

Think Retail

Future transformation of grocery-anchored real estate

April 2019

RESEARCH VIEW OF GROCERY-ANCHORED REAL ESTATE

- The grocery-anchored retail space is set to undergo a significant transformation in the next decade(s) due to rising e-commerce grocery sales, advancements in in-store technology, as well as a growing number of lower and higher income households (i.e. continued shrinking middle class).
- Mass adoption of in-store technology likely means that customers will prefer to shop in-store for fresh produce and meats while opting to pick-up (or have delivered) the 'middle-isle' (i.e. non-perishable goods).
- Retail gross leasable area (GLA) space per grocery store should shrink over time and the configuration of the current-day grocery store will evolve as a majority of the space will be utilized as a last-mile distribution center for the 'middle-isle' pick-up or shipment.
- 'Winning' grocers will anticipate and cater to the needs of their customers through technology and in-store customer experiences.



Daniel Manware
Research Associate, Americas

- ‘Losing’ grocers are unable or are unwilling to anticipate and to cater to their customers due to a variety of reasons from being over-levered to general mismanagement. These grocers will face obsolescence similar to what has happened in the general retail space in the last decade (Fig 1).
- While there will be ‘winners’ and ‘losers’ among grocers, grocery stores are not going away any time soon and in some sense are future-proof from a pure ‘everyone needs to eat’ perspective. We recommend adding grocers to mixed-use retail strategies.

Fig 1: Nuveen Real Estate’s preferred grocers analysis

	Best-in-class grocers	At-risk grocers
Examples:	Publix	Smart & Final
	Whole Foods Market	Natural Grocers & Vitamin Cottage
	Kroger brands	Ingles Market
	Weis Markets	Albertsons LLC: Legacy & SuperValu stores (retail & wholesale)
	Lidl	Albertsons LLC: Safeway: core/Tom Thumb/ Randall/ Pavilion
	Trader Joe’s	Ahold Delhaize: Food Lion/ Hannaford
	Aldi	Fairway Group Holdings
	Grocery Outlet	The Fresh Market
	Stew Leonards	Sav-A-Lot
	Wegman’s	
	H-E-B	
	Sprouts	
	Ahold Delhaize: Stop & Shop/ Giant-Carlisle/ Giant-Landover/ Food Lion/ Peapod.com	
	Smart & Final: Cash & Carry	
	Roundy’s: Marinos/ Pick N Save/ Metro/Copps	
	Albertsons LLC: United Supermarkets/ Amigos/ United Express/ Market Street/ Albertson Market	
	SpartanNash: Family Fare Supermarkets, D&W Fresh Markets, Family Fresh, No Frills, Bag ‘n Save, Sun Mart, Econofoods	
Characteristics:	High growth potential	Low to negative growth potential
	Competitive advantage	Low competitive advantage
	Various store locations	Limited store locations

Source: Nuveen Real Estate, Q1 2019.

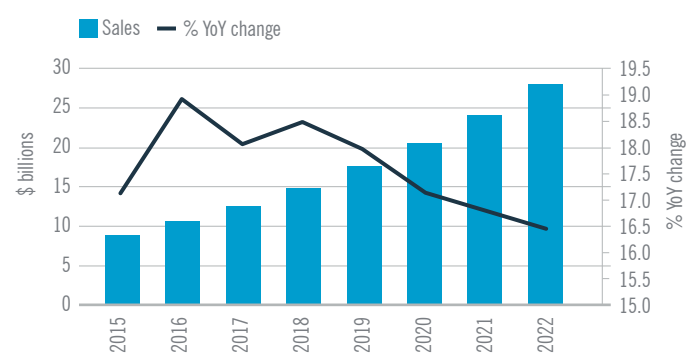
E-COMMERCE IMPACT

E-commerce has disrupted but not hurt the grocery-anchored retail sector. E-grocery sales currently comprise 2.8% of total food and beverage sales in the U.S. According to eMarketer, this market penetration is expected to rise to a minimal 3.1% share by 2022.

While e-commerce food and beverage sales are expected to rise in the near term, sales growth in this e-commerce segment is expected to decelerate (Fig. 2). E-commerce capabilities have given grocers the ability to gain in-store traffic due to order online and pick up methods of purchase.

