



Opportunities and Challenges for Retail to Warehouse Conversion

Integration of Property Uses to Fulfill Consumers Needs

Abstract: This article discusses the synergies between retail and industrial real estate and the converging drivers that have become more apparent during the COVID-19 pandemic. It covers the immediate opportunities and challenges that property owners should consider when integrating industrial warehouse space into existing retail properties or locations.

Acceleration of Existing Trends

The COVID-19 pandemic has amplified the need to get goods to consumers quickly. While e-commerce has played a vital part in that process, noticeable strains, such as delays within the supply chain, have become more evident. In March and April, during the early stages of COVID-19, the expectation for same-day and two-day delivery was difficult to meet due to high consumer demand.

Potential solutions for this include placing more warehouse facilities closer to consumers and for retailers to utilize their brick-and-mortar locations as fulfillment centers and pickup locations. Prior to implementing solutions, the following questions should be addressed: (1) What impact have changes to consumer expectations on the accessibility of goods had on retail real estate? (2) What should landlords consider before incorporating industrial space into the existing properties to help narrow the “last mile” delivery?

I. Impact of Goods Accessibility on Retail Real Estate

Meeting New Consumer Demands

The demand for warehouse space is growing as businesses are revamping the supply chain. As noted in a recent CBRE report,

“Lease renewals and new leases jumped 43% from April 15 to May 14 from the previous 30-day period.”¹ The importance of having warehouse space was already increasing as “total transactions for the year are 2.8% higher than at this time in 2019 even though activity fell 29% between March 15 and April 14 as lockdowns aimed at halting the spread of the coronavirus extended across the U.S.” The COVID-19–related fallout will only accelerate that demand.

The emergence of online food shopping has been amplified during the pandemic and that trend is expected to continue. However, retailers such as Walmart or Target that sell more than just food, unlike like most supermarkets, already have a distribution structure in place. In fact, many grocers tend to reinvest in their store base instead of having a self-distribution structure.² As a limited number of grocery chains have fully functioning distribution, alternative locations may be useful. One way to meet the growing demand for online food shopping is for supermarket chains and food distributors to have secondary warehouse space available to be used as micro-fulfillment centers. Supermarkets may be able to secure big-box facilities that are close to supermarkets as a method to distribute essential goods to their communities more effectively.

Key Takeaways

- The demand for warehouse space is growing rapidly. As noted in a recent CBRE report, **“Lease renewals and new leases jumped 43% from April 15 to May 14 from the previous 30-day period.”**
- According to an ICSC survey, **53% of U.S. adults of consumers say due to the COVID-19 pandemic, “they are expecting shopping centers and stores to invest in onsite inventory, distribution and pickup options to give them a fuller and more efficient shopping experience.”**
- According to a July 2020 CBRE release, **59 projects that have either been completed, proposed or underway since 2017.**
- There are several variables to consider **for warehouse conversions such as location, local government regulations, rezoning and highway access**, but the need for fulfillment centers is growing.

¹ The Wall Street Journal “Warehouse Demand Surges as Retailers Reset Supply Chains” June 21, 2020

² MWPVL, “The Global Distribution Center Network in North America”

Proximity Advantage of Physical Locations

Shopping centers are already positioned near the consumer and in many cases offer large spaces to accommodate distribution. The obvious benefit to converting existing retail locations to warehouse space is to serve customers more quickly and become a last mile delivery solution. Conversions from retail to industrial properties across the U.S. have accelerated to meet ecommerce needs.

According to a July 2020 CBRE release, there are 59 projects that have either been completed, proposed or underway since 2017.³ This is up from 24 conversions that began since 2017, as reported in January 2019.⁴ These projects total approximately 13.8 million sq. ft. of retail space converted to 15.5 million sq. ft. of industrial space.

A recent NAIOP⁵ article noted that one approach gaining traction is to merge retail and warehouse into one location to create a “hybrid” mall, also referred to as shopping fulfillment centers or SFS. One such company at the forefront of this concept is ShopFulfill, which offers turnkey services to retailers and brands related to fulfillment and distribution. The approach allows brick-and-mortar retailers to serve the consumer with a wider array of easily accessible inventory that can be sold in-store or shipped. ICSC’s consumer survey shows 53% of consumers say due to the COVID-19 pandemic, “they are expecting shopping centers and stores to invest in on-site inventory, distribution and pickup options to give them a fuller and more efficient shopping experience” and is most notable in the South region. (See Chart 1.)

Consumer Demand for Convenience

Companies that invested heavily in automation before COVID-19 have had the easiest time implementing curbside pickup—and customers appear to be responding. In Q1 2020, more than 2 million customers tried Target’s drive-up service for the first time and four-times more customers tried Walmart’s curbside pickup for the first time compared with recent periods.

