

The Future of Retail: Places to Connect, Explore and Engage

Retail spaces have always been many things: a place to shop, a place to bring the family, a place to meet friends. The future of retail real estate will lean into this concept—and the best places will center on curated experiences, dining, entertainment, differentiated product offerings, and showcases for new and emerging brands.

Today, the retail industry is quickly adapting to changes in consumer behavior brought about by the COVID-19 pandemic. Yet high-quality physical retail is alive and well in the U.S., as we are seeing every day. With 80% of sales continuing to come from in-store shopping, it continues to provide the bedrock for online sales success, rather than the other way around.

Through our research, first-hand experience and long-term interactions with leading retailers, we have identified three themes that are foundational to the future of physical retail:

1. Focusing on high-quality retail real estate.¹

Consumers, businesses and communities are seeking spaces that serve a wider range of needs. High-quality retail real estate is best positioned to meet this demand in the long term, with a focus on “placemaking”—that is, transforming properties into hubs of daily life and commerce.

2. Transitioning to “One Channel” strategies.

One Channel, the retail industry’s modernized take on “omnichannel,” provides the consumer with a relevant, consistent and individualized

experience across both digital and physical assets to allow for seamless brand engagement. While the importance of this transition has been widely understood as critical for some time, the pandemic accelerated the trend.

3. Harnessing the “halo effect.”²

Brick-and-mortar stores continue to be valuable profit centers. Retailers that have invested in a physical presence have been rewarded with an overall incremental sales lift of 26% in a single market.

As a result of changes in the way people live and interact, these themes will create opportunities for retailers—and those that can adapt and transform their offerings to answer the call will be

the winners. Our experience has shown us that retailers and retail real estate owners can work together to implement One Channel strategies in high-quality locations in the U.S.—and pave the way for the next phase in the industry’s evolution.

~80%
of retail sales
are generated by
physical stores

QUALITY COUNTS

The U.S. has 24 square feet of gross leasable retail area (GLA, or the amount of space in a commercial property that is actually leasable for use by a tenant) per capita. That is 50% more than in Canada, the next-largest national market among developed countries.³ Yet U.S. retail sales were only one-third larger than Canada's. Why? Because the U.S. has a relatively high share of lower quality real estate. Data as of April 2020⁴ suggest that low-quality C-rated malls, as measured by Green Street Advisors, comprise 22% of total U.S. GLA but account for just 11% of retail sales (see Figure 1). Conversely, A-rated properties account for 58% of overall sales but represent only 36% of mall GLA.⁵

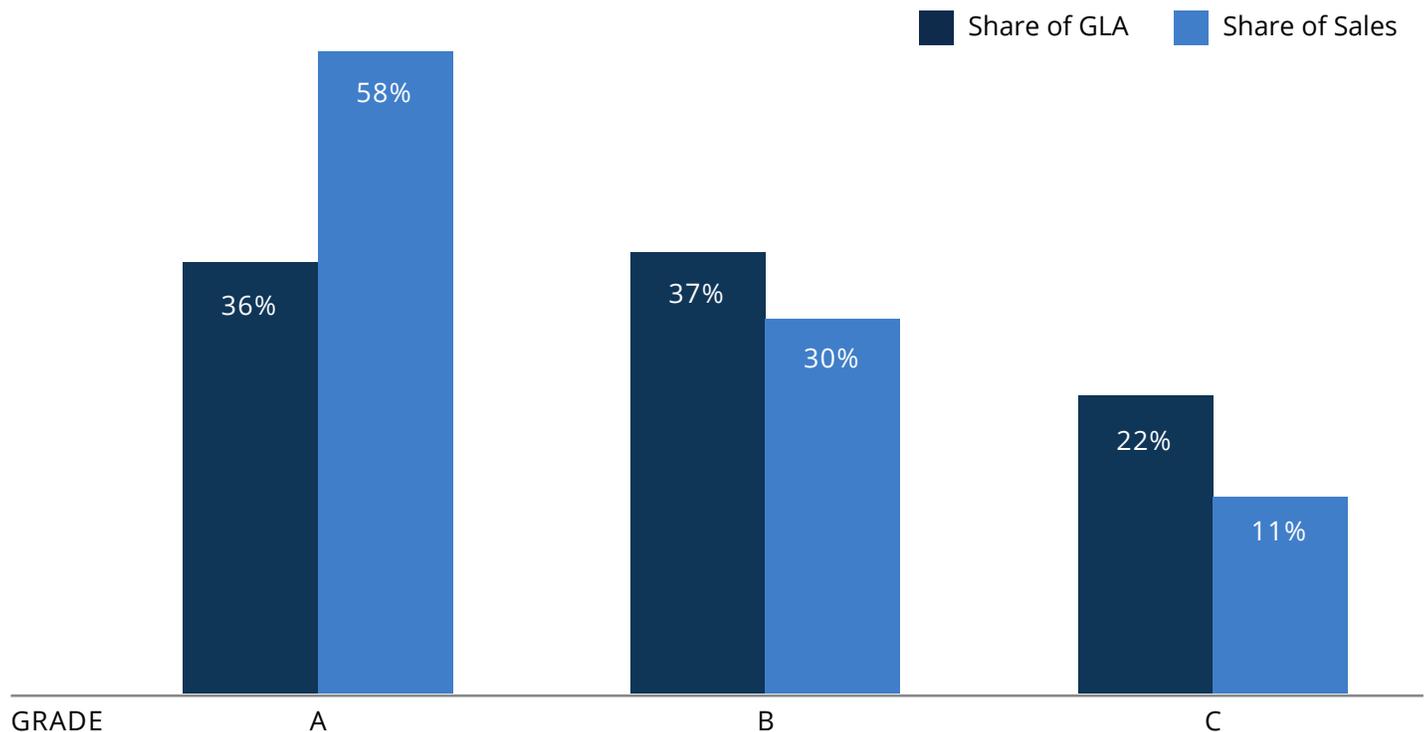
While the government-mandated economic shutdown brought swift and significant changes to the retail ecosystem, one thing remains the same: High-quality shopping centers occupied

by the most desirable brands and located near a concentration of engaged shoppers serve as a strong platform for customer acquisition, overall sales growth and order fulfillment.

