

# The pandemic and the future of retail real estate

Changing consumer behavior may leave a lasting impression on retail real estate.

## Retail rebound

U.S. retail spending in August continued to expand, albeit at a slower pace, marking the fourth consecutive month of expansion.<sup>1</sup> Sales momentum may slow following the expiration of one-time stimulus payments in April and enhanced unemployment benefits in July. However, in our view, rising employment should help to pick up the slack: Employers added 1.4 million jobs in August, pushing the unemployment rate down to 8.4% from 10.2% in July and a peak of 14.7% in April.<sup>2</sup>

Yet, the recovery is uneven (see Exhibit 1). Under stay-at-home orders, U.S. consumers were forced to shop online as a result of government-mandated store closures. In August, non-store sales (largely e-commerce) increased 22% (year-over-year), while clothing-store sales fell 20% (year-over-year).<sup>3</sup> Some of these shifts may prove to be permanent and structural rather than temporary and cyclical. According to eMarketer, the total share of U.S. ecommerce sales is projected to reach an all-time high of 14.5% of total retail sales in 2020. If gasoline and auto sales were removed from total retail sales, ecommerce's share will jump to 20.1%.<sup>4</sup>

## U.S. RETAIL SALES – YEAR-OVER-YEAR PERCENT CHANGE, AUGUST 2020

Clothing & clothing accessories	-20%	<div></div>
Food services & drinking places	-15%	<div></div>
Gas stations	-15%	<div></div>
Electronics & appliances	-2%	<div></div>
Miscellaneous	-1%	<div></div>
General merchandise		<div></div> 1%
Furniture & home furnishings		<div></div> 4%
Total (excl. motor vehicle, parts, gas)		<div></div> 4%
Motor vehicle & parts		<div></div> 5%
Health & personal care		<div></div> 6%
Food & beverage		<div></div> 10%
Sporting goods, hobby, instrument, & books		<div></div> 11%
Building material & garden		<div></div> 15%
Nonstore retailers		<div></div> 22%

Source: U.S. Census Bureau, Advance Monthly Retail Trade Survey  
Data as of: August 2020

<sup>1</sup> U.S. Census Bureau, Advance Monthly Retail Trade Survey, August 2020 <sup>2</sup> U.S. Bureau of Labor Statistics

<sup>3</sup> U.S. Census Bureau, Advance Monthly Retail Trade Survey, August 2020 <sup>4</sup> eMarketer, U.S. Ecommerce 2020

## Shifting spending patterns

In our view, apparel, commodity goods or retail that lacks a defined experience will see penetration advance as a result of the current state and ongoing changes in consumer behavior. Categories such as books, toys, hobbies, and electronics will likely see slower growth rates going forward given the share of online sales is already high relative to other categories.

The home décor and home improvement sectors are having a moment right now. This sector is seeing outsized growth due to the pandemic, but there are also cyclical influences fueling demand for bigger ticket items such as appliances and home renovations. We have viewed the home improvement category as a stable sector which should continue to perform as the housing market improves.

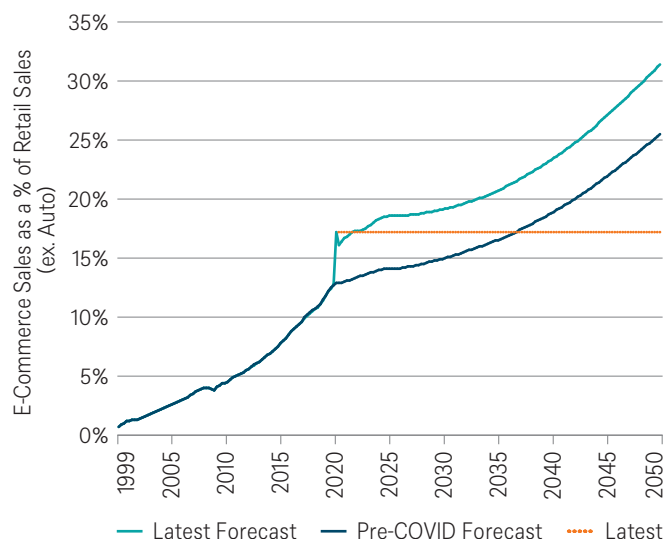
The growth of health, wellness, and beauty is in some ways a corollary to the consumer's shift away from apparel. Going forward, this category is expected to continue to see tremendous growth post-pandemic as a renewed focus on health and wellness – inside and out – will likely be a consumer priority as mobility recovers.

