BCLP. Client Intelligent

Insights

TRADING SPACES: REPURPOSING RETAIL AS LOGISTICS

Jan 22, 2021

SUMMARY

Retail's struggles were well documented before the events of 2020 really upped the ante. As the UK tries to navigate the second wave of COVID-19, what opportunities are there for the real estate sector to build a sustainable strategy around the repurposing of retail? Might the answer be found in urban logistics?

COVID restrictions have undoubtedly lit the burners beneath e-commerce. Online groceries have seen a massive surge in demand, leading to a huge storage requirement and a focus on supply chain modelling including last mile delivery. This has led to a renewed interest and uptake in the logistics sector, triggering both the creation of new pure logistics funds and mixed funds looking to increase their exposure in the short to medium term.

Lenders with retail on their books are also looking to their borrowers for new strategies including restructuring, releveraging and repurposing, at the very least hoping to minimise exposure to business rates and service charge on any voids.

When you consider the figures it's not surprising. In the market this year we're regularly seeing terms of over 10 years in the mid-big box segment (which are becoming rarer in other sectors including retail and offices) with impressive yields of 4% or lower on prime assets.

The industrial and logistics sector has not only shown resilience in terms of occupancy and income recovery in these challenging times, but it's also this sector which is poised to capitalise on two current mega trends being the anticipated need for gigafactories to produce batteries for e-vehicles and bigger, better and smarter R&D facilities for public health and vaccine manufacture, its storage and distribution.

Where?

Repurposing retail in order to locate distribution hubs near to populated urban areas speeds up last mile delivery, allowing online retailers to challenge bricks & mortar retailers sweeping up those customers who want their goods in real time. In 2018 a BPF report estimated that each new home built requires 69 sq ft of warehouse floorspace – a figure that will have sky-rocketed this year – and of course Christmas 2020 is expected to be the biggest test so far in terms of online fulfilment. A central location can also provide an “on tap” workforce, particularly if the infrastructure surrounding the hub is strong.

London will undoubtedly lead the charge purely from a valuation perspective. For retail to covert to logistics you need to have a significant value for it to work – for example Prologis’ acquisition of Ravenside Retail Park in Edmonton as a last mile hub. With the recent resurgence of retail parks this may more often mean looking at secondary or tertiary shopping centres, although many local authorities would resist such a change of use if such centres are located in a town centre.

The recent changes to the Use Classes Order 1987 did not affect B8 (storage and distribution). A change of use application (from E to B8) will be required in addition to any planning permissions related to physical changes at the site. Local Planning Authorities are more likely to want diversity of uses – now facilitated by the breadth of Use Class E – to maintain the town centre as a community focus.

Locating logistics hubs near to housing will also ring alarm bells for planners. Noise, air quality and delivery movements (in and out of the facility) are likely to be controversial with residents and politically charged.

Even if the principle is acceptable, operational restrictions imposed by conditions may make the facility unviable.

An urban site will probably mean a smaller site to play with, although current sites do often have inefficient footprints so there may be scope for an imaginative architect to optimise the square footage. Vehicle circulation is key so that is likely to mean a smaller building footprint whilst allowing enough turning, loading and parking space for deliveries and pick-ups particularly if HGV deliveries are contemplated. These locations do tend to be well-connected and subject to getting the planning, building configuration and costs to stack up, you can expect to see more vertical land use within these urban locations. Retailers are also re-purposing themselves with retail at the front of the unit and urban fulfilment centres at the rear.

What might appease the planners? Given the economic outlook and rising unemployment, the regeneration angle should be maximised. Moreover, done properly, repurposing isn’t just about re-using existing buildings, it’s about building back better (a theme emphasised in the Planning White Paper), with ESG at the fore. With the built environment currently contributing approximately 40% of carbon emissions, as the UK Government strives to achieve its net zero targets by 2050 it will be looking directly at the property industry to contribute and in a big way.