Indeed, strong A-rated regional shopping centers deliver more unique shoppers—around 40% more during a three-month period, on average—than urban retail districts do, excluding Manhattan (see Figure 2).⁶ Additionally, mall shoppers come primed and ready to buy rather than browse, meaning brands with a shopping mall presence not only garner greater exposure for customer acquisition but also benefit from higher sales volume due to consumers' mission-based trips.

Although some media headlines continue to assert that physical retail is in distress, nearly 57% of store closures year to date have been attributed to brands that were financially challenged prior

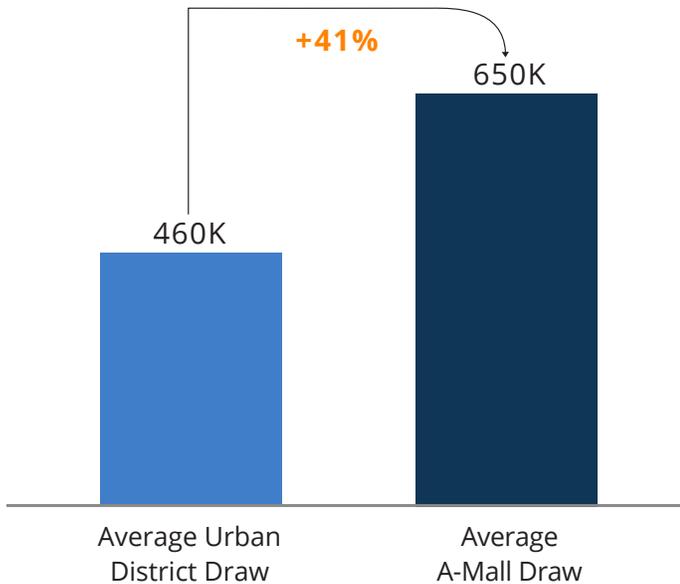
FIGURE 1: HIGH-QUALITY MALLS LEAD SIGNIFICANTLY IN SALES



SOURCE: GREEN STREET ADVISORS, APRIL 2020.

FIGURE 2: STRONG REGIONAL SHOPPING CENTERS ARE A BIGGER DRAW THAN URBAN DISTRICTS

SHOPPERS REPORTING TO HAVE VISITED A RETAIL LOCATION IN THE PAST 3 MONTHS



SOURCE: SCARBOROUGH. NOTE: TOP 10 DMAS INCLUDE ATLANTA, BOSTON, CHICAGO, DALLAS, HOUSTON, LOS ANGELES, PHILADELPHIA, SAN FRANCISCO, AND WASHINGTON DC; NYC EXCLUDED GIVEN ITS INCOMPARABLE URBAN DENSITY. DRAW REFERS TO ADULT SHOPPING BEHAVIOR (18+).

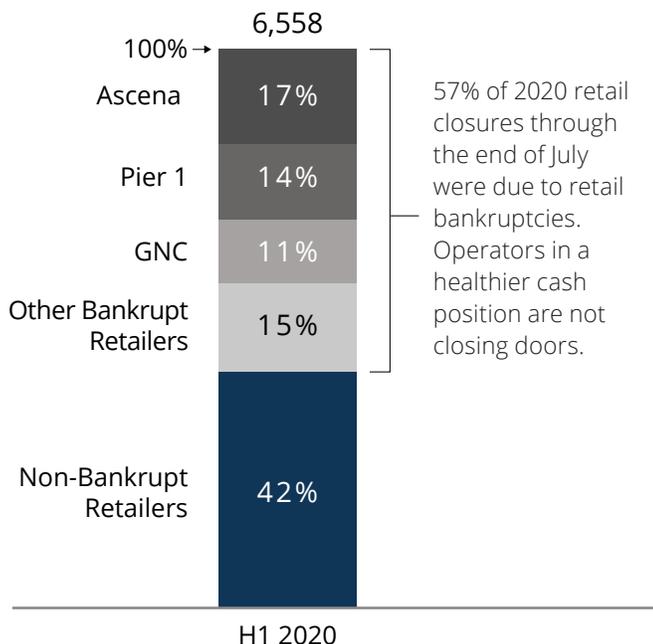
to the pandemic (see Figure 3).⁷ These recent bankruptcies of unhealthy brands should not be conflated with the health of physical retail store operations that have proven to be an accelerator for businesses committed to a One Channel strategy in high-quality retail centers.

Therefore, we believe that developing and redeveloping high-quality retail centers will be a key factor in the retail industry's future. Consider a traditional mall that is underperforming but is located in or easily accessible to a desirable area. While the traditional model may not currently be working, skilled owners and developers can spot the potential to increase traffic to these spaces. In our experience of owning and redeveloping properties for over 65 years, we have found what is essentially the silver bullet: Focusing your efforts on serving the community.

By designing and curating our retail spaces to give our surrounding communities what they need—whether it's housing, day care centers, medical clinics, grocery stores or pharmacies, or all of these things—we also drive traffic to the high-quality retailers we partner with. The focus on placemaking also needs to be ongoing, with owners continually refreshing their properties and tenant mixes as new needs arise. For example, the redevelopment of Oakbrook Center in Chicago illustrates how we curate tenant mixes and amenities to benefit both retailers and local consumers.

Overall, we see the future of retail bifurcating along quality lines in the years ahead. The properties that will come out on top are those that focus on carefully selecting a compelling, modern mix of merchants that is less fully focused on traditional retail.