A recent consumer survey conducted by Market Force Information indicates that 14.9% of respondents used a buy online, pick-up-in-store method to purchase groceries in 2018, up from 8.9% in 2017. To adapt to this growing trend, Wal-Mart plans to offer e-grocery pickup at 2,000 stores (40% of their store locations) by the end of 2018.

Fig 2: U.S. food & beverage retail e-commerce sales



Source: eMarketer, Q4 2018.

CONSUMER EXPERIENCE: IN-STORE TECHNOLOGY ADVANCEMENTS

Consumer experience is more important than ever before. According to a recent KPMG study, grocery retail remains the leading sector in the U.S. for customer experience, achieving the highest scores of any sector across all of the six pillars. In this study, over 250 brands were analyzed across ten business sectors to identify leading customer champions. Three grocers were amongst the top ten brands: H-E-B (#4), Publix (#6) and Wegmans (#7).

According to KPMG’s Customer Experience Excellence findings, the six pillars of customer experience are:

Fig 3: KPMG’s 2018 six pillars of customer experience

<p>Personalization</p> <p>Using individualized attention to drive emotional attention.</p>	<p>Time and effort</p> <p>Minimizing customer effort and creating frictionless processes.</p>
<p>Integrity</p> <p>Being trustworthy and engendering trust.</p>	<p>Resolution</p> <p>Turning a poor experience into a great one.</p>
<p>Expectations</p> <p>Managing, meeting and exceeding customer expectations.</p>	<p>Empathy</p> <p>Achieving an understanding of the customer’s circumstances to drive deep rapport.</p>

Source: 2018 U.S. Consumer Experience Excellence Analysis, KPMG, Q3 2018.

In our view, advancements in technology will enhance consumer experience and ultimately productivity for brick-and-mortar grocers. Omni-channel services across various U.S. retail grocery stores increased in 2018 (Fig. 4). Kroger is among the leaders. Kroger has recently collaborated with Microsoft to test digital shelf technology. Kroger EDGE (Enhanced Display for Grocery Environment) is a technology powered by Microsoft Azure that digitally displays pricing and nutritional information, as well as video ads and coupons for various products. Further, it gives Kroger the ability to instantly change prices, activate promotions and undercut sales at other chains. Kroger’s ‘Scan, Bag, Go’ app enables customers to pay for their items without checkout lanes, registers or cashiers.

Microsoft is developing its own cashierless store technology in hopes of implementing in the stores of existing grocers which would directly compete with the Amazon Go concept. Grocers that will be able to compete in the medium and long term are those implementing technology in their stores to enhance the customer experience. Amazon Go’s cashierless technology provides customers with the seamless, convenient shopping experience that consumers crave.

Additionally, the more technologically advanced grocers will likely start to analyze each store’s purchase data in order to tailor the goods in each store to the consumer. Amazon is already implementing this concept in one of its newly opened stores in the SoHo neighborhood in New York. At this store, Amazon only offers products (groceries and beyond) that are rated 4-stars or higher. Products are categorized together

across the store in different cohorts including: ‘Highly rated’, ‘Most wished for’ and ‘Trending around NYC’. In our view, we believe that the grocers (and retailers) that analyze their customer data in order to create efficiencies in-store will be winners in the future.

Fig 4: Omnichannel services offered at grocery stores according to U.S. retail grocery retail executives

	2017	2018	% change
Mobile shopping apps	29.6%	54.2%	24.6%
Click and collect	22.5%	31.8%	9.3%
Third-party vendor home delivery	16.9%	31.8%	14.9%
Curbside delivery	18.3%	30.8%	12.5%
Store-supported home delivery	14.1%	28.0%	13.9%
In-store mobile product scanning	8.5%	24.3%	15.8%
Ordering kiosks	2.8%	16.8%	14.0%
Other	1.4%	32.7%	31.3%

