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We are all aware that organisations, whatever industry they are in, need to manage their own real estate.

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The impact of an organisation's approach to occupying real estate is felt not only by the occupier but also by its consumers, its workers and its landlords. The latter include property investors such as real estate investment trusts, banks, asset managers, insurance companies, governments, family offices and sovereign wealth funds. The development of an integrated real estate strategy can present real benefits to an occupier, while posing both opportunities and risks to investors.

To translate the impact of local and global trends into an integrated real estate strategy that is practical, functional and implementable, you need to understand how each trend is impacting on the specific organisation's industry sector and predict how to align with their real estate requirements. This article focuses on the impacts of the changing state of the retail industry on real estate; however, the principles apply to any evolving industry where market participants hold a high volume of property assets.

Industries as varied as health, banking and finance, warehousing and distribution, telecommunications, and higher education can all derive benefits from developing an integrated real estate strategy aligned with, and derived from, their evolving business strategy.

Trends in the retail and consumer industry impacting real estate strategy

The business environment for retailers has never been more complex. Consumers are developing their own approach to researching and purchasing, both online and in-store. More and more people are purchasing online instead of in-store. Single's Day – the 24-hour shopping festival in China that now dwarfs Black Friday in terms of sales – is often used as a bellwether for China's e-commerce market. This year, Alibaba's Single's Day online sales came in at US$14.3 billion, a 60% increase over 2014.

Online shopping during the 2015 Thanksgiving weekend accounted for almost 29% of sales, up 12% over 2014 and Goldman Sachs predicts that mobile commerce will account for almost half of e-commerce by 2018.

However, this is not the complete story. According to PwC's annual consumer survey, *Total Retail: Retailers and the Age of Disruption*, the physical store still remains the retail touch point for most consumers. More than 36% of our global sample goes to a physical store at least weekly. That is a significant difference compared to how often they shop weekly online via PC (20%), tablet (10%) or mobile phone (11%).

Reasons for shopping in physical stores relate to experiencing the merchandise, confirming goods are a good fit and obtaining immediate ownership. Even for goods where consumers predominantly buy online, consumers may research online but actually buy in-store – 73% of US respondents report that they research online when buying clothing, footwear, toys and health and beauty products (60% globally). Yet despite their continued use of physical stores, today's consumers want their shopping needs met in a way that minimises uncertainty and inflexibility and maximises efficiency, convenience and pleasure.

As a result of these actual and anticipated changes in consumer behaviour and the resulting challenges to retailers' economic models, PwC predicts that by 2020 many of the current models for successful retailing will have undergone significant change. Retailers will have to develop new strategies and tactics to engage the consumer in a profitable manner. Historically, the retail store model required a store to sell enough product at a sufficiently high margin per physical building to offset real estate and operating costs and deliver a successful return on investment (ROI). With new pricing mechanisms and changes in buyer behaviour, intense pressure will build on this margin structure. As a result, there will be a need for retailers to find new ways to keep stores profitable. If sales from physical store locations decline, a reduction in real estate operating costs will be key to achieving this.

What does declining sales from physical stores mean for an occupier's real estate strategy?

From a real estate perspective, PwC anticipates that retailers' strategies are likely to develop to find new real estate environments from which to engage with the consumer. Over the coming decade, the pressures of competition and the range of digital shopping solutions may force retailers to reconsider the value of their store formats. Many of today's major retailers will be transitioning from traditional, larger stores into non-traditional, typically smaller store formats. Those formats are likely to be numerous and varied to match the shifts in what, when, and where consumers want to shop, and will be supported by the deployment of technology to enhance and support consumers' shopping experience. This may include short-term formats such as pop-up stores and mobile retail trucks. Pop-up stores are currently booming in the US, with a value of US$50 billion in 2014.

Retailers will also demand greater flexibility through shorter lease terms, break clauses and options to alter their store area, despite the higher costs involved. Also, the need to create destination shopping environments will impact on occupiers' demands of investors. Occupiers will not accept a lacklustre shopper experience in the wider shopping mall, due to the need to complement their own drive to control consumers' in-store experience and spending behaviour. We have also seen that changing store formats are forcing property-level strategy changes, with e-commerce enhancing the integration between industrial and retail real estate.