FIGURE 3: THE IMPACT OF RETAIL BANKRUPTCIES ON STORE CLOSINGS



SOURCE: CORESIGHT RESEARCH 2020 STORE TRACKER.



HOW THE REDEVELOPMENT OF OAKBROOK CENTER SPURRED GROWTH IN SALES AND NOI

OAKBROOK CENTER

Oakbrook Center is the premier shopping destination for Chicago's affluent western suburbs.

Since 2012, Brookfield has invested approximately \$300 million in a major multi-phase redevelopment of the asset. The plan further elevated the center's merchandising differentiation, and included:

- A common area revitalization, including modernized amenities with compelling water features and landscaping, as well as the creation of a community gathering space
- Proactive anchor redevelopments, including conversions to increase retail productivity and create areas for dining and fitness uses
- An expansion for a new AMC IMAX theater and food hall

As a result of the redevelopment, total sales volume has grown approximately 40% since 2012 and net operating income (NOI) has grown by about \$30 million, reflecting an approximate 10% yield on invested capital. This implies a value creation of \$350 million in excess of our investment.

ONE CHANNEL IS THE WAY FORWARD

In the early 2000s, the retail industry coined the term “omnichannel” to describe the integration of the e-commerce business back into the overall corporate operations of a retailer. “One Channel” is a more modern term used by the industry that reflects the influence of social media today. For example, although a retailer does not own Facebook, Amazon Marketplace or Pinterest, its merchandise may be both marketed and distributed via those channels. Accordingly, a strong One Channel operator can maintain a consistent look, feel and voice across its marketing messaging, branding and product assortment in any and all locations where the consumer may encounter it.

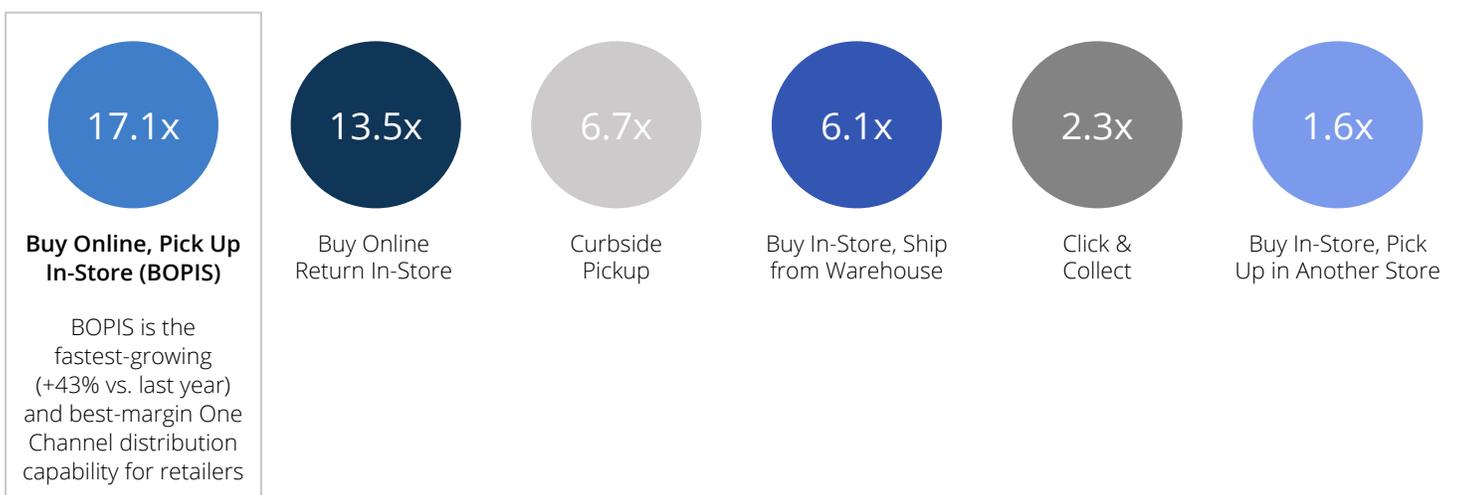
We have long viewed the transition to a One Channel strategy as essential for the future of the retail industry. Yet it has been a challenge among many retailers for years. While the pandemic-spurred shutdowns have been widely blamed for some retailers’ recent struggles, the coronavirus simply accelerated the timeline for them to either get on board or be left behind.

More and more, customers have been demanding access and flexibility to obtain the products and services they need—anytime, anywhere. The new standard baseline for fulfillment options includes “buy online, pickup in store” (BOPIS) and curbside pickup, which have doubled in usage since the pandemic began and have generated proven results (see Figure 4). For example, Dick’s Sporting Goods rolled these services out earlier this year, helping to drive a 40% increase in digital sales during the first quarter of 2020, completely offsetting the profitability hit from store closures.⁸ Ulta Beauty also expanded curbside pickup and found that customers who used this service spent three times more than those who kept their purchases completely online.⁹

These services play an even bigger role during the holiday season, when e-commerce sales increase, and shipping capacity and order fulfillment become constrained and costly due to excessive demand. Retailers need to ensure that they can execute on these fulfillment services effectively to capitalize on their biggest sales

FIGURE 4: THE BOPIS BUMP

OPTIMIZED FULFILLMENT JOURNEY MARGINS VS. THE SAME JOURNEYS, NON-OPTIMIZED



SOURCE: IHL GROUP, ADOBE ANALYTICS, WWD.

period of the year—and beyond. Indeed, 62% of Americans who used BOPIS for the first time during the pandemic plan to continue or increase their use of the service after the pandemic is over.¹⁰ To keep up with this shift, owners of high-quality retail real estate will need to partner with retailers to optimize the operations of their physical locations into centralized hubs focused on discovery, fulfillment and returns.