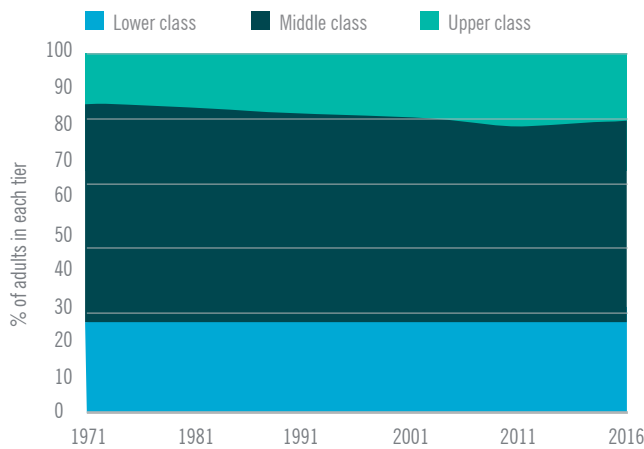
Source: Progressive Grocer, ‘85th Annual Report of the Grocery Industry’, Q2 2018.

SHIFTING DEMOGRAPHICS

During the last 30 years, middle class income households have shrunk while upper and lower income households have grown (Fig. 5). As a result, organic and locally sourced grocers (targeting upper income households) and discount grocers (targeting lower income households) are desired more than ever before. For example, Aldi, a chain that typically caters to lower income households, was one of the leading retailers (of all retail types) for store openings in 2018. Aldi opened nearly 200 store locations in 2018 across the U.S. and plans to open nearly 700 additional locations by the end of 2022.

While historically discount grocers have targeted lower income households, many are starting to target, and capture, higher income households as well. For example, Lidl and Trader Joe’s capture higher income households because they offer unique private label brands and products. Lidl offers its customers freshly baked croissants for just 99 cents. Wal-Mart, via Jet, is also trying to capture part of higher income households’ budget. Overall, we believe that grocery-anchored retail investment should match the demographic that it serves, as opposed to a limited number of zip codes.

Fig 5: Middle class is shrinking



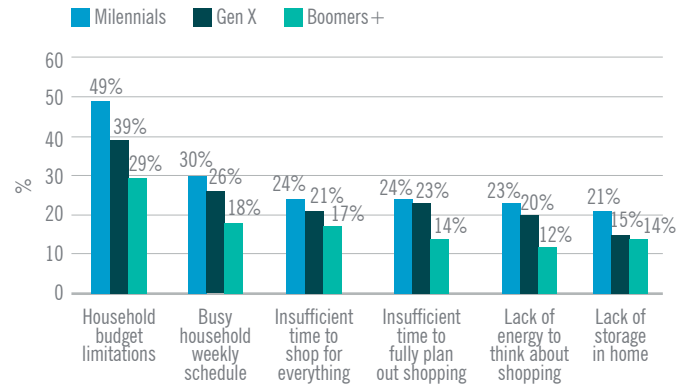
Source: Pew Research, Q3 2018.

Generations are divided on e-grocery adoption. A survey conducted in July 2018 by *Brick Meets Click* investigated food and beverage e-commerce purchases by age cohort. The results indicated the 18-29 age cohort was the only cohort to increase usage from 2017 to 2018. All other cohorts had a decrease in usage year over year. Several generalizations/assumptions can be made from this survey:

1. YMs (young millennials or those ages 18-29) are driving growth in online grocery sales and are more adaptive to innovative methods of grocery shopping.
2. OMs (older millennials or those ages 30 – 34), Boomers and older generations prefer to shop in-store for their items.

Stronger usage amongst YMs can be credited to time constraints due to their complex household and work schedules. Older generations may have more time to shop in-store for their items and do not appreciate the convenience aspect that e-grocery provides to busy YMs that are establishing their careers and households. These generational differences can be further explained in a survey conducted by The Hartman Group (Fig 6).

Fig 6: Top issues that make shopping more difficult



Source: The Hartman Group, Q4 2014.

