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OMNI-CHANNEL RETAILING AND THE RISE OF THE DIGITAL CONSUMER:

EVALUATING THE OPPORTUNITIES AND TRENDS FOR CANADIAN RETAIL PROPERTY

PORTFOLIO ANALYSIS & RESEARCH SERVICES

GWL REALTY ADVISORS

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AT A GLANCE

- Omni-channel retailing is an important concept describing the multiple access points connecting shoppers and retail products, as well as the growing influence of digital activities on these relationships. Omni-channel retailing is important for property investors as it marks a new way of thinking for both retailers and consumers. This is changing tenant demand for retail property, and accordingly, its purpose and use.

- Mobile technologies such as smartphones and tablets have been critical to the growth of omni-channel retailing, allowing consumers instant access to retailers and their products. Accordingly, retailers are also supporting this growth though capital investments in technology, logistics and store efficiency to improve their omni-channel offerings. These investments are different from retailer strategies a decade ago, where a majority of the growth was directed towards physical stores and increasing store counts.

- Although online sales still account for a relatively small share of total retail sales in Canada, it continues to grow at a rapid pace. Media, Clothing and Accessories and Electronics in particular have seen the most online exposure. The most notable real estate impact of growing online sales is reduced retail space demand, but research suggests that omni-channel retailing also helps reinforce the need for physical space. The key difference is that retail property is now being used in more efficient and strategic ways by retailers.

- An analysis of store counts, store sizes and Canadian shopping centre performance suggests that shopping centres are beginning to experience changes due to omni-channel retailing in terms of tenant composition and sales performance. However, Canada's small retail market, high barriers to entry and relatively conservative development industry continue to make retail real estate a stable asset class.

- For retail property investors, strategic investment and development recommendations include focusing retail assets around one of experience, convenience or function, as well as looking beyond traditional financial and demographic criteria when evaluating investment opportunities towards more qualitative and tenant-specific factors. Also important is the ability for real estate investors to promote omni-channel activities at their retail properties, either through logistical, experiential or technological means.

SECTION 1: INTRODUCTION

Defined as a new retail paradigm where multiple methods such as physical stores, websites, mobile devices and social media are used to access and communicate with shoppers, omni-channel retail is now on the minds of many as a powerful, emerging theme changing traditional shopping activities. Retailers such as Apple, for example, continue capturing news headlines not only for their strong sales performance, but also for their retail strategies which include large online platforms and holistic, service-oriented physical shopping experiences.

The growth of omni-channel retailing has had a noticeable effect on retail property in recent years, foremost being the impact of online shopping and reduced space demand. However, while bricks and mortar stores face the most headwinds in an omni-channel environment, we note that they are still relevant—the key trend is that retailers are now using them in more strategic and efficient ways, particularly in the facilitation of consumer experiences and product movement.

"Taking a step back... it is easy for us to see that retail is doing what it always does-change constantly. In our shop, we use the term that retail is Darwinian. If a retailer does not change, they will become extinct. The big difference now is that retail is changing faster than ever, driven by technology and a consumer that is restless."

Maureen Atkinson, Senior Partner, J.C. Williams Group (Atkinson, 2015)

The concept of omni-channel retailing is important for retail property leasing and investment in that it marks a new way of thinking for both retailers and consumers. Consumers are now connected to retail products more than ever, but these connections are no longer through traditional "single channel" ways such as store browsing or going to a website. Instead, these connections are made at a variety of overlapping levels, be it digitally, socially or physically. As a result of this trend, retailers' business efforts are now directed towards leveraging these connection points to drive sales, with retail property no longer the only channel, but one of many. Retail property investors today should look at real estate as a means to facilitate these connections, as latter sections of this report will discuss.

THE REPORT FOCUSES ON THE FOLLOWING QUESTIONS:

- What is the state of omni-channel in Canada? What is its current and expected market capacity?
- To what degree does omni-channel and online shopping affect different retail categories?
- What is the role of omni-channel retailing and how does it affect retail property? What are some emerging tenant trends?
- What is the expected impact on physical retail space and where are there specific exposures or risks?
- What are the opportunities and risks from a real estate management and investment perspective?

This report is the second in GWL Realty Advisors' (GWLRA) continuing research on e-commerce and omni-channel retailing and its effects on commercial property. In the summer of 2014, GWLRA published a report[1] examining the impact e-commerce would have on industrial real estate in Canada. Among the report's findings is that the growth of online shopping is creating multiple sales channels for retailers and the division between offline and online retail is becoming more blurred than ever. As such, what constitutes an "in-store" or "online" sale is no longer as relevant as retailers are now focusing on more broad-based market strategies to access their customers. Also important is the fact that multiple logistics models are emerging and that the physical store still plays a role in the access and distribution of goods.

GWLRA's own research and analysis on the topic was supplemented by discussions with industry experts, including those from commercial leasing, supply chain and retail sectors. GWLRA would like to especially thank J.C. Williams Group for their perspectives on this topic.

[1] Yuen, A., & Waters, W. (2014). Digital Shift: Understanding the Emerging Impact of E-Commerce in Canadian Industrial Real Estate. Vancouver: GWL Realty Advisors.

SECTION 2: AN OVERVIEW OF OMNI-CHANNEL RETAIL

DEFINING OMNI-CHANNEL RETAIL

Omni-channel retailing is a concept used to describe the increasing variety of access points between customers and retailers, brought on by the growth of online shopping and its integration with physical stores. Omni-channel retail highlights the notion that ways of researching, purchasing, receiving and returning a product are more diverse and connected than ever before (Figure 1). For example, a customer can choose from a variety of methods to research (online, in-store, social media), buy (online, in-store), receive (in-store, home, post office, shopping centre) and return (in-store, supplier, home, post office) an item. The result has been retailers working to integrate these various digital and physical channels into their existing business and logistics operations (Yuen & Waters, 2014).

Figure 1: Omni-Channel Experience

E-commerce and omni-channel are often used interchangeably to describe the process of purchasing products online. And while e-commerce and omni-channel retail are two related themes, they are different in terms of definition and scope. E-commerce refers to shopping activities done online, while omni-channel refers to not only online shopping but a host of other digital and physical shopping methods and more importantly, their interconnectivity.

THE MARKET CAPACITY OF OMNI-CHANNEL

Although online shopping has been around since the mid-1990s, it has been within the last five years that the concept of omni-channel has emerged. **Mobile technology such as smartphones and tablets were important in the growth of omni-channel retailing** as online shopping became accessible nearly anywhere and anytime. Online platforms to support omni-channel retailing such as websites, mobile applications and digital payment also improved, and retailers over the last several years have also increased their online product offerings and operational capabilities in the segment (Yuen & Waters, 2014).

In Canada, we note several trends supporting the growth of omni-channel retailing:

DEMOGRAPHICS

According to Statistics Canada (2013) and Ipsos (2014), those aged 16-24 are the highest online shoppers, particularly for clothing and accessories and media. Unsurprisingly, this age cohort was the first group born fully immersed with internet access and mobile technology and as this cohort ages (along with subsequent cohorts), the Canadian population will be increasingly adept at making purchases online. Increasing spending power from this age cohort over time could also lead to higher online purchases as well.

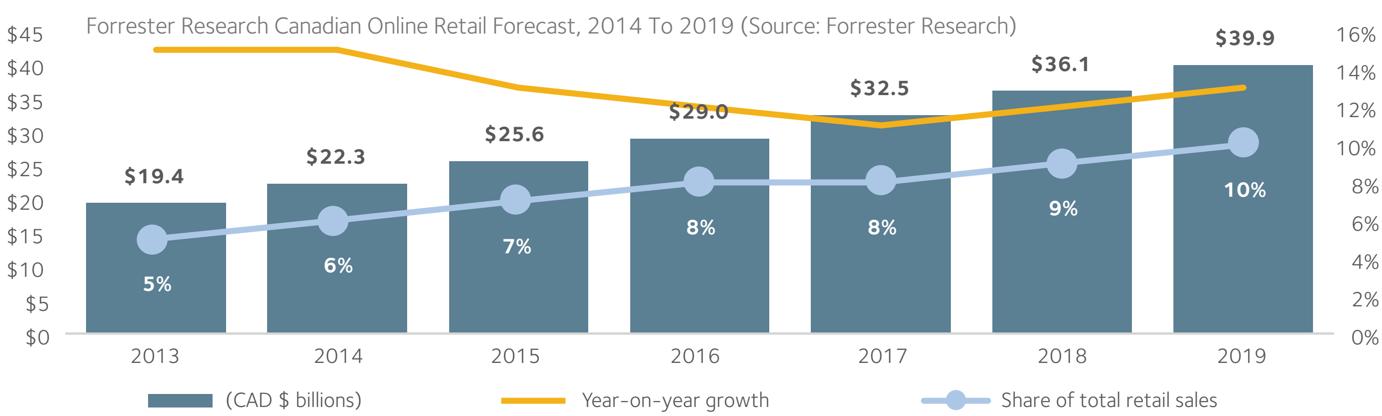
E-COMMERCE IN CANADA: SMALL AND IMMATURE, BUT GROWING FAST

Online retail sales[2] have been on a strong growth trajectory the last decade, witnessing nearly double digit growth annually in Canada since 2004. According to Forrester, a global market research firm, online retail sales in Canada reached $19.4 billion CAD in 2013, nearly a 300% increase from 2004 levels (Figure 2) and making up just over 5% of the total retail market (Sheldon et al., 2014).

