALAN BRAITHWAITE, LCP CONSULTING

One of the most potent examples of this in action comes from the ongoing post-merger restructuring of Dixons Carphone. The long-term plan, involving bringing together the three key brands – PC World, Currys and Carphone Warehouse – into combined three-in-one stores, makes perfect sense in retailing terms. But the net effect on its overall property requirements isn't exactly cheery news in real estate circles: 134 stores are to close in the next 18 months.

Possible rationalisation

So what would happen if some of the big mergers currently being discussed, most notably Sainsbury's likely buyout of Argos, do go through? The potentials for economies of scale are obvious, as is the inevitability that a merged company would end up with stores from across the brands side by side in many cases, perhaps to the benefit of each, perhaps not, but definitely calling out for some rationalisations to be made. As Damian Sumner, head of retail agency at JLL, says: "It takes a while for these things to play out but, as with the Dixons Carphone merger, you eventually see big savings in sharing space."

The decision in March by BHS owner Retail Acquisitions to put the company's bulky store chain through a CVA came as no big surprise, not least to Sir Philip Green, the former owner who sold the company for £1 less than a year before. Green's public statements that he would be seeking to rationalise Arcadia's presence on the high street and reduce rents, and consequent offloading of BHS, have served as a statement on behalf of modern retailing: that store chains don't need to be the giants they once were; that new, agile solutions are being sought.

One of Green's own solutions for the existing Arcadia chain is equally revealing. As of the end of last year, shoppers have been able to find Evans, Burton and Dorothy Perkins conces- ↘

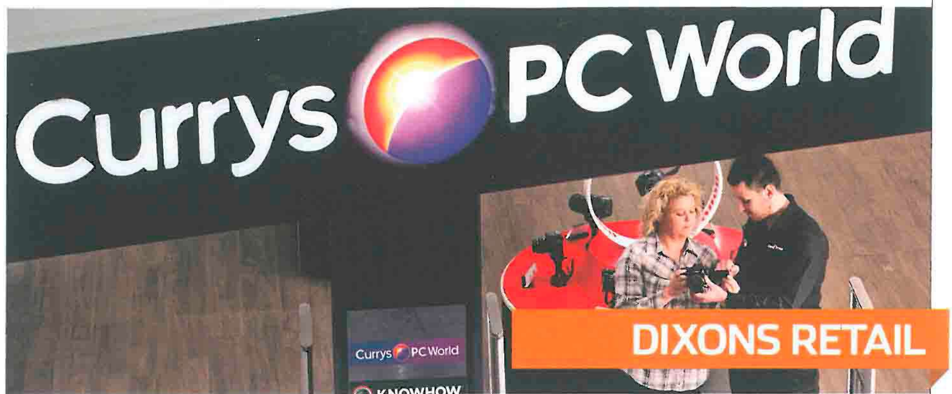
sions within selected Tesco stores, and Claire's Accessories concessions in others, thanks to tie-up deals the grocer has made. For Tesco it's a handy solution to excess space problems, and for Green's Arcadia it's a way of keeping a presence without the big costs of full stores.

CBRE head of retail tenant representation Graham Barr says: "Green wants to consolidate his high street portfolio but open more concessions. Retailers like Green have said publicly that they want to reduce their stores; this way he is able to drop his overall bricks-and-mortar costs but still leave himself with that point of sale."

Alliances like these might just be the future for large sectors of the retail industry. Especially with Coupe's statements following an already well-established precedent – think Costa concessions in Debenhams, Barclays bank branches in various supermarkets and now Decathlon in Asda stores. Indeed, Sumner says that increasingly retailers are taking the possibility of brand alliances seriously, despite the risk of some business being lost in the process.

He says: "We've got lots of retail clients who are asking us to look at possible brand tie-ups as a new way to approach their property strategy. The challenge for the supermarkets is to make sure that they don't double up too much on the products they sell in store; they don't want to carve off space for another brand which will affect their own store performance."

As Coupe said in March, the future is hard to predict – not least in retail property, which has seen so much change. But with rationalisation sometimes the sole driver for a merger or strategic tie-up, and pressure to have ultra-efficient store estates showing no signs of easing, no strategy, not even the unexpected, is off the table at the moment.



"The challenge is to make sure they don't double up on products

DAMIAN SUMNER, JLL

Mergers and rationalisation: the impact on landlords

While retailers are in the position to adapt, landlords aren't so lucky. Especially, as Joanne Fearnley, specialist in commercial property at law firm Gordons, says, the rationalisations from mergers and alliances is just the latest shift in a wider move towards an overall reduced appetite for space.

"This is a trend that has been going on since the start of the recession," she says. "Initially there were the retailer insolvencies, then the changes with online shopping and click-and-collect, and now there is a whole new way of shopping. Mergers and brand tie-ups are the latest in this long-term change."

For landlords the results of this have been tough, but there are still bright spots. MMX Retail founding partner Nick Symons says: "Overall the

market is healthy but it is patchy; every town has its nuances. Retailing in the UK has never been more complex than it has become now. In 90% of locations landlords have dropped occupational costs as far as they can. In some of these locations rents have dropped by as much as 60% to 70%."

And, while mergers and rationalisations, brand alliances and the 'clicks versus bricks' debates are clearly going to remain a part of the retail narrative for some time, Knight Frank head of retail research Stephen Springham says that this doesn't necessarily equate to as gloomy a picture for retail property as some suggest.

He says: "Vacancy rates are coming down and most retailers are still in expansion mode. Retailers are mainly closing stores when they are not profitable, not because of a seismic shift but because of digital. And, while there are some big examples of retailers downscaling because of mergers, these tend to be the exception rather than the rule."