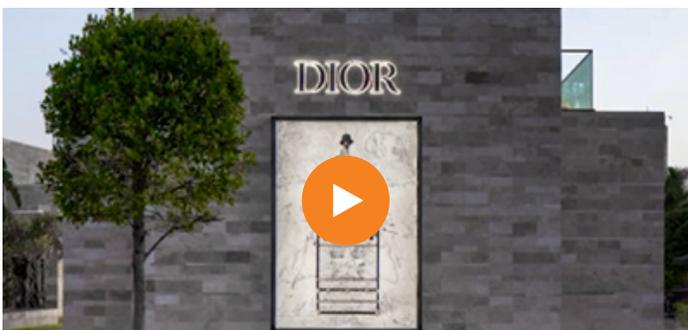
In our experience, savvy retailers have long recognized the myriad benefits of physical retail within a One Channel strategy (see Figure 5). For example, Lululemon—a recognized leader in One Channel¹¹—connects with its customers through community events and in-store fitness classes, facilitating e-commerce transactions through the online registration process and generating awareness on social media when attendees post photos of these events.

FIGURE 5: A HOLISTIC LOOK AT STORE VALUE



SOURCE: BROOKFIELD PROPERTIES BUSINESS INTELLIGENCE & STRATEGY.

DIOR’S CHAIRMAN AND CEO ON THE VALUE OF BRICK AND MORTAR



Finally, as a growing number of retailers adopt One Channel, some are finding new ways to use physical locations to strengthen their relationships with customers. For example, Whole Foods Market is testing a dark-store concept in Brooklyn, New York, where only online orders are fulfilled.¹² And the luxury fashion brand Off-White has announced that its latest store will be a flexible flagship retail

location that will enable logistics and fulfillment, as well as event space to host large-scale events such as runway shows.¹³ Indeed, luxury brands have long recognized the value of having a physical presence, and continue to do so. According to Pietro Beccari, Christian Dior’s chairman and CEO, "brick and mortar will have capital importance for luxury brands such as Dior [in the future]."¹⁴

THE HALO EFFECT: PHYSICAL RETAIL IS THE MONEY-MAKER

Physical stores are workhorses that benefit brands in profitable ways—they move the entire retail enterprise forward. Prior to Q1 2020, physical retail sales had been increasing 2% per year since 2016 and accounted for almost 80% of all retail sales. When combined with non-store sales, such as digital and catalog, this resulted in an overall retail growth rate of 3.4% annually during that period.¹⁵

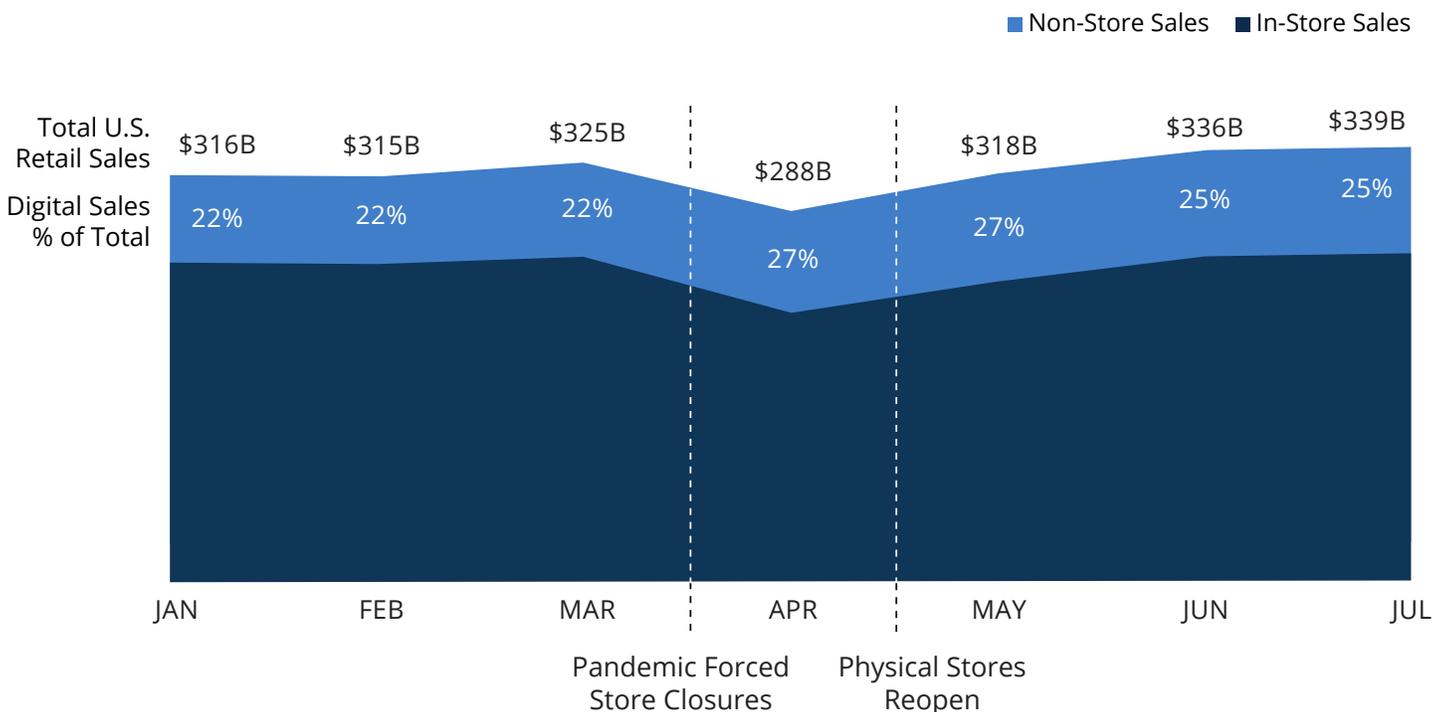
The financial impact of physical stores has never been clearer than during the coronavirus shutdown. In April 2020, with most brick-and-mortar retail closed around the world, online retail sites saw an 88% increase in traffic.¹⁶ Yet that growth came with constrained margins stemming from exorbitant

online-fulfillment and customer-acquisition costs. Indeed, many of the online-only distribution channels were unable to keep up with the demand surge during the pandemic shutdowns. The winners were retailers that had very large physical footprints, such as Walmart, Best Buy and Target.