Although growing, the market share of online sales in Canada is smaller compared to the United States (US) and the United Kingdom (UK) where online sales make up 6%-12% of total retail sales and is much larger in real terms at approximately (CAD) $290 billion and $127.2 billion respectively as of 2013 (eMarketer, 2014). On a per capita basis, online shopping accounts for approximately $916 and $1,984 in sales in the US and UK respectively, compared to $552 in Canada. **This trend is important as it illustrates the relatively small size and immaturity of Canada's e-commerce market relative to other global markets, as well as the sheer size of regular bricks and mortar sales activity.**

From 2002 to 2012, online sales accounted for 15% of the total retail sales growth in Canada and from 2007 to 2012 accounted for 25%. Over the next five years, online sales could reach upwards of $40-$50 billion in Canada by 2019 according to several estimates, pushing the share of purchases made online to over 10% of the total retail market. The growth of online sales, estimated to average 13% annually from 2014-2019, is expected to well exceed the pace of in-store sales which is estimated to grow at less than 4% per year. Estimates vary on how large and how fast e-commerce will grow in Canada, but in other global markets where e-commerce is at a more mature stage such as the UK, online sales represent 10%-12% of sales and are forecast to stabilize at 20-25% (IMRG/Capgemini, 2013).

Figure 2: Online Sales in Canada



[2] For the purposes of this report, online retailing and e-commerce will be used interchangeably to define the wide range of business to consumer (B2C) commerce activities completed through the internet including physical products as well as digital services and transactions.

TOP 20 INTERNET RETAILERS *According to a report by Internet Retailer looking at the top 20 online retailers in Canada based on annual sales growth, these groups have averaged 28.7% compounded annual growth from 2009 to 2012 in online sales. Even more impressive is the total growth from 2009 to 2012 for some retailers, including lululemon (978%), Beyond the Rack (2248%) and Hudson's Bay (306%). Most groups have come from the apparel and accessories sectors. It should be noted that not all the top internet retailers have physical stores; Beyond the Rack and Cymax for example, are online only retailers.*

Internet Retailer – Top 20 Online Retailers (Top 10 Shown)	2009 Web Sales	2012 Web Sales	2009-2012 % Growth	CAGR
lululemon athletica	$ 18,300,000	$ 197,300,000	978%	120.9%
Beyond the Rack	$ 6,158,624	$ 144,600,000	2,248%	186.3%
Hudson's Bay	$ 35,000,000	$ 142,260,000	306%	59.6%
The Shopping Channel	$ 85,000,000	$ 130,032,000	53%	15.2%
Cymax Stores	$ 80,000,000	$ 101,760,000	27%	8.4%
Indigo Books & Music	$ 82,000,000	$ 90,810,602	11%	3.5%
Soft Choice	$ 38,394,096	$ 53,526,750	39%	11.7%
Ice.com	$ 60,000,000	$ 45,000,000	(25%)	(9.1%)
Mountain Equipment Co-op	$ 19,705,815	$ 26,969,580	37%	11.0%
Aldo Group	$ 19,800,000	$ 25,733,500	30%	9.1%
Top 20 Online sales	$ 494,830,155	$ 1,055,065,590	113%	28.7%
Top 20 Online sales		Average	221%	29.1%

Source: Internet Retailer 2013

ONLINE SHOPPING HAS MULTIPLE DEFINITIONS AND MEASURING IT REMAINS DIFFICULT[3]

Measuring online sales performance remains difficult, due to a lack of standardization in methodology and definitions[4]. Online shopping generally covers the following activities, although tracking online sales through these channels can vary:

- Products researched online and purchased offline
- Products purchased online and collected in store
- Products purchased in-store (could be through store website) but for home delivery
- Products purchased online and delivered to customer
- Digital products and services purchased online

Most measures of online sales are done through two ways: 1) large consumer surveys whereby respondents are asked questions about their online purchases and consumer behaviours, and 2) large retail business surveys where respondents provide their estimates of online sales relative to their in-store and overall retail sales. Both methods are then used to extract trends for the general population.

One difficulty is determining when and where a sale is considered online: products 'researched online and purchased offline' and 'store to direct' purchase methods for example, are both in-store activities but can be also considered online purchases. Other considerations include measuring online sales for retailers who do not have physical stores, tracking digital products and services (software, online games, mobile applications, online food orders), as well as cross-border transactions from US and international retailers. These are important distinctions to be aware of as some online activities have no direct relevance to retail property.

[3] The growth of online retail sales could also make it more difficult for retail landlords charging percentage rents to properly track sales. While no clear solution has emerged, some landlords are using creative ways to track sales, either by taking a percentage share of total market sales, or requesting more detailed sales records from retailers. Another method is shifting to more gross and net rent agreements with retailers. Although an issue with legal and regulatory considerations, the retail and real estate industry is adapting to this trend.

[4] Although the US Census Bureau regularly tracks e-commerce sales, data is limited in Canada through Statistics Canada. Statistics Canada's (CANSIM) annual retail store survey and internet use survey, conducted from 2010 to 2012 with e-commerce data, provide the most reliable government-led sources. Outside of Statistics Canada, there are several independent consulting firms that track online sales data, such as J.C. Williams, Forrester, CBRE Limited, and eMarketer.

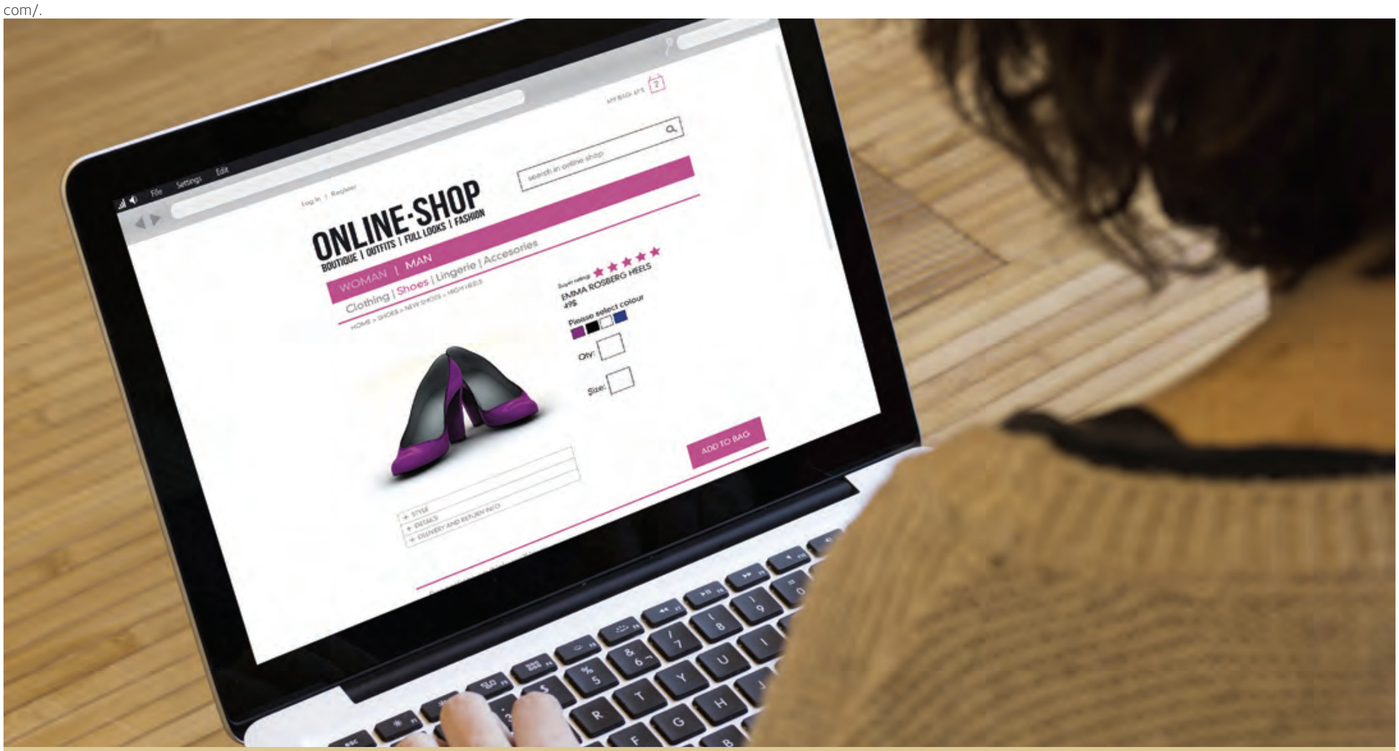
INCREASING ONLINE/E-COMMERCE INVESTMENT FROM RETAILERS

Recently, retailers have started to shift their expansion plans away from physical stores and towards omni-channel integration and technology hoping to benefit from a relatively new but fast growing market segment (Yuen & Waters, 2014). Despite being capital intensive, some of Canada's largest retailers over the last few years have expanded their online offerings, upgraded websites and invested in technologies and infrastructure to better manage product inventories. Although there are many retailers only thinking about omni-channel retailing at the moment, more groups continue to make the transition. The overall result has been a retail market that is more proficient with omni-channel activities, something that was limited to only a handful of retailers prior to the 2008-2009 recession. Some of the historic barriers to the growth of omni-channel retail in Canada have been a lack of retailers with sufficient websites, operational knowledge, inventory control or infrastructure to support online activities as well as high shipping/logistics costs due to the low density of Canada's population (Yuen & Waters, 2014; Gragtmans, Hay, & West, 2013). These issues are starting to be overcome as more retailers invest in their online platforms, improve distribution/refund channels and start to offer the same products online as in-store. Shipping costs remain a challenge for retailers, although multiple logistics models are starting to emerge to help balance high distribution costs and how, where and when shoppers get their products.