The Government has recently launched its “green industrial revolution” and brought forward the ban on the sale of new petrol and diesel cars and vans to 2030, but is there more than can be done to accelerate the transition to zero emission vehicles? Could empty retail units present an opportunity for industries supporting (and the adoption of) electrification of mobility to be part of a city-specific or national pandemic recovery response? There will clearly be technical issues to work through, not least ensuring sufficient power to the site and surveying load capacities of existing buildings, but a long-term view and approach may be needed to save the UK from swathes of unoccupied retail space.

What will key infrastructure look like in the future? Could charging points be as important as a good road or train network? Arguably the current polices from the Government (including the further devolution of powers away from central Government to encourage further city wide ultra-low emission zones and clean air zones across the UK) create a positive eco-system for the greater adoption of battery electric vehicles (BEVs). If you add to this the potential for car scrappage schemes, parking incentives and fast-lanes (through the newly announced green number plates), benefits-in-kind company car taxes, further capital allowances, plug-in grants and incentives around the location and building of charge points – the conditions for great adoption for consumers and business owned fleets will be present. If we can further add incentive to landowners to host BEV charging points through tax incentives, this could "turbo charge" BEV adoption and really help cities post pandemic. And in turn the move to BEVs may open up new opportunities for logistics to repurpose, or at least reconfigure, current petrol and service stations.

Not forgetting that Brexit is also likely to increase the appeal of repurposing opportunities near ports. As the Government continues to negotiate the Brexit deal, getting our ports strategy right is regularly described as being key to our future outside of the EU. For logistics that may be finding sites for the implementation of storage solutions, product finalisation or full processing. Ports that are closely located to their main market make for reductions in carbon as well as minimising the risk of disruption through transport congestion. The Government's newly announced Freeport's policy could also offer turbo charged opportunities around existing sea, air and rail ports as early as next year.

The competition?

An urban location with good connectivity attracts more than just the logistics sector. The build to rent, multi-family and data centre developers are often vying for these opportunities to and, in many cases, can offer a premium price per sq ft. We know, even in this year's disrupted market, that mixed use, community focussed developments are a serious contender in this space. In a customer focussed model, logistics should arguably now form a key part of any such development strategy. We've seen that happen, for example, on new office developments in the City. Consolidated delivery management systems mean that goods can be stored in a dispatch centre outside of a city, with tenants using a digital goods management system to call for those goods when they actually need them, delivery being scheduled for off-peak times with low/zero emission vehicles. It would be no surprise if we saw more industrial and logistics developers teaming up with developers who have traditionally not operated in this space.

How?

If prices are rising, how can logistics get more bang for their buck? Certainly, efficiency is key – of space (think cubic not square metres) and of working practices (think automation). But going up carries different challenges – vertical space requires lifts and the right structure to support considerable loading – unlikely to be the basis upon which a purpose-built retail unit will have been constructed. Getting fire safety right will also be key.

The modelling will be interesting too. Over the last few years, we've seen an explosion in the number of serviced/flexible office offerings, with even institutional landlords now seeing the concept as a key part of their office strategy. The pandemic has certainly served to shine a light on the benefits of flexible office space going forward. Flexible serviced logistics models are now also in play. The diversity of occupiers and their particular requirements makes this model a challenge but investors who've successfully implemented flexible offices will have a strategy in place including a slick (potentially online) leasing model, and the ability to cope with the intensive management demands.

How will it be funded?

Whilst there is support from the banks, valuing is tricky, particularly where big boxes are built to suit. We've seen COVID make that harder and doubly so for repurposing. Retail rents may have to be re-based to allow for a more palatable yield differential on the paper trail.

By Verity Waington (Partner) and Victoria Duxbury (Associate Director Knowledge Development Lawyer) With special thanks to the Planning and Zoning, Retail and Consumer Products, and Infrastructure teams.

This article was first published in Estates Gazette on 5 December 2020.

RELATED CAPABILITIES

- Real Estate

MEET THE TEAM

Victoria Duxbury

Co-Author, London

victoria.duxbury@bclplaw.com
+44 (0) 20 3400 3190

Verity Waington

Co-Author, Southampton

verity.waington@bclplaw.com
+44 (0) 20 3400 2502