Further, the scale of physical in-store sales versus digital e-commerce sales became abundantly clear—nearly all nonessential retailers saw total sales decline, despite in many cases doubling or tripling their digital e-commerce sales while their store fleets remained shuttered. Digital growth of \$6.7 billion could not come close to offsetting the \$44.3 billion lost in physical retail stores (see Figure 6).¹⁷

FIGURE 6: DIGITAL SALES COULD NOT FILL THE GAP LEFT BY PHYSICAL STORES

YTD 2020 U.S. RETAIL SALES VOLUME BY CHANNEL

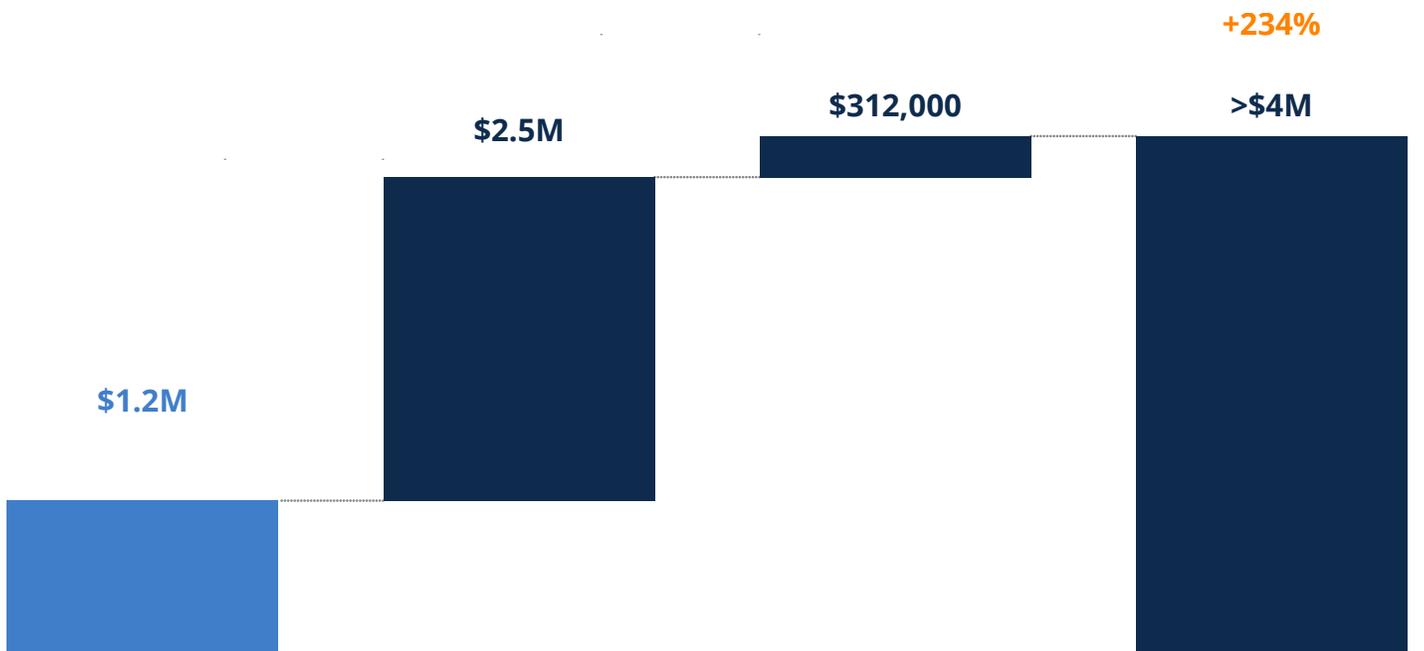


SOURCE: U.S. CENSUS BUREAU: TOTAL RETAIL SALES EXCLUDING AUTO, GAS, AND FOOD SERVICE, JUNE 2020.

Put simply, a successful online strategy requires a successful brick-and-mortar strategy—something that has become more and more apparent to online retailers. Even Amazon had been aggressively expanding into physical retail before the pandemic, as evidenced by the accelerated rollout of its specialty stores like Amazon 4-star, as well as grocery and distribution hubs.¹⁸ To compete with Walmart and Target, which use their stores to drive transactions and fulfillment, Amazon continues to look to build a network close to its target markets.

A 2018 study published by the International Council of Shopping Centers (ICSC) highlights the impact that opening a physical store can have on previously online-only retailers. They named this impact the “halo effect.”¹⁹ Simply put, the halo effect is the incremental e-commerce sales lift that occurs upon a store opening in a market with appropriate consumer demand. The findings in the ICSC study can be applied to demonstrate an illustrative overall market sales increase of as much as 234% (see Figure 7).²⁰ Inversely, according to the ICSC, when a retailer closes a

FIGURE 7: THE HALO EFFECT IN ACTION



01.
An average market without a physical store may deliver \$1.2 million in digital sales.

02.
If a retailer opens a physical store in a market where there is appropriate consumer demand, they could realize the average inline mall sales per store: \$2.5 million.