PROLIFERATION OF MOBILE TECHNOLOGY AND DIGITAL SHOPPING PLATFORMS

Mobile technology has been a key driver for the growth of omni-channel retail, providing shoppers with constant access to products. While a recent Ipsos (2014) internet use survey reveals that desktop computers and laptops are still the most dominant method of online purchases (80% of respondents) in Canada, purchases through smartphones and tablets continue to rise annually. Additional research reveals that **mobile technology has helped to expand omni-channel capabilities not necessarily through direct purchases on smartphones or tablets, but through other means** such as using mapping features to find store locations, researching products, or comparing prices (L2, 2014; Duong & Lella, 2014). Mobile applications and websites[5] such as Truefit and Pinterest, for example, have also helped to expand the growth of digital shopping, allowing customers to shop more efficiently and interactively online.

[5] For more information on these applications see http://www.truefit.com/ and https://www.pinterest.com/.



SECTION 3: EMERGING RETAIL THEMES IN AN OMNI-CHANNEL ENVIRONMENT: SAME RETAIL SPACE, DIFFERENT RETAILER USES

"While the death of physical stores seemed a real possibility six years ago, a greater focus on quality over quantity has reshaped retailers' business models, together with their property mind-sets"

- Retail's Digital Future (Addleshaw Goddard; BCSC; Blackstock, 2014).

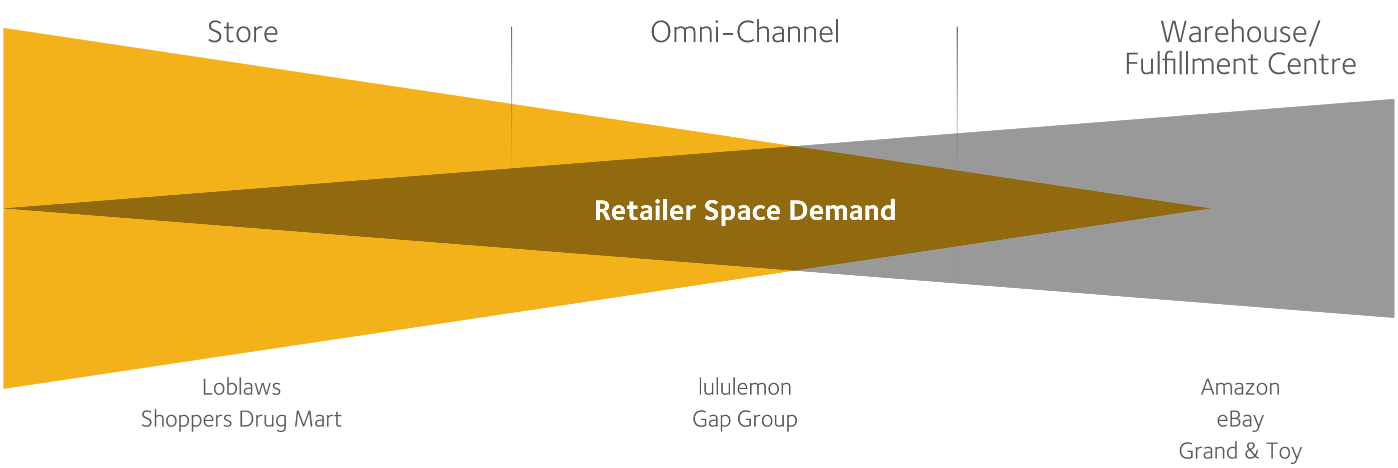
A NEW, CONNECTED VIEW ON ONLINE AND IN-STORE SALES

Because customers can choose how and where they purchase products in an omni-channel environment, sales at individual stores are no longer the only indicator of sales performance. A customer researching a product online and purchasing a product in-store ("webrooming") is just as important as a customer researching in-store and buying a product online ("showrooming").

Websites and physical stores are emerging as the "front of house" access points for retailers while "back of house" product inventories are now being stored and dispersed through multiple logistics points including storerooms and fulfillment/distribution centres (Figure 3). The net result is a more holistic perspective from retailers on retail sales performance and the integration of bricks and mortar stores with other retail channels.

Figure 3: Omni-Channel and Retail Space Needs

Finding balance: space demand varies by retailer and e-commerce structure. *Image not to scale: shown for illustrative purposes only.*



"RIGHT SIZING": SMALLER, LOCATION EFFICIENT AND MORE VARIED STORES

"The economics of retail are changing, driving a reduction of store space as retailers migrate to more cost-effective formats, venues and channels"

-How many stores will we really need? UK non-food retailing in 2020 (Javelin Group, October 2011)

"For decades, the retail industry has followed the same straightforward formula for growth: open new stores. By replicating a proven store format in a new catchment area, retailers could reliably enlarge their customer base and count on healthy increases in sales… But the world has changed. More than half of consumers now research their retail purchases online, making purely in-store purchase decisions the shrinking minority."

- McKinsey Insights (Herring, Wachinger, & Wigley, 2014)

For much of the last century, retailers' growth strategies centred on a "strength by numbers" approach; the only way to gain market share and competitive advantage in a market was by having more store locations. Today, the cost-efficiencies brought on by omni-channel retailing and more purposeful shopping trips by consumers[6] suggests some retailers no longer require as many or as large of stores to generate sales in a market (Herring, Wachinger, & Wigley, 2014).

The advantages of omni-channel retailing allow retailers to apply a more flexible and market specific strategy to their stores. Retailers used to have a one-size approach for all their stores and will now scale their store sizes and number of locations. Examples include urban format (e.g. Canadian Tire, Urban Brick, CityTarget) and satellite format (Best Buy Mobile, Ikea) stores.

Part of this trend is due to the cost efficiencies generated through online shopping, as well as the reduced need for "back-up" inventories in physical storerooms given improvements in product inventory tracking and logistics. Retailers are also using stores more efficiently—in some cases, larger format suburban stores with lower rents are emerging as storage and distribution points for smaller, more expensive urban locations.

A direct leasing risk from retailers "right-sizing" their store portfolios is the potential for **reduced space demand. This is particularly the case for retailers with significant store counts in over-lapping market areas. We also note that as retailers reduce their store counts, they will tend to keep high performing stores in strong locations often clustered with similar retailers.**

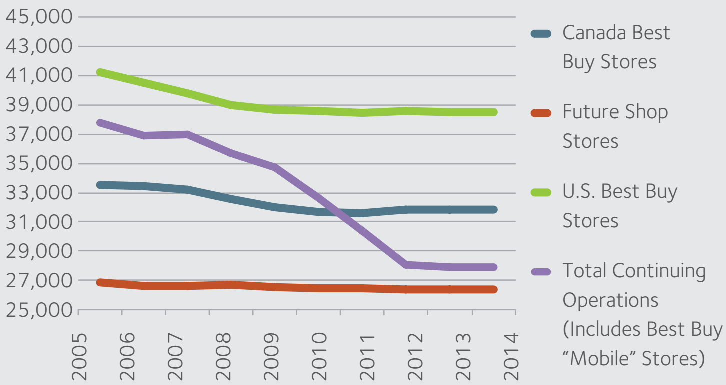
Figure 4 profiles the store count and average size of several notable retailers in Canada and North America. Note the general trend towards both reduced store sizes and store counts.

[6] An ICSC report (Connolly, 2011) and a 2009 GWLRA report (Vandervelde & Waters, 2009) found that shopping trips are now more purposeful as shoppers visit retail centres to buy specific items (as opposed to "browsing" trips). By using omni-channel strategies many retailers are able to gain a larger market capture out of a single store – they no longer need 2-3 stores in a market because customers go to specific shopping centres for selective trips or for product pick-ups.