NEAR-TERM HEADWIND: ENHANCED DELIVERY SERVICES

In efforts to step up their battle against Amazon, Wal-Mart's Jet unit is now offering three-hour same-day grocery delivery and next-day delivery options in New York City. Jet said it aims to 're-humanize' e-commerce and sharpen its focus on customers in major metropolitan cities, starting with New York City and rolling out to other urban markets later on. Jet's primary strategy is to reach urban consumers in large metros and serve as a 'city grocery experience'. As such, they have leased a 250,000 sq ft fulfillment center in the Bronx to fulfill their same-day and next-day delivery commitment to the city. This center will stock Jet inventory, including groceries and everyday essentials and other select merchandise. This new offering comes one year after Walmart acquired Parcel, a technology-based, same-day and last-mile delivery company. In our view, last-mile fulfillment center may be the future of some grocery-anchored retail GLA space. Amazon still leads the e-grocery business, though. Amazon Prime now offers same-day grocery delivery and pick-up across 48 cities. Their 2017 acquisition of Whole Foods Market solidified the need for traditional brick-and-mortar grocery space in order to remain competitive and successful in the food and beverage industry.

Kroger has piloted the innovation front. Kroger has teamed up with Nuro, a self-driving delivery start-up, to deliver groceries via self-driving vehicle from a Fry's Food Store (subsidiary of Kroger) to customers in Scottsdale, AZ. Kroger's integration with this advanced technology showcases their pioneering approach to stay relevant as the industry

transforms. Stop & Shop has also embarked on an innovative approach to grocery delivery. Beginning in Spring 2019, Stop & Shop (in engagement with Robomart) will launch driverless grocery delivery in the Greater Boston Area. These vehicles will bring selected produce, meal kits and convenience items directly to their consumers' doorsteps. Longer term, if these delivery programs are successful and become scalable in other metros, fewer consumers will need to go to a physical store to pick-up their goods, which can threaten in-store foot traffic.

MEDIUM-TERM HEADWIND: MULTI-GROCER PENSION PLANS

One trend we will be investigating going forward is the potential domino effect of closing grocers negatively impacting multi-employer pension plans. As grocers cease operations, other grocers in their multi-employer pension plan will be obligated for the pensions of those failing grocers.

OUTLOOK

In the long run, the need for physical grocery stores will remain across the U.S. The rise of online grocery shopping, shifts in consumer behavior and advancements in technology will continue to disrupt the U.S. grocery-anchored retail market. However, grocery stores are not going away any time soon. We believe that these disruptions will continue to create compelling grocery-anchored investment opportunities across the U.S. in the years ahead.

CONTACT US



Melissa Reagen

Managing Director, Head of Research,
Americas

T: +1 212 916 6643

E: melissa.reagen@nuveen.com



Daniel Manware

Research Associate, Americas

T: +1 212 916 6542

E: daniel.manware@nuveen.com

For more information, please visit us at [nuveen.com](https://www.nuveen.com)

This material is provided for informational or educational purposes only and does not constitute a solicitation in any jurisdiction. Moreover, it neither constitutes an offer to enter into an investment agreement with the recipient of this document nor an invitation to respond to it by making an offer to enter into an investment agreement.

This material may contain 'forward-looking' information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of yields or returns, and proposed or expected portfolio composition. Moreover, certain historical performance information of other investment vehicles or composite accounts managed by Nuveen has been included in this material and such performance information is presented by way of example only. No representation is made that the performance presented will be achieved by any Nuveen funds, or that every assumption made in achieving, calculating or presenting either the forward-looking information or the historical performance information herein has been considered or stated in preparing this material. Any changes to assumptions that may have been made in preparing this material could have a material impact on the investment returns that are presented herein by way of example.

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The information and opinions contained in this material are derived from proprietary and non-proprietary sources deemed by Nuveen to be reliable, and not necessarily all-inclusive and are not guaranteed as to accuracy. There is no guarantee that any forecasts made will come to pass. Company name is only for explanatory purposes and does not constitute as investment advice and is subject to change. Any investments named within this material may not necessarily be held in any funds/accounts managed by Nuveen. Reliance upon information in this material is at the sole discretion of the reader. They do not necessarily reflect the views of any company in the Nuveen Group or any part thereof and no assurances are made as to their accuracy.

Past performance is not a guide to future performance. Investment involves risk, including loss of principal. The value of investments and the income from them can fall as well as rise and is not guaranteed. Changes in the rates of exchange between currencies may cause the value of investments to fluctuate.