*At this point, because the merchant has a digital **and** a physical presence, the halo effect kicks in.*

03.
Due to the physical store, digital sales in the market grow +26%, or about \$312K, thanks to the halo effect.

04.
Adding the \$1.2 million digital sales + \$2.5 million physical sales + \$312K halo effect sales = total sales of +\$4 million.

By adding a physical store, this brand increases sales by +234%.

SOURCE: ICSC, BROOKFIELD PROPERTIES

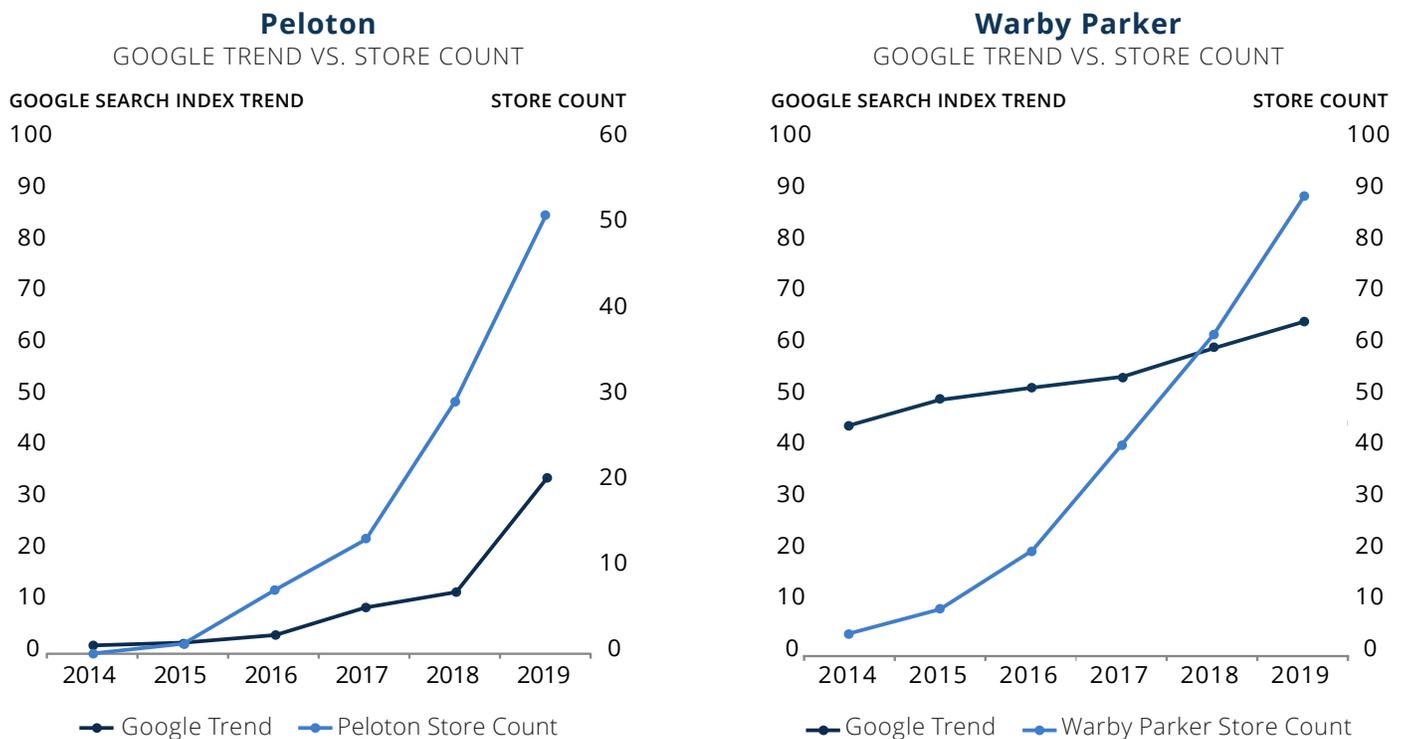
store in a market with balanced consumer demand, it loses not only sales from that brick-and-mortar location, but also about 10% of digital sales in the same market.²¹

Without physical locations, digital-native or emerging brands' advertising can be quickly forgotten as customers scroll through their social media feeds. Using Google Search Indices as a proxy for consumer awareness, we see that shopper interest in online-only brands such as Warby Parker and Peloton spikes in parallel with physical-store openings (see Figure 8).²²

By driving customer awareness of a brand, and by allowing consumers to touch and feel previously online-only products, retail stores play a vital role in the sales funnel that digital-only retailers cannot match. Indeed, Brookfield retail assets are home to numerous digital-native brands seeking the accelerated customer-acquisition platform and top-line sales growth that opening a physical store at our properties gives them.

Put simply, retail stores are the most effective customer-acquisition tools that digital-native brands can invest in.