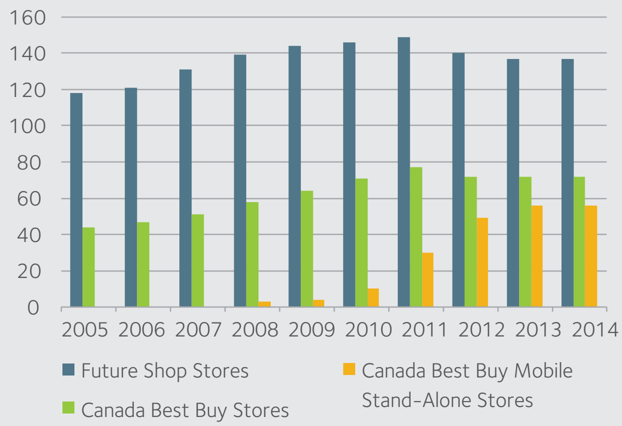
Figure 4: Notable Canadian Retailer Store Counts and Store Sizes (Source: Retailer Financial Documents)[7]

BEST BUY (FUTURE SHOP CANADA)

Average Store Size (SF), Best Buy & Future Shop Stores – N. America

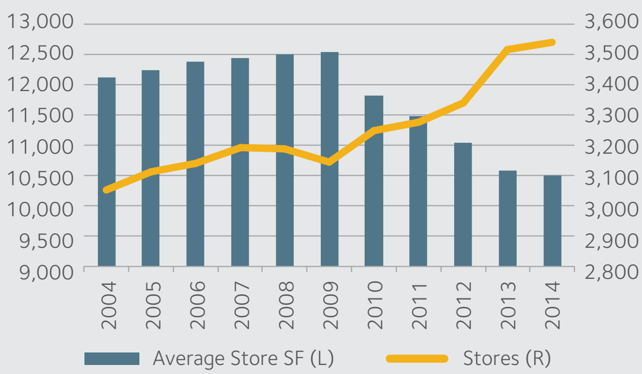


Total Store Count-Canada



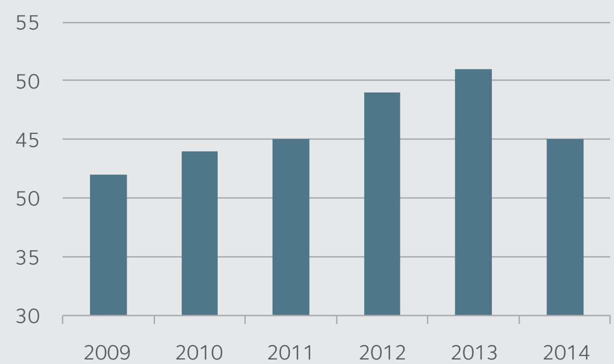
GAP INC. (GAP, OLD NAVY, BANANA REPUBLIC)

Global Store Size and Count



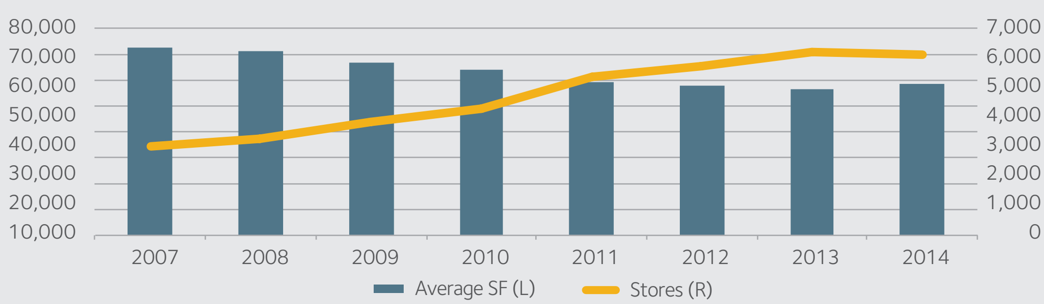
LULULEMON ATHLETICA INC. (CANADA)

Total Store Count-Canada



WALMART INTERNATIONAL

Global Store Size and Count



[7] As of March 2015, 66 Future Shop locations were closing in Canada while 65 other stores were converted to Best Buy locations as part of a consolidation and restructuring effort by Best Buy, the parent subsidiary. In June of 2015, Gap Inc. announced the closure of 175 Gap store locations across North America for cost-savings measures. Note that these recent changes are not yet reflected in their public records.

FLAGSHIP LOCATIONS AND MORE INTERACTIVE STORES

"What has changed is that the market is not growing and consumers are shopping across channels... so what we need now is fewer but better stores..."

- Elliott Chun, Best Buy spokesman, *No place for Future Shop as shopping's future shifts, Globe and Mail* (Strauss, 2015).

As retailers start to right-size their store portfolios, they are also turning several of their existing stores into flagship locations. These stores are usually their best performing locations in very high-traffic areas or top-tier shopping centres that provide critical mass and clustering of similar tenants. These flagship locations are well-designed, highly interactive stores and utilize technology to enhance a consumer's shopping experience (hence the growing use of the term "experiential" retail), either through product information on interactive displays, mobile applications that consumers can download on their phone and use directly in the store, or have kiosks/computers that allow customers to purchase products (Figure 5). Sales staff are focused on the service experience and product expertise as opposed to completing sale transactions. Groups such as Sport Chek, Hudson's Bay and Nordstrom for example, have converted or launched several flagship locations in Canada, often in high-streets or top-tier shopping centres.

Flagship locations many not carry a retailer's entire inventory, but instead feature specific or highly desired product lines. Flagship locations reinforce the concept of "endless aisles" – the store itself may not have all the products physically in the store, but they use their online platforms and product supply chains to support their product offerings by having rapid delivery and different pickup options for online orders.

Figure 5: Apple Interactive Stores, Hointer and Sport Chek

Apple Flagship showroom Store in New York City

Hointer Jeans "no-stock" showroom store

Sport Chek's in-store Medical Motion Gait Analysis tool for Runners

NEW RETAIL TENANTS

Omni-channel retailing is generating new types of retailers that require physical store locations. Online only or "pure-play" retailers are recognizing the merits of both showrooming and webrooming and are opening flagship store locations in high performing markets. Online retailers[8] such as Amazon, Frank and Oak and Clearly Contacts for example, have opened physical locations to enhance their e-commerce business.

Other non-traditional retailers such as Tesla (Figure 6) and Audi have also opened up retail locations in major markets; although having limited or no stock, the store serves as an access point for customers wanting to know more about the companies' product offerings beyond websites and dealerships. Pop-up concepts, although limited in amount in Canada currently, are also taking advantage of omni-channel and driving demand for retail space. Art, clothing and small accessories have been leading the pop-up trend.

THE NEED FOR A DIFFERENT TYPE OF STORE AND SHOPPING CENTRE

The emergence of multiple sales channels is keeping stores more relevant than ever, although their role has changed from facilitating sales only to now serving as showrooms and product distribution points. As an RBC Capital Markets report (Downey & Smith, 2015) notes, "in our view, the future of retail lies in "bricks and clicks," not "brick vs. clicks" as the omni-channel evolves" (P.77), suggesting that online and in-store channels are mutually beneficial. Supporting research suggests that omni-channel shoppers tend to spend more than single channel shoppers highlighting the need for strategic bricks and mortar locations in addition to online platforms (Turner, Wowchuk, & Tang, 2014).

The role of retail property in online delivery has also emerged, creating new opportunities for real estate managers. **Some retail landlords and retailers are building on-site product "pick-up" locations for online orders at shopping centres to drive more shopping visits and alleviate shipping costs for retailers.** Layouts and site configurations of these shopping centres are changing, focusing on quick vehicle access and convenience.

Figure 6: Tesla Retail Store in the United States

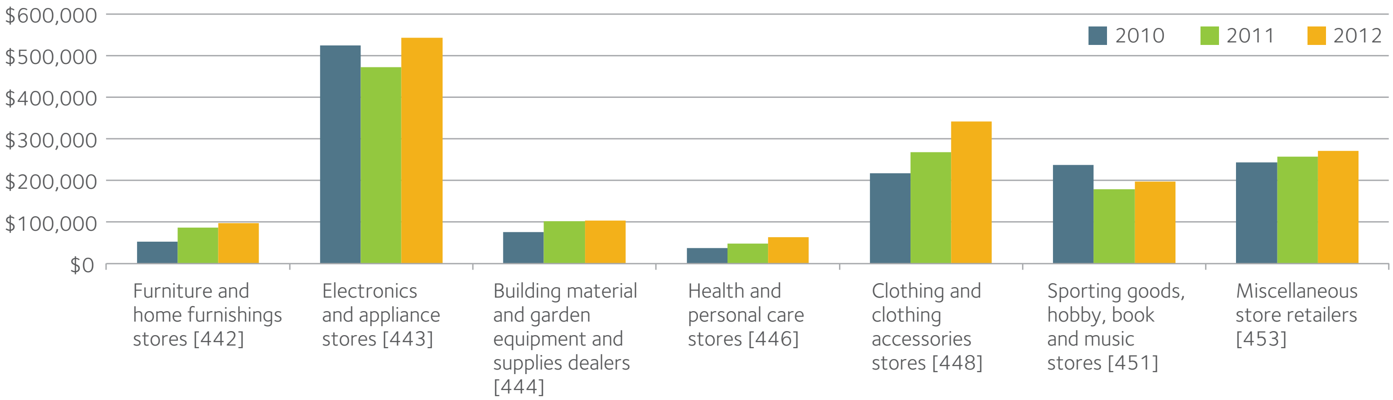
[8] For more information on these retailers please go to: http://www.amazon.ca/, https://www.frankandoak.com/ and http://www.clearlycontacts.ca/

ONLINE SALES EXPOSURE AND RISK VARIES WITHIN AND BETWEEN PRODUCT CATEGORIES

Although total online sales represent less than 5% of all retail sales in Canada, a majority of the activity is centered within a few categories, including electronics and appliances, clothing and accessories, media and travel/tickets. Clothing and accessories and electronics and appliances, based on 2012 figures[9] from Statistics Canada for example, comprise 20% ($884 million) of the online market in Canada. Figure 7 provides total online sales by retail category based on Statistics Canada's annual retail store survey.