Some of the changes in retail occupier portfolios could include:

- Decreased footprint per store;
- High demand for store presence in new or growing consumer markets;
- Increase in demand for warehousing/ distribution centres;
- Relocation to transport hubs or centres with good infrastructure;
- Prioritisation of shopping locations that provide additional attractions beyond shopping; and
- Flexibility in leases to allow for rapid response to changes in consumer behaviour.

These are just a few of the possible developments in occupier requirements. However, the key issue for occupiers will be how to implement these types of strategic decisions without adversely impacting on business operations and within the constraints of their existing portfolio. This is where an integrated real estate strategy adds real value.

How to develop an integrated real estate strategy?

Juggling current and future consumer trends requires regular reviews of and amendments to a retailer's business strategy. However, in the retail and many other sectors we have found that this is often not translated into property practice. In some cases, business and real estate strategies do not align or, worse still, are at odds with one another. In other cases, occupiers' existing real estate strategy fails to keep pace with the changing nature of the business, leaving them with high operating costs and vacant premises.

The approach set out in Figure 1 on the next page provides a real estate strategy that is practical, functional and implementable, responds to business and consumer demands and optimises operating costs during transition.

The benefits of an integrated real estate strategy

The benefits of adopting an integrated real estate strategy include improving and increasing market access and the organisation's operational advantage by responding to consumer demand.

Figure 1

01 Business strategy

The key to developing an integrated real estate strategy is to first understand and challenge the organisation's business strategy and operating model. This includes defining the business or service model and product mix and identifying current and future strategic and financial goals. The business strategy also establishes the configuration of the business segments and operating units, such as retail and administrative functions. The business strategy will also pick up anticipated changes in operating models, as illustrated in the examples from the retail sector.

02 Current portfolio analysis

It is then necessary to undertake a thorough analysis of the current real estate portfolio. This might include a review of: the current and future use of the properties; existing tenure type and structure; and current rents, market conditions and commercial options. Opportunities for single or portfolio-wide exit from owned/leased properties would be considered at this stage, together with a property opportunity analysis, including developments and disposals. An analysis of operating expenditure and capital expenditure projections; current and potential tax and accounting positions; and sustainability performance would also be completed.

Integrated Real Estate Strategy

Applying this understanding of business requirements, a premises and location strategy should then be developed. Here the occupier should design a location portfolio mix to meet business objectives – e.g. scale, cost efficiences, growth, consumer locations and risks. Premises requirements should be defined, and steps should also be taken to ensure ongoing optimisation of portfolio for alignment with business and financial goals.

03 Workforce management

The work undertaken in the development of an integrated real estate strategy also brings together plans for workforce management, determining workplace and workforce needs/behaviour (e.g. level of collaboration/ frequency of interaction) and infrastructure requirements and mobility standards (e.g. mobile, telecommuting).

04 Occupancy management

The preparatory work must also consider demands of occupancy management, including capacity forecasting and planning consistent with workplace standards, space/ facilities (e.g. lease, contract negotiations) and ongoing occupancy optimisation.

Workplace and retail function flexibility, increased employee productivity and an improved consumer experience can be combined with sustainable occupancy cost management, future proofing and de-risking the organisation's real estate portfolio, and allowing a rapid response to any change in the business environment.

What might these benefits mean for investors?

And what does this mean for property investors, owners of shopping malls and the like? Investors need to be aware of changes in their tenants' real estate strategies and make their own leasing and development plans accordingly, taking into account demographic differences in retail habits.

Shopping malls engage with and predict future trends to offer market-leading retail space to their tenants, while also considering new opportunities for investment areas such as warehousing and distribution and supporting infrastructure.

Investors should also be alert to new opportunities. For example, one potential result of an integrated real estate strategy is the possible spin-off of real estate assets into separate vehicles or into sale-and-leaseback or strip-income transactions. Retailers such as Toys R Us and Walmart, and corporates such as UBS, American Tower, and Iron Mountain have all sought to use their real estate holdings to gain access to cash for shareholders or investment in repositioning business. Windstream Holdings, a US telecommunications corporation, recently announced it intends to spin off its copper and fibre network into a REIT. The REIT would then lease the fibre and copper networks back to Windstream, with the income passing through to investors. And, according to the Wall Street Journal, at least eight hotel operators have announced spin-offs over the past two years, more than in the previous four years combined.

The competitive advantage

Considering the potential challenges that will emerge from new and evolving operating environments, occupiers should give careful consideration to the benefits of implementing integrated business and real estate strategies that provide a competitive advantage to their organisation.

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