FIGURE 8: THE HALO EFFECT ON PELOTON AND WARBY PARKER

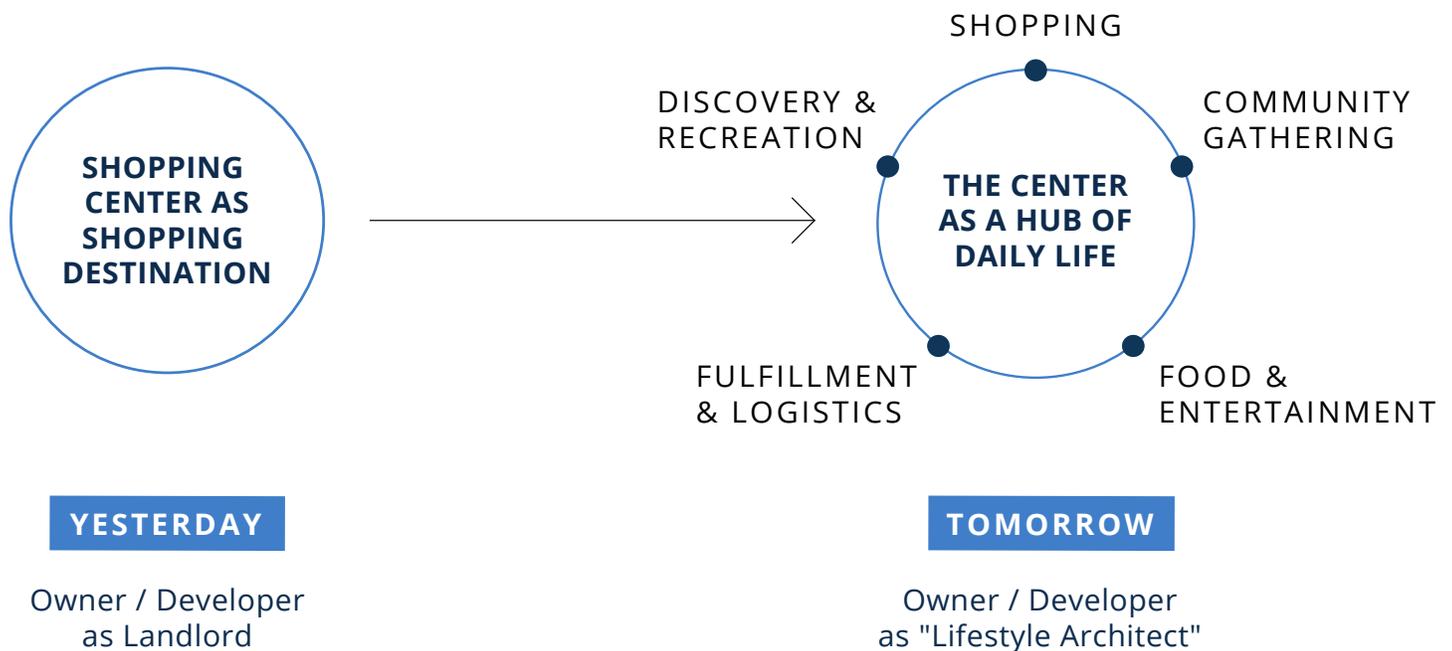


SOURCE: GOOGLE TRENDS AS OF JANUARY 2019.

LOOKING TO THE FUTURE

In 2020 and beyond, high quality real estate continues to play a critical role in the future of retail. Healthy retailers remain committed to their plans to open stores this year, with over 3,000 new stores having already opened year to date, 5% more than in the same period last year.²³ The increase in retail bankruptcies this year will also enable mall owners to further accelerate their placemaking strategies, bringing an exciting assortment of new brands and services to their retail centers and communities (see Figure 9). The benefit of a community and a center working together is mutual—it drives improvements for both, ensuring long-term relevance and helping future-proof the industry.

FIGURE 9: THE FUTURE OF RETAIL IS NOW

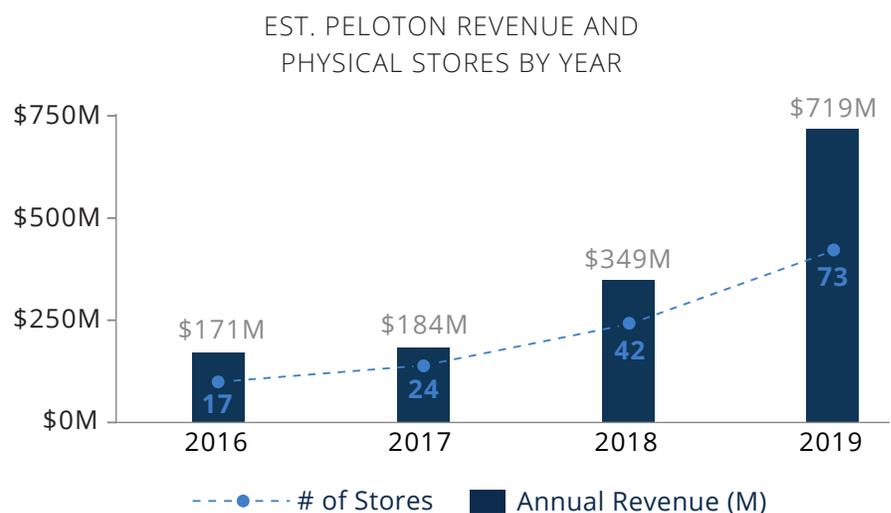


SOURCE: BROOKFIELD PROPERTIES.

PELOTON: A STUDY IN SUCCESS

Peloton's performance across many store openings over the past four years clearly shows the opportunity available to retailers looking to grow their business (see Figure 10).²⁴ Peloton's online sales have skyrocketed during the pandemic, but its CEO, John Foley, is still focused on stores: "I am really excited about the opportunity that is going to present itself with some retailers struggling and Peloton being able to pick up more premium retail locations. We're going to be investing and making those special locations."²⁵

FIGURE 10: LOCATION GROWTH BOLSTERS OUTSIZE REVENUE GROWTH AT PELOTON



SOURCE: PELOTON IPO FILINGS WITH U.S. SECURITIES AND EXCHANGE COMMISSION, 2019.

COMMUNITY ENRICHMENT THROUGH RETAIL SPACE

At Brookfield, a crucial element of our placemaking strategy is supporting the neighborhoods that we are fortunate to serve. Across our portfolio, we strive to create a lasting benefit through corporate charity initiatives and property-led community events. In 2019 alone, our retail assets hosted over 500 community events, such as:

- **The Howard County Public School Art Exhibit** at the Mall in Columbia in Columbia, Maryland, where it has been a tradition for 47 years. The exhibit runs throughout the common areas of the mall and features over 3,000 works of art from 72 Howard County public schools. The mall is also home to Family Fun Day, which features events such as singalongs, story time, magic acts, puppet shows and more that are free to the community.
- **The University of Minnesota’s “Master Gardener” Program** at Ridgedale Center in western Minneapolis. The program is one of the first community gardens at a U.S. mall property and features native plants including two varieties of Minnesotan apple trees, which were developed, in part, by the university. Customers are welcome to harvest and enjoy items from the garden.
- **A pilot food donation program** at three of our retail properties in the Atlanta market. We engaged with food tenants at our malls to promote the donation of surplus food to local charities as an alternative to merely discarding it. This program connects food tenants with local charities and creates an easy and direct way to donate leftover food to communities in need. We are looking to expand this program to other markets and are excited by the additional opportunity to positively impact the communities we serve.