Figure 7: Retail Store Survey – E-Commerce Sales Only

Statistics Canada- E-Commerce/Online Sales (Notable Categories) - Annual (dollars x $1,000)

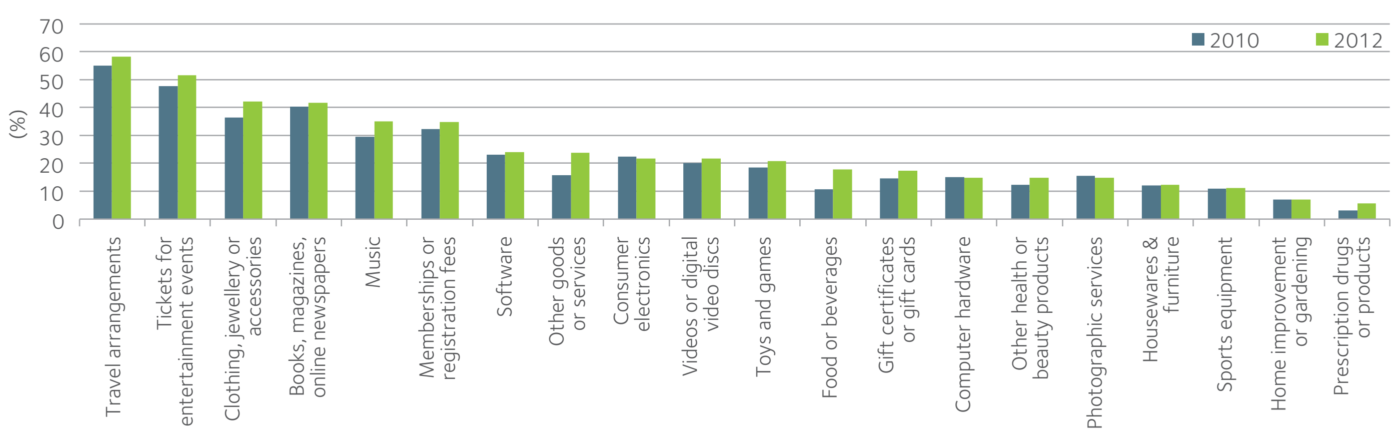


Source: Statistics Canada/CANSIM. Annual retail store survey, method of sale by North American Industry Classification System (NAICS) and store type.

Although electronics and appliances represent the largest online segment by dollar value (perhaps given the higher value of the products), research suggests that other retail categories account for larger shares of online consumer activity. Looking at retail categories which have the highest share of online sales orders from Statistics Canada (Figure 8), travel/tickets command a majority of the e-commerce activity for Canadian consumers, followed by clothing, books and music. Comparing 2010 to 2012, we see that clothing and music are two major categories that have increased their online sales share significantly. Electronics was a segment that remained little changed in terms of consumer orders. Although small, food was another segment that has seen substantial growth.

Figure 8: Canadian E-Commerce Orders by Shoppers, by Type of Product/Service

Electronic commerce, types of goods or services ordered, 2012 (Source: Statistics Canada)

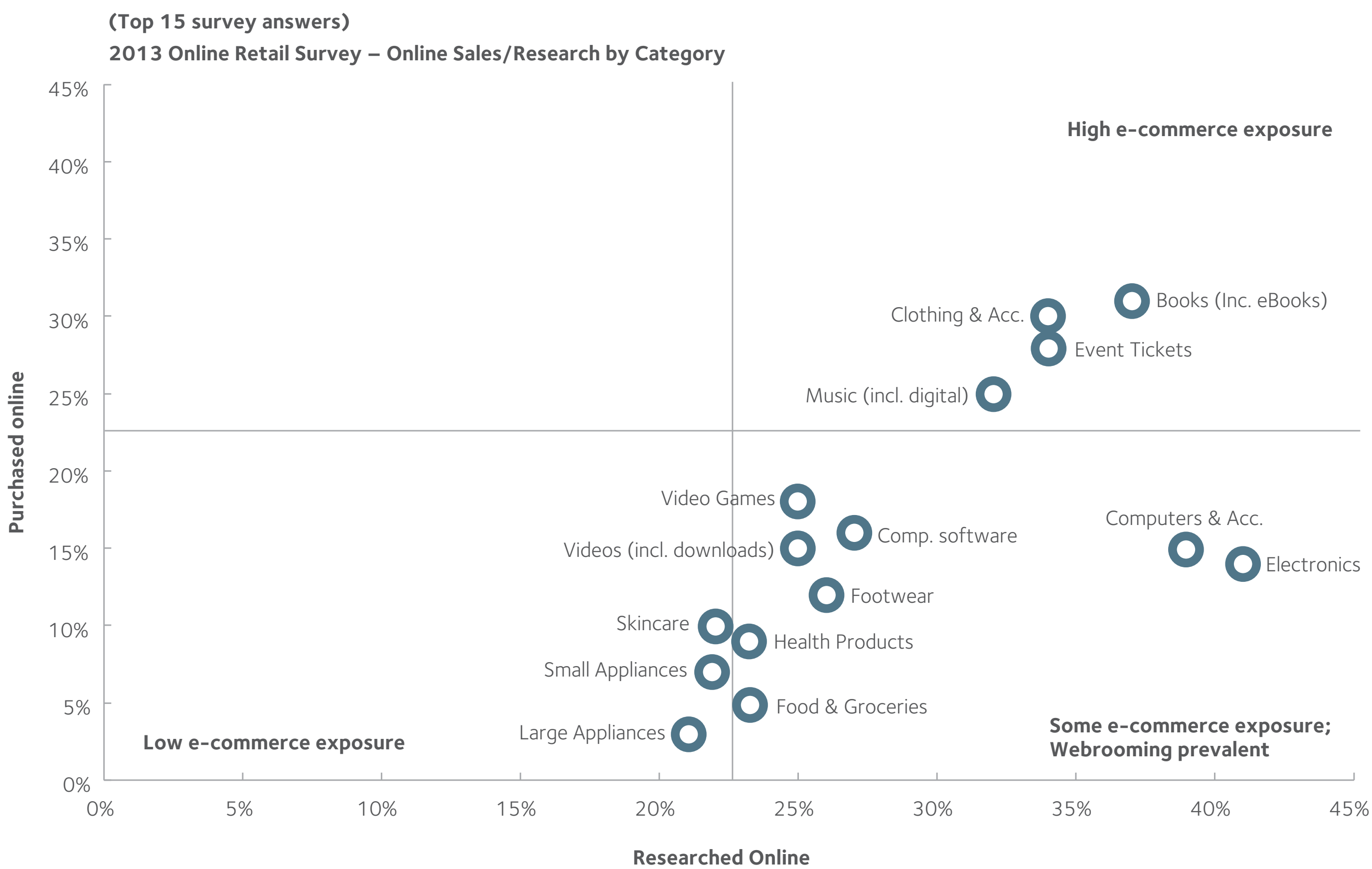


Source: Statistics Canada/CANSIM. Canadian Internet use survey, electronic commerce, electronic orders by age group and type of good and service.

[9] 2012 is the latest data available for e-commerce sales through Statistics Canada

From a recent Forrester (Sheldon et al., 2014) study on online shopping habits (Figure 9), we see that products such as books, tickets and clothing are being both researched and purchased online, while other products tend to be researched more often than purchased online (namely computers, electronics and footwear). Other products such as food, appliances and health products also have limited online presence. Online-only retailers continue to command a majority of the online purchases in Canada, with Amazon, eBay, Apple iTunes, Chapters/Indigo and Groupon representing the top 5 retailers according to Forrester research[10].

Figure 9: Forrester Online Sales Survey



Source: Forrester Survey of 4,000 Canadian Respondents

[10] Study results based on a Forrester Research survey of Canadian online adults who have purchased products/services online in the past three months and were asked what websites they purchased from. Respondents totaled 3,351 in 2013 and 4,034 in 2014 (Sheldon, Canadian Online Retail Forecast 2013-2018, 2013; Sheldon, Wigder, Wray, Varon, & Katz, 2014).

EVALUATING TENANT TRENDS FOR RETAIL PROPERTY

In relation to real estate, almost every retail category has exposure to online shopping but there are a **few sectors that have experienced a significantly higher transition online:**

- Smaller commodity items that can be distributed easily such as office supplies and books
- Digital products and paperless transactions such as tickets, travel, music and software
- Products with low differentiation in terms of use and brand (small electronics and accessories)
- Products that are easily returned (clothing)

Segments that have lower e-commerce exposure, conversely, include:

- Goods that require physical inspection and retailer expertise (luxury goods, high end electronics, automobiles and jewelry)
- Food and perishable items that require physical inspection
- Products purchased with frequency that are in small quantities and are of lower value (personal care items)

Segments that have limited to no e-commerce exposure include:

- Restaurants and food service
- General services
- Health, medical and fitness

The general theme is that regardless of category, **undifferentiated products have the most exposure to online sales**, while products that are specialized and personalized have the lowest exposure. Overall, **the most risk from a leasing perspective is in retail segments that face competition from online retailers who can compete on cost and similar product offerings**. The growth of Amazon, eBay and Apple iTunes for example, has been driven by the sale of undifferentiated commodity products at the expense of bricks and mortar retailers in similar segments (mobile phone accessories for example, is not brand specific and can be sold/distributed by any retailer globally).