Target and Walmart with big-box facilities saw a quarterly sales lift of roughly 10% during February, March and April (see quarterly 10Q reports). Most of the increase occurred in March and April, as those retailers were well positioned as fulfillment centers with large locations that could handle the demand for essential goods. Both retailers reaped the rewards of curbside pickup, and Walmart Inc.’s first quarter U.S. ecommerce sales (ended May 1) rose by 74% as the coronavirus outbreak drove more shoppers to buy online and pick up outside stores.

II. Considerations Before Converting Retail to Industrial Use

Local Government Resistance: Regulations and Traffic

One major obstacle is convincing municipalities that there is a pressing need for more industrial space and how it can enhance retail and serve the community to a higher degree. Despite the potential benefit in some cases of increased property tax revenue from previously vacant locations, local governments are sometimes reluctant to add industrial space to their communities. Concerns of residents in nearby areas around traffic, heavy trucking and air pollution are factors that often deter local governments from adopting industrial conversions.

Depending on local requirements and regulations, retail properties often require rezoning for industrial-type use. Municipalities have sometimes opposed rezoning, fearing that the converted space might service areas outside the community. However, same-day delivery spurred by e-commerce is forcing adequate distribution to the community to become a requirement, which may lead to a reassessment of zoning restrictions. Trade areas for fulfillment must be considered (for grocery stores, it is 3-5 miles; for industrial space, it is much larger) . However, local governments may limit the number of properties that will be available for conversion and rezoned for industrial use.

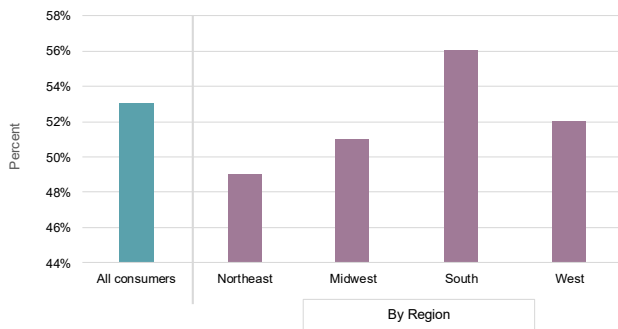
Site Selection, Viable Locations and Conversion

Vacant big-box or anchor spaces can make for good locations for conversion to a distribution center, and those locations that are easily accessible to a highway are ideal. However, those same locations are also often near populations and may still have the potential to be viable retail properties. As a result of that uncertainty, local governments may not see the need to authorize retail-to-industrial conversions and may opt to maintain a retail use for the property.

While location is a key driver for a retail-to-industrial conversion, logistics and costs need to be considered as well. Converting retail space into a fully functioning warehouse facility capable of distributing large quantities of goods may require extensive

Chart 1

Consumer Expectations Shopping Centers and Stores to Invest in Onsite Inventory, Distribution and Pickup Options



Source: ICSC Research

It is unclear what pandemic-driven consumer behaviors and expectations will remain as COVID-19 eventually subsides and people resume their daily lives. However, the potential need for more space to accommodate social distancing may result in retailers’ moving to a showrooming model that allows for space but meets the shopper’s desire to touch and feel items prior to making a purchase. With less inventory in store, the need for the immediate availability of goods nearby could increase the presence of localized warehouses.

³ CBRE U.S. MarketFlash: “Retail-to-Industrial Property Conversions Accelerate” July 23, 2020

⁴ According to CBRE U.S. MarketFlash: [Trading Places: Retail Properties Converted to Industrial Use](#), January 2019.

⁵ NAIOP Development: [“Retail-to-Warehouse Conversions Gain Momentum.”](#) Fall 2019, Ron Derven, Jennifer LeFurgy, Ph.D.

retrofitting. In some cases, properties may require additional dock doors and three-tier stacking to accommodate more trucks access.

Competition for the properties that meet criteria such as location and access to freeways and can accommodate a conversion may increase. While properties being considered for conversion may not be deemed A+ retail properties, they may in fact be highly sought-after industrial locations. Recently, the 2.2-million-square-foot Randell Park Mall in suburban Cleveland became home to a new Amazon e-commerce 900,000-square-foot fulfillment center. Two more locations in Ohio were also acquired. Amazon has strategically selected locations that are close to highways and will inevitably help reduce fuel costs. However, it also highlights that locations that meet all criteria may quickly become scarce.

Conclusion

The integration or conversion of existing retail space depends on many variables like location, property uses, access to freeways and the physical restrictions of the space itself. In one to two years, new systems will have been created quickly and tested. Within three to five years, as consumers react to these innovations and companies refine them further, a wide variety of fulfillment strategies will emerge. A new model will then develop in America's shopping centers, one resting more heavily on automation and synergistic use of space, but still on the longtime need to provide a central point where consumers can access goods and services. COVID-19 was not the catalyst for the changes on the horizon, but it has acted as an accelerant.