What is Driving the Acceleration and Integration of Industrial and Retail?

A Conversation Between Our Experts

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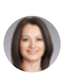
Anjee Solanki
National Director,
Retail Services & Practice Groups


Stephanie Rodriguez
National Director, Industrial Services

What are the Trends in Big Box* Space?

Big Box retail, in existence for 30-40 years, has evolved from its one-size-fits-all model. Retailers now utilize data to reshape their market position, tapping into information collected from Point of Sale (POS) and other systems to enhance their brand's value, covering SKUs, consumer preferences, and store layout. Abundant data sources include POS, foot traffic, online and in-store mobile data, location data, and purchase specifics. Despite the absence of a universal retail playbook, many retailers have grown increasingly sophisticated through data utilization.

Landlords are seeing a lot of demand from retailers and a continuing trend by certain brands to take on more retail space to fulfill their last-mile demands. Costco and its competitors seek last-mile sites with a smaller footprint, in the 50,000 square foot range. The continuation of Big Box, plus the liquidation of Bed Bath and Beyond sites and the acquisition of those sites by other retailers, have the industry thinking of the future.



Despite a 29% drop in the first half of 2023, demand for industrial big box product is returning to pre-pandemic levels, as we're coming off a period of unprecedented frenetic demand in 2021 and 2022.

Vacancy rates, particularly in big-box industrial space, are climbing throughout the country primarily due to the delivery of record new supply. While this could be cause for concern at first glance, big box vacancies can be a good thing. Vacancy rates had gotten so low in some markets that tenants had little to no options. The push for new supply will dramatically increase the available options in modern space, returning big box vacancy rates to healthier, functional levels. Heading into 2024, the construction pipeline will drop off dramatically, resulting in a renewed balance between supply and demand.

What New Strategies are Tenants Implementing?

Retailers are considering a slightly larger footprint in a shopping center, while the larger big box retailers are reducing their footprints. **Many retailers are testing new formats in different markets to gather customer**

*Big box industrial buildings are defined as a market's most modern, investment-grade product. The subset includes buildings 200,000 SF and larger, with ceilings 28' clear and higher, and precast construction. Big box retail is defined as a store that occupies more than 50,000 square feet of physical space, offering a variety of products to its customers. These stores achieve economies of scale by focusing on large sales volumes.

feedback and determine how to replicate the multichannel model in the future. Retailers like Target, who is moving towards a larger footprint, have implemented new design elements to see how they deliver to guests, whether browsing the aisles, shopping online, or stopping in for same-day services. The new store layout provides a backroom fulfillment space that is five times larger than the previous stores of similar size. The additional space will support the ongoing growth Target has recently experienced, fulfilling more than 95% of the retailer's digital orders and same-day services accounting for more than 10% of its overall sales.

Industrial tenants are also making adjustments, particularly on the last mile front. We're seeing a push for micro-fulfillment centers in multiple markets, most notably in Chicago and Florida:

- In Chicago, Target recently leased a 25,000-square-foot space in a masonry building built in 1950 on the city's north side. While the building only has two interior docks and low 15' clear ceilings, it is conveniently located adjacent to a large population of Target shoppers.
- South Florida has seen a lot of movement on the last-mile front. Kroger recently opened a micro-fulfillment center in Orlando, allowing their delivery arm to supply 10,000 fresh food items and essentials within 30 minutes. They now plan to expand their service further south and into Miami. Similarly, Publix recently launched its 15-minute grocery delivery service in Miami's Wynwood neighborhood, utilizing a new "nano-fulfillment" center in partnership with Instacart.

How have E-Commerce & Omnichannel Approaches Affected the Market?

E-commerce, along with supply chain reorganizations and 3PL requirements, catalyzed the unprecedented push for industrial space over the past two and a half years. Sales from e-commerce accelerated in 2020 due to the pandemic and have since returned to its trend line, representing 15.4% of all retail sales. **By 2027, e-commerce sales are projected to grow to more than 20% of retail sales,** increasing by over 1% annually. This growth will result in continued demand for industrial distribution space, both large-scale distribution centers and smaller last-mile facilities.

Tenants had few vacant options over the past few years, particularly in record-tight markets. The ongoing influx of new construction industrial facilities significantly increases the available options for these tenants, making it easier to build their distribution networks to support their omnichannel approaches.

Retailer brands are still exploring their multichannel approach and evaluating the capital they need to support the lag in sales growth, customer loyalty, and spending. **We expect to see a focus on digitalization within stores to streamline processes and improve manual systems,** making it convenient for people to walk up and find what they're looking for through touch-screen search, whether using their devices or any digital signage device available in-store. In addition, some grocers using POS technology in-app on the user's device to search and scan products as they shop, enabling shoppers to find what they need without asking staff members. McDonald's recently began testing a drive-through pull-up feature that uses artificial intelligence and mobile recognition to personalize the consumer experience, where the ordering kiosk greets you by name and asks about your order--all exciting stuff.

We saw a spike in e-commerce sales in 2021, with store workflows impacted for a portion of that time, although largely dependent on the market. Since then, the economic spending has shifted. In 2019, total retail spending reached $4.9 trillion, with e-commerce accounting for 10.5% of total sales, while sales escalated to $7.1 trillion, with e-commerce accounting for 14.6% of total sales in 2022.

What is the Forecast for the Upcoming Holiday Season?

Leading up to the holiday, the last mile of the supply chain becomes exponentially more critical. Supply chains falter due to a need for more inventory on shelves and in warehouses. **Ensuring end-to-end visibility for shipments and the stocking of in-demand items is crucial.** Retailers and 3PL providers need contingency plans should the supply chain break down – particularly within the last mile. The 2023 holiday season will likely test the industry again following severe supply chain disruptions during the past two years. We can only hope that the streamlining changes retailers and 3PL providers have implemented results in a much smoother holiday season in a world increasingly dependent on e-commerce sales.

We are forecasting that overall holiday spend will grow by 3.1% this year, with high sales, in-store quality experiences, and opportunities for consumer enjoyment with increased consumer spending across categories. Strong merchandising, omnichannel options, and deep discounts will be vital to driving retail traffic. Omnichannel fulfillment is expected to be strong, with consumers increasingly choosing mobile ordering, especially younger generations. As for retailers, better-controlled inventory levels and improved supply chains have supported margins in the first half of 2023 and will be critical to preserving margins during the holidays as consumers shop for bargains.

Contacts

Anjee Solanki
National Director, Retail Services & Practice Groups
Colliers | U.S.
+1 415 288 7871
anjee.solanki@colliers.com

Stephanie Rodriguez
National Director, Industrial Services
Colliers | U.S.
+1 305 359 3690
stephanie.a.rodriguez@colliers.com

Nicole Larson
Manager, National Retail Research
Colliers | U.S.
+1 954 652 4602
nicole.larson@colliers.com

Craig Hurvitz
Director, National Industrial Research
Colliers | U.S.
+1 847 698 8295
craig.hurvitz@colliers.com