The clothing and accessories and electronics sectors remain the most interesting (and among the largest) segments in retail, with some groups thriving with omni-channel retailing and others struggling. Although having growing online sales, some retailers have benefitted from having higher levels of differentiated products and strong branding. Groups such as Apple and lululemon for instance, operate self-branded stores featuring their own products. This is opposite to groups such as Sears or Best Buy that feature a variety of brands within their stores and whose products overlap with online (and other bricks and mortar) retailers. Price transparency and competition, accordingly, is very high for these types of "department-store" retailers. One emerging strategy is for retailers to promote and curate a variety of independent brands at their stores; each brand is independently marketed and promoted instead of the usual strategy of aligning products by type. Groups such as Hudson's Bay have started doing this, focusing on featuring several well-known brands within their flagship locations.

Segments that have low and limited online sales exposure, however, should not be seen as "bulletproof" sectors; technological and business innovation is continually advancing and all product categories increasingly have some form of online exposure, be it directly or indirectly. One example is the growing trend of online ordering for fast food establishments.

SIGNS OF A SHIFTING LEASING MARKET: CHANGING TENANT MIX AND RETAILER PRODUCTIVITY

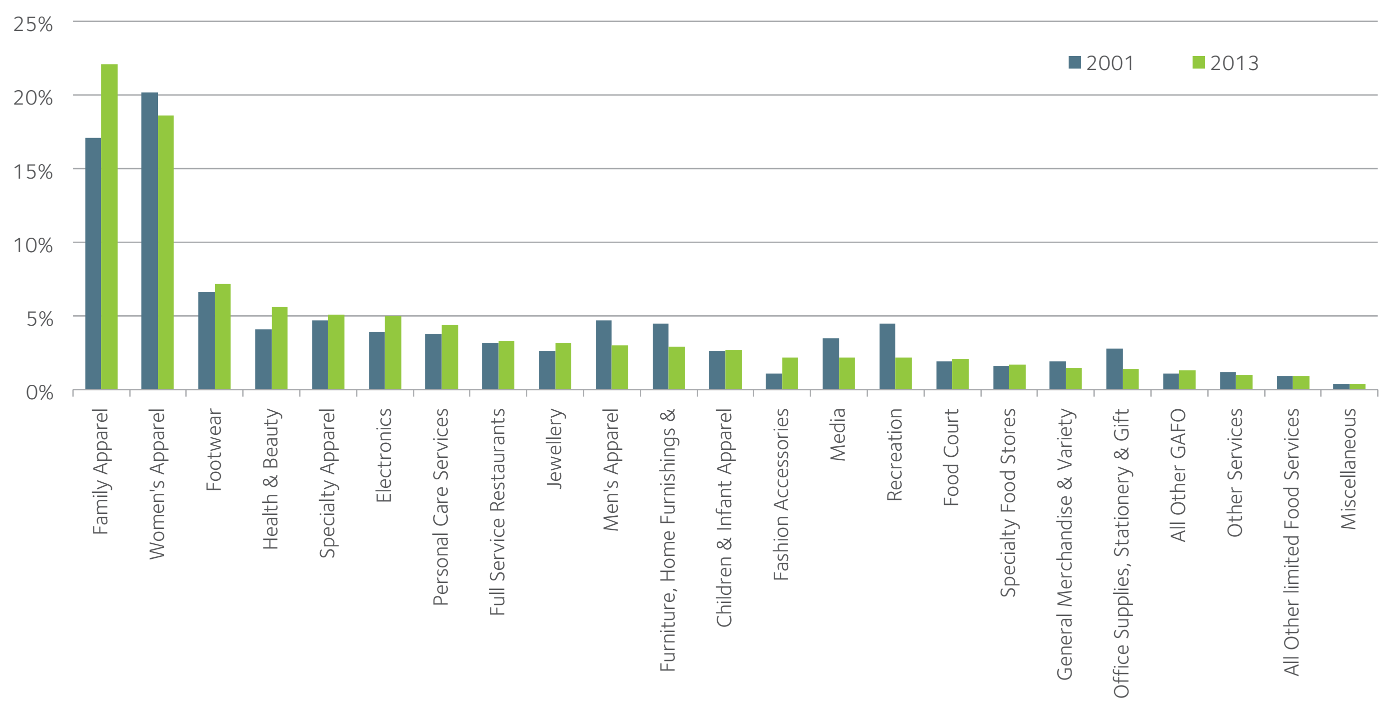
TENANT MIX DATA FROM ICSC

Data from ICSC tracking tenant occupancy ("mall shares") by retail category within super regional and regional shopping centres highlights noticeable changes within certain retail segments over several years (Figure 10). While the data focuses on super regional and regional shopping centres exclusively, the findings are still relevant and can be used as a proxy for other shopping centre types[11]:

- Women's and men's apparel, media, recreation and office supplies have been notable decliners in term of total occupancy the last decade.
- On the other hand, family apparel, while in the same category as women's and men's apparel, has seen the most growth the last decade, driven by the popularity of larger discount and unisex retailers such as Winners, H&M and Forever 21.
- The electronics sector, although being a segment with high online exposure, has grown slightly over the last several years due to the emergence of independent brand stores such as Apple and Microsoft as well as the general expansion of products in this sector.

Figure 10: Mall Share (SF) by Retail Category

Canadian Shopping Centre SF Mall Share by Tenant, 2001 – 2013 (Source: ICSC QuickStats)



Looking at Figure 11, although the change in tenant share within Canadian shopping centres is small (less than 5%) for each category, the impact is still noticeable. Using a 500,000 SF shopping centre as an example, a 5% increase within the family apparel segment in the last decade totals 21,000 SF of retail space, while at the same time a 1.6% and a 1.7% decline for women's and men's apparel equals 14,000 SF of combined space. It is particularly interesting to note the varied dynamics within the clothing and accessories sector: while the segment as a whole as has not changed dramatically in terms of its shopping centre share (approximately 60% of retail GLA), the individual categories have shifted.

[11] Detailed data tracking retail sales performance and occupancy for other retail properties remains limited in Canada.

Figure 11: Mall Share by Tenant Size - Sample Mall

Canadian Shopping Centre SF Mall Share by Tenant, 2001 – 2013 ICSC – Assumes 500,000 SF Regional Shopping Centre
(Data Source: ICSC QuickStats, Calculations by GWLRA)

	2003	2013	2003	2013	Net	% growth
Family Apparel	17.10%	22.10%	89,500	110,500	21,000	5.0%
Health & Beauty	4.10%	5.60%	20,500	28,000	7,500	1.5%
Fashion Accessories	1.10%	2.20%	6,000	11,000	5,000	1.1%
Electronics	3.90%	5.00%	20,000	25,000	5,000	1.1%
Footwear	6.60%	7.20%	34,500	36,000	1,500	0.6%
Personal Care Services	3.80%	4.40%	20,500	22,000	1,500	0.6%
Jewellery	2.60%	3.20%	13,500	16,000	2,500	0.6%
Specialty Apparel	4.70%	5.10%	23,500	25,500	2,000	0.4%
Food Court	1.90%	2.10%	9,500	10,500	1,000	0.2%
All Other GAFO (General Merchandise, Apparel/Accessories, Furniture and Other)	1.10%	1.30%	5,500	6,500	1,000	0.2%
Children & Infant Apparel	2.60%	2.70%	14,000	13,500	(500)	0.1%
Specialty Food Stores	1.60%	1.70%	7,500	8,500	1,000	0.1%
Full Service Restaurants	3.20%	3.30%	14,500	16,500	2,000	0.1%
All Other limited Food Services	0.90%	0.90%	4,500	4,500	–	0.0%
Miscellaneous	0.40%	0.40%	2,000	2,000	–	0.0%
Other Services	1.20%	1.00%	5,500	5,000	(500)	(0.2%)
General Merchandise & Variety Stores	1.90%	1.50%	10,000	7,500	(2,500)	(0.4%)
Media	3.50%	2.20%	16,500	11,000	(5,500)	(1.3%)
Office Supplies, Stationery & Gift Stores	2.80%	1.40%	13,500	7,000	(6,500)	(1.4%)
Women's Apparel	20.20%	18.60%	100,500	93,000	(7,500)	(1.6%)
Furniture, Home Furnishings & Décor	4.50%	2.90%	22,500	14,500	(8,000)	(1.6%)
Men's Apparel	4.70%	3.00%	21,500	15,000	(6,500)	(1.7%)
Recreation	4.50%	2.20%	20,500	11,000	(9,500)	(2.3%)

RETAILER PRODUCTIVITY: NOTABLE SECTORS

Retailer productivity can also be used as an indicator for shopping centre performance. Analyzing total shopping centre sales and sales per square foot (Figures 12 and 13) within regional and super regional shopping centres further provided by ICSC, we note that the performance within the clothing and accessories, media and office supplies segments have stagnated or declined over the last several years, while food court, electronics and jewellery have had growing sales productivity. The electronics sector, in particular, has seen strong growth over the last ten years, driven mainly by the growth of groups selling high value products (cellular phones, tablets, etc.) such as Apple, Rogers and Telus. Apple in particular, since opening its first Canadian location in 2005, has had among the highest sales per square foot values of any retailer in Canada annually.