Finally, environmental goals are another important step in the ongoing evolution of retail. Investing in proven and emerging technologies to drive operational efficiencies has demonstrated measurable benefits for Brookfield. For example, in 2019, we saw a 31% reduction in controllable greenhouse gas emissions against a 2014 baseline. This substantial reduction is the result of an ongoing sustainability program that includes solar installations, smart building analytics and efficiency upgrades.

We are focused on evolving our strategic initiatives to meet the demands of changing consumer behavior, adapting to new environmental conditions and limiting the carbon footprint of our business operations. Our commitment to environmental, social and governance (ESG) principles is an integral part of our pursuit to deliver value to all of our stakeholders.

THE BOTTOM LINE

The importance of social interaction and the need for meaningful in-person experiences have never been clearer. As a species, we crave community—and real estate owners and retailers will continue to fulfill this human need by providing spaces for people to connect, explore and engage, while also meeting their everyday shopping needs. High-quality retail centers have always been lifestyle hubs, and now more than ever all parts of the industry must focus on building the marketplaces of the future—by focusing on high-quality real estate, embracing One Channel and reaping the benefits of the halo effect.

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ENDNOTES

- ¹ One Channel retail is defined as providing the consumer a consistent, relevant, and individualized experience across digital and physical assets to deliver seamless engagement with the brand.
- ² The International Council of Shopping Centers (ICSC) defines the halo effect as the direct impact of physical stores on digital engagement and consumer awareness of a brand.
- ³ International Council of Shopping Centers (ICSC), 2016.
- ⁴ U.S. mall real estate is quality-ranked A++ to D. High-quality is defined as A++ - B-; low-quality properties are defined as C-D grade.
- ⁵ Green Street Advisors (GSA), April 2020. Gross leasable area (GLA) based on shop square footage. GSA, a respected and independent third-party firm, assesses institutionally owned retail centers and scores them on a scale from A++ (highest) to D (lowest).
- ⁶ Scarborough. Notes: Top 10 DMAs include Atlanta, Boston, Chicago, Dallas, Houston, Los Angeles, Philadelphia, San Francisco, and Washington DC; NYC excluded given its incomparable urban density; Draw refers to adult shopping behavior (18+).
- ⁷ Coresight Research 2020 Store Tracker. YTD measured as Jan 1-July 31, 2020.
- ⁸ Telsey Advisory Group, "Dick's Sporting Goods Update," June 26, 2020.
- ⁹ Coresight Research, "Ulta Beauty Management Discusses Its COVID-19 Experience and Expectations for the Post-Crisis Reality," June 11, 2020.
- ¹⁰ McKinsey & Co., "COVID Retail Response and Action Planning #6," May 22, 2020.
- ¹¹ Forbes' 2019 Retail Awards, December 27, 2019.
- ¹² Supermarket News, "Whole Foods opens online-only 'dark store' in Brooklyn," Sept. 2, 2020.
- ¹³ Dezeen, "Virgil Abloh and AMO design flexible flagship Off-White store in Miami that 'can host a runway show,'" August 12, 2020.
- ¹⁴ Bloomberg, "Leaders With Lacqua: Christian Dior Chairman CEO Pietro Beccari," October 2nd, 2020.
- ¹⁵ Euromonitor. Time period is 2016-2019.
- ¹⁶ Bazaarvoice, "The impact of Covid-19 on e-commerce by category," July 15, 2020.
- ¹⁷ U.S. Census Bureau: Total Retail Sales excluding Auto, Gas, and Food Service, June 2020.
- ¹⁸ Chain Store Age, "Amazon to double down on expansion of Amazon 4-star stores," January 31, 2020.
- ¹⁹ ICSC, "The Halo Effect -How Bricks Impact Clicks," 2018.
- ²⁰ Analysis across 804 store openings/closures 13 weeks pre- vs. 13 weeks post-opening. Notes on Halo Model: Average sales per store is 2017 Brookfield Properties data from a selection of top 16 retailers: L Brands, Foot Locker, Gap, Ascena, Abercrombie & Fitch, Express, American Eagle, H&M, Williams-Sonoma, Urban Outfitters, Caleres, DSW, Finish Line, J. Crew, Lululemon, Deckers Outdoor. Average e-commerce sales \$ from same 16 brands' public 2017 eMarketer data, averaged across 929 Census CBSA markets
- ²¹ ICSC, 2018.
- ²² Google Trends.
- ²³ Coresight Research 2020 and 2019 Store Trackers. YTD comparing Jan 1-July 31, 2020 vs. Jan 1-July 31, 2019.
- ²⁴ Peloton IPO Filings with U.S. Securities and Exchange Commission, 2019; True Ventures, "What's Working: Peloton's Retail Showroom Strategy," August 29, 2018; Retail Insider, "Peloton Enters Canada with retail Expansion," October 14, 2018; MarketWatch, "Peloton IPO: 5 things to know about the interactive exercise-machine company," Sept. 28, 2019; Vox, "The Peloton bike company plans to unveil its next product: A treadmill," Nov 28, 2017.
- ²⁵ Time, "Peloton CEO John Foley Talks Cheaper Bikes and Making the Most of Staying Home," May 26, 2020.

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