In terms of grocery, the digital progression of sales will likely continue to increase albeit at a slower rate than in commodity categories. At 4%, e-grocery has a lot of room to grow.<sup>5</sup> However, there are limits on the speed and profitability of delivery and in-store fulfillment models that grocers need to refine.

## COVID-19 accelerated recent trends

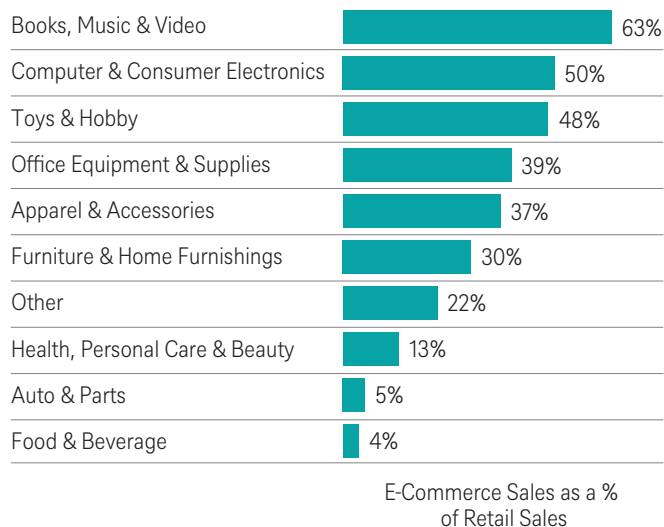
### 10+ years of e-commerce penetration occurred over past 3 months

**E-COMMERCE SALES AS A % OF RETAIL SALES (ex. auto)**



Note: Pre-COVID consensus forecasts as of March 12, 2020.  
Source: Moody's Analytics (Consensus Forecast) and eMarketer.  
Data as of August 2020.

**E-COMMERCE PENETRATION RATE BY CATEGORY (2020)**



Source: eMarketer, U.S. Ecommerce by Category 2020.  
Data as of May 2020

<sup>5</sup> eMarketer, U.S. Ecommerce by Category 2020

The sectors of retail that have been ravaged by the pandemic that we believe will eventually recover include dining, entertainment, in-person fitness, and personal services. Pre-COVID, these categories were re-invigorating centers as demand from apparel and soft goods retailers waned. We believe that these categories will recover as consumers gravitate towards a sense of community and interaction once there is a vaccine or it is otherwise safe to return to these activities.

The strong comeback of China's luxury market is likely not a perfect leading indicator for luxury in the U.S., however, it highlights the divide between relevant brands and those in decline, alongside the interplay of retail technology, innovation and adoption. Heritage luxury brands have been able to raise prices on coveted items in Asia, Europe and the U.S. to make up for sales lost during weeks of coronavirus lockdowns, with some brands reporting sales growth in excess of 50% year-over-year in China in early April. In our view, this illustrates that strong brands that are relevant will be in demand, and will have pricing power.

## Conclusions and implications

The pandemic has accelerated shifts in consumer behaviors and has vastly accelerated the digital progression of online sales. The retail trends we were witnessing prior to the pandemic are being exacerbated by the economic downturn and COVID-induced structural changes. However, retail will adapt and endure; there are some green-shoots that point to the growth of health and wellness categories and eventual recovery of the types of retail we have long favored – grocery-anchored and dominant power centers.

We believe that omnichannel strategies and innovative pick-up, delivery, or contact-free models will become more prominent. Retailers with the most agile logistics networks stand to outperform and meet consumer expectations. The local nature of these types of assets lend well to this model. However, an accelerated shift toward e-commerce reinforces our underweight call on apparel-heavy assets such as malls, lifestyle centers, and high street retail.

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