Figure 12: ICSC Mall Sales Index

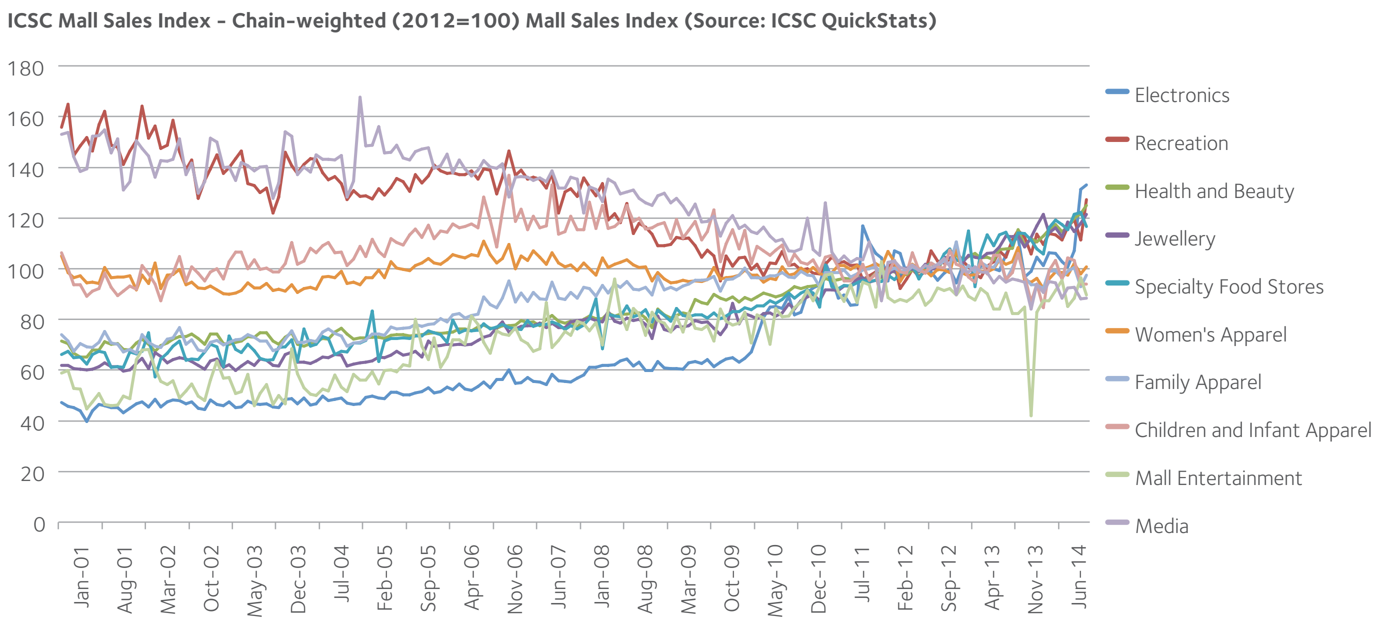
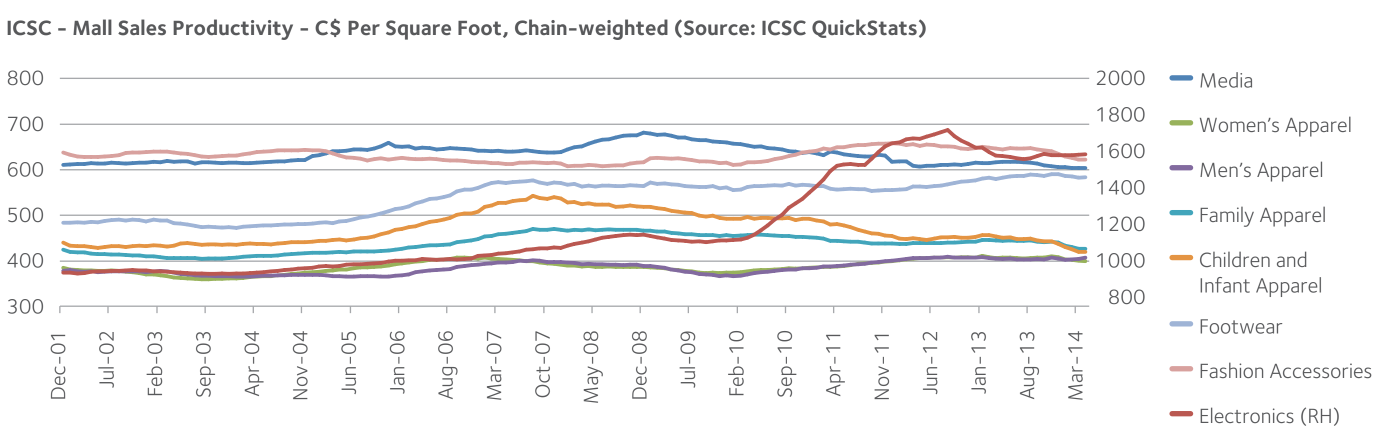


Figure 13: ICSC Mall Sales Productivity

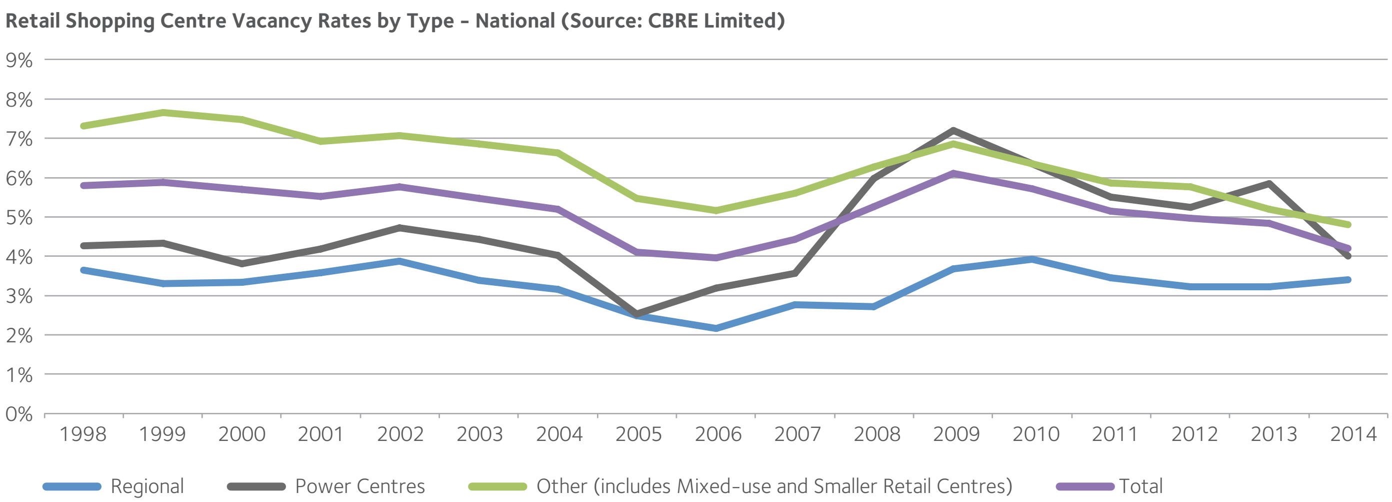


REINFORCING THE VALUE FOR RETAIL PROPERTY IN AN OMNI-CHANNEL ENVIRONMENT

CHARACTERISTICS OF THE CANADIAN MARKET DRIVE OVERALL STABLE DEMAND

The Canadian retail market has performed relatively well from a vacancy standpoint over the last decade, driven by controlled development and stable demand from existing and new retailers. Canada enjoys a relatively low retail space per capita ratio (estimated at 14.6 SF per person), and relatively high sales performance (estimated at $605 per SF for major shopping centres) (Smerdon & Bell, 2013). The combination of these factors has helped to stabilize the retail market in Canada[12]. This trend is contrary to the US retail market that has characteristically been oversupplied with retail space and as a result, has felt the effects of online sales growth to a larger and more negative degree. For the most part, the amount of retail property in Canada has grown in line with population growth (Smerdon & Bell, 2013) with overall shopping centre vacancy rates averaging 5% the last decade (Figure 14).

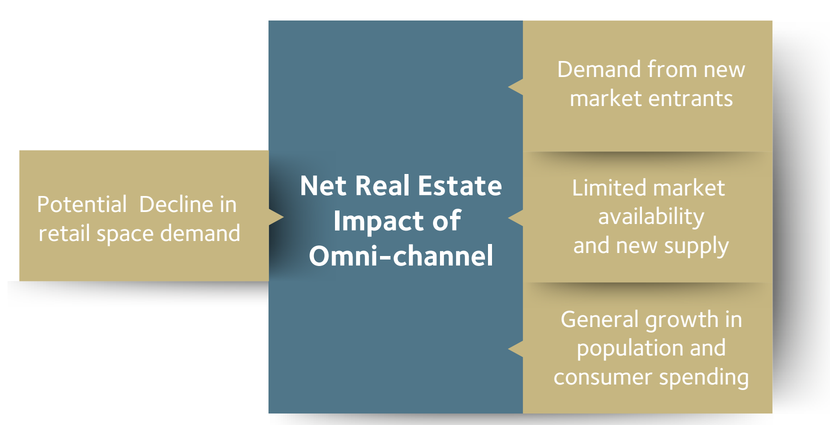
Figure 14: National Retail Vacancy Rates by Type



BALANCING EXPECTATIONS

The growth of omni-channel retailing and its impact on real estate will not move in isolation. As discussed, while existing retailers continue seeking efficiencies with their real estate needs, contrasting market forces exist, including 1) the current size and maturity of Canada's e-commerce market, 2) demand from new and growing retailers, 3) the historically low availability rate for Canadian retail property and 4) general growth in population and consumer spending (Figure 15). What may occur is that long-term, ongoing demand for retail space may be somewhat less than what has been seen in the past (Kircher, 2013; Yeates & Hernandez, 2013)—something that affects new development and certain property segments more so than all properties.

Figure 15: Potential Omni-channel Impact on Real Estate



[12] A recent RBC Capital Markets report (Downey & Smith, 2015) focusing on Canadian REIT performance and omni-channel retail highlighted that occupancy rates for 11 major Canadian REITS have stayed very stable over the last decade, with a variance of only 200 bps. Over the last decade, retail focused REITs and REOCs have averaged 96.4% (weighted) occupancy, ranging from 95% in 2002 to 87% in 2008.The analysis covers 155 million SF of retail space, and primarily excludes super regional malls.

CONSIDERATIONS FOR REAL ESTATE MANAGERS AND INVESTORS

THE VIEW AHEAD

What was only a murmur within the commercial real estate industry a decade ago, omni-channel retailing is now on the minds of many as a growing, disruptive change for retail property. And although many had called for the "end of bricks and mortar" a few years ago, we now know and recognize the importance of physical stores and their integration with digital shopping activities.

While retail property remains highly relevant in today's technologically-influenced retail environment, there are new considerations ahead for retail owners and investors given the efficiencies derived from less and smaller stores in certain retail segments, as well as the growing variety of shopping methods available to consumers. Investors that employ a combination of defensive leasing strategies with offensive omni-channel initiatives are best suited to thrive. Those who continue to take a traditional view on retail property —including the way it is leased, designed, marketed and managed — will face more challenges ahead.

Accordingly, the growth of omni-channel retailing does not mean that existing retail leasing and asset management strategies should be ignored, however; strong property management and operations, careful consideration of lease covenants, and pro-active tenant management all continue to be critical for retail property investment. In terms of acquisition and development considerations, rental rates, strong demographics and location remain highly important. The main theme is that omni-channel retailing adds new risks and opportunities to consider for investors—most of which are focused on qualitative aspects of retail property such as tenant programming, branding/marketing and amenities. For already well-managed retail assets, omni-channel strategies will only help to reinforce tenant and consumer demand.

The following section outlines omni-channel strategies for retail real estate managers and investors.

KEY OPPORTUNITIES

RETAIL MANAGERS AND INVESTORS SHOULD FOCUS ON CREATING A DEFINED ROLE AND PURPOSE FOR THEIR SHOPPING CENTRES WITHIN A MARKET

As consumers become more selective and efficient with their shopping activities, research indicates that 'generalist' retail properties are becoming less prominent. Retail assets with an unfocused tenant mix are expected to face the most leasing risk in an omni-channel environment. Overall, a balanced tenant mix is less about having a wide variety of retailers as it is more about focusing on a market segment in terms of anchor tenants, clustering, product offerings and target population. For example, a grocery-anchored, neighbourhood shopping centre that is food and service-oriented but with a few "one-off" clothing and electronics retailers will face vacancy risk from the clothing and electronics retailers. This is because there is no clustering or omni-channel benefits for those groups as say, a super regional mall would be able to provide.

Research (Addleshaw Goddard; BCSC; Blackstock, 2014) suggests that real estate managers and investors should align their existing properties around one of the following formats (Figure 16): Experience (upscale, 'day out', browsing and leisure shopping experiences), Convenience (quick access and services), and/or Function (essential items and similar products).

It is important to note that not every retail property has to be the experiential mall or luxury retail village to be successful with the realities of omni-channel retailing—smaller community centres can also perform well if they complement a segment of omni-channel retailing such as increasing access to customers, reducing shipping/operational costs or clustering similar tenants. In some cases, shopping centre managers are also finding growing interest from non-traditional groups such as medical and community services given their limited online exposure and high demand.

Figure 16: The Growing Differentiation of Retail Properties

Shopping Centre Typologies	Shopping Centre Types	Key Tenants	Notable Characteristics
Experience	• Super Regional • Regional • Lifestyle • High street	• Clothing & Accessories • Food/Dining • Electronics	• Upscale design • Pedestrian amenities • Clustering of fashion and accessories • Enhanced leisure offerings and community programming
Convenience	• Mixed-use • Community • Neighbourhood	• Grocery • Food • Health and medical • Services • Fitness	• Free parking and good highway access • Click and collect services • Clustering of services • Relatable anchor tenants
Function	• Outlet • Power Centres • Community	• Grocery • Home & Hardware Supply • Discount • General Merchandise	• Driven by similar product lines and complementary tenants • Purposeful shopping with endless aisle and click and collect capabilities

THE DIGITIZATION OF SHOPPING CENTRES COMPLEMENTS OMNI-CHANNEL STRATEGIES AND IS CHANGING THE ROLE OF THE RETAIL MANAGER AND INVESTOR

Digital strategies are not only for retailers—landlords also have an opportunity to reinforce demand for their properties by integrating more technology into their operations and coordinating marketing efforts with their tenants. Location intelligence such as tracking beacons are gaining ground within shopping centres, benefitting both landlords and tenants by monitoring shopping patterns, store visits, shopping duration and foot traffic (Addleshaw Goddard; BCSC; Blackstock, 2014; Rossi, 2014). Mobile shopping programs are also increasingly common, whereby customers can receive shopping centre information and centre-specific promotions and loyalty programs for retailers through their smartphones via Bluetooth technology. Strong websites/branding, online marketing initiatives and high quality wifi remain 'must-haves', increasing the omni-channel presence for shopping centres and their tenants (Cisco, 2014).

DEVELOPING A QUALITATIVE FRAMEWORK EVALUATING RETAIL PROPERTY INVESTMENTS

When evaluating acquisition opportunities or assessing existing retail assets, there are a variety of market, asset and strategic factors that should be considered with the growth of omni-channel retailing in addition to market, financial and operational criteria (Figure 17).

As shown on the chart, market and competition considerations are important as tenants continue to 'right-size' their store portfolios, while tenants should be also evaluated on their omni-channel strength and exposure. Understanding lease expiry profiles will help insulate potential vacancies as a result of tenant consolidations, while assessing a property based on its role and purpose is important in maximizing consumer demand.

Figure 17: A Qualitative Framework Evaluating Retail Property

Market and Competition Considerations:	Tenant Considerations:	Asset Considerations:
• Does the asset have immediate retail competition in terms of similar shopping function and scope? Do nearby properties detract from, or reinforce demand for the subject property? • Does the asset contain tenants (with high online exposure) that have multiple stores within the same market? How much do these stores overlap in terms of trade area? If a tenant was to consolidate its store portfolio within a region, what stores would be the first to close and how is the asset relatively positioned?	• For retailers in segments that have high online exposure, how strong is their omni-channel platform? Does the retailer have a strong website and mobile, digital and logistics capabilities? • For retailers in segments that have high online exposure, are their products unique? Can you substitute the product with something easily accessed online? Does their brand and products carry significance/uniqueness? • How integrated are the anchor tenants to the other retailers in the property and relative to competitors?	• What is the lease expiry profile for retailers in segments that have high online exposure? Are there any complementary tenants with similar lease expiry dates? • How well does the property and tenant mix fit around the experience, convenience or function categories as mentioned previously? Does the asset provide either 1) great shopping or leisure experience, 2) efficient shopping or, 3) non-omni-channel, essential goods and services? • Is the property branded with a website? Can people find information on the property and its tenants easily online?
To Watch:	**To Watch:**	**To Watch:**
• Competitive retail properties with better marketing and differentiation/clustering of its offerings will sustain better tenant demand	• Strong tenants will be retailers with good branding, websites and integration of products between stores and websites both digitally and logistically • High online sales growth will need to be evaluated with its product segment and online exposure • Preference for retailers with strong, self branded products, that do not have immediate online retail competition • Anchor tenants should be complementary to the tenant mix of the property	• There is leasing risk if there is no clear omni-channel support at the property, including having complementary tenants or operational benefits for retailers • The property needs to be defined in its purpose and role within a market • Regardless of property type, a strong online presence for the property and its tenants are important for demand

IN ASSESSING POTENTIAL AND EXISTING TENANTS, OMNI-CHANNEL RETAIL IS LESS ABOUT SHRINKING RETAIL DEMAND AS IT IS A NEW FORM OF RETAILER STRATEGY

The emergence of omni-channel retailing suggests that in-store sales are no longer the only key indicator of a tenant's financial strength. A tenant's market segment, their online sales performance and the strength of their omni-channel platform are key considerations. As mentioned, strong online sales are not directly a negative for retail property—what is more important is the strength of a retailer's overall omni-channel platform. It is also important to note that omni-channel retailing affects tenants both within and between retail categories in different ways. Not every electronic or clothing and accessories retailer is at risk of multiple store closings; retail success is still very much dependent on the retailer. Competition, product pricing, customer experience, unique product offerings and brand strength continue to be important and complementary factors to omni-channel, all of which were relevant before the growth of online shopping.

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PROVIDING PERSPECTIVE: CANADA'S REGIONAL AND NATIONAL ECONOMIES IN CONTEXT, October 2008

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