Amazon's Prime Real Estate Play

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Summary

With one stroke of the pen and a large electronic transfer of funds, Amazon validated the strategic role that physical stores play in showcasing, selling, and distributing goods to consumers. With the closing of its acquisition of Whole Foods, the e-retailing giant has illustrated that, rather than the current "physical vs. online" retail debate, consumer preferences and costs are following a new path, as retailers compete to reach customers in the most efficient and effective manner. We expect to see continuing convergence of pure online and physical retailers, with the most successful morphing into hybrids to better compete for consumer dollars.

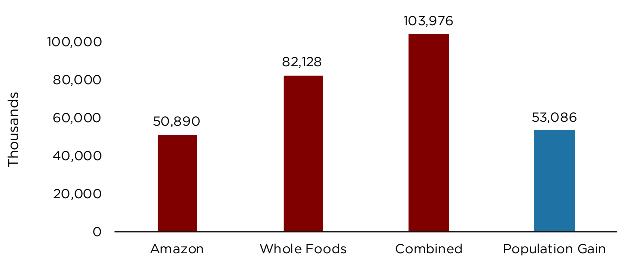
The Four Ps of Amazon's Whole Foods Acquisition

In a single transaction, Amazon acquired the equivalent of a more than 400-asset last-mile distribution network. Through this network, it can more efficiently and effectively operate its Amazon Fresh business, a network that comes with the bonus of a grocery operating company with a reputation for quality, a reputation that Amazon can leverage to increase its Amazon Fresh business. While these may be the first reasons that come to mind, Amazon also gained greater proximity to a large base of customers, increased purchasing power within a 15 minute or less drive to its newly acquired locations, increased profitability and improved strategic positioning.

Proximity

Through this acquisition, Amazon literally moved closer to its customers. Previously, Amazon's logistics facilities were within a fifteen minute or less drive of nearly 51 million Americans. While that sounds impressive, Whole Foods stores are located within a similar distance to more than 82 million consumers. When combining these two totals and accounting for overlap, Amazon now has a real estate footprint that is proximate to nearly 104 million potential customers.

> Population within 0-15 Minute Travel Time



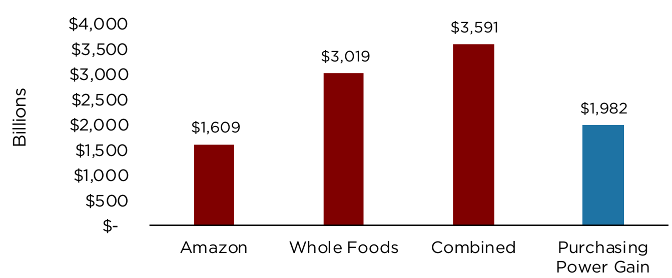
Source: CoStar

Why does this matter? The time it takes to go from choice to consumption is becoming a competitive lever in the battle for consumer dollars. The faster that online purchasers can go from choice to consumption, the more value an online retail offering has and the more desirable it becomes. With the acquisition of Whole Foods locations, Amazon took one giant step closer toward narrowing the gap between its choice-to-consumption timeframe and that of physical retailers.

Purchasing Power

Proximity translates into greater sales potential. The aggregate income within a fifteen minute or less drive to an Amazon facility, before the Whole Foods acquisition, was $1.6 trillion. While that figure represents substantial purchasing power, after the acquisition, Amazon effectively doubled this total.

> Household Purchasing Power within 0-15 Minute Travel Time

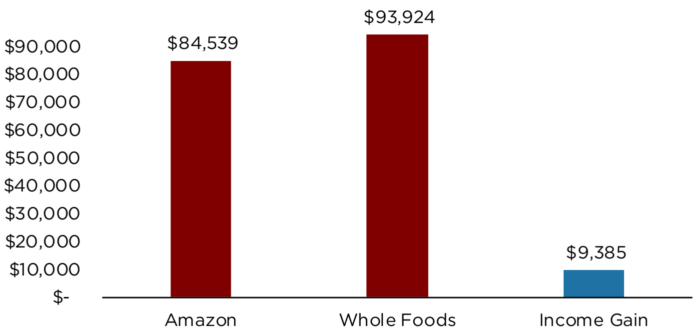


Source: CoStar

Through the purchase of Whole Foods, Amazon moved within 15 minutes or less of nearly an additional $2 trillion of purchasing power. Remembering the importance of the time it takes to go from choice-to-consumption, Amazon just became a lot more competitive in the battle for a much larger portion of consumer dollars.

Not only did Amazon move closer to increased purchasing power, those dollars are coming from more affluent consumers. Pre-acquisition, the average income within a fifteen-minute drive of Amazon's locations was $84,539, while the corresponding figure for Whole Foods locations was $93,924, an 11% difference. In a world of minimal profit margins, access to a more affluent consumer base is highly valuable.

> Average Income within 0-15 Minute Travel Time



Source: CoStar

Profitability

Through this acquisition, Amazon not only put itself in a stronger position to capture a larger share of each consumer's personal expenditures, it can now do so at a lower cost. Each Whole Foods store has the potential to become a customer pick-up location – a critical component in reducing one of the greatest cost challenges to online retailers, the last-mile, which is the final stage in the process of moving goods from the producer to the purchaser. According to the Council of Supply Chain Management professionals, the costs associated with last-mile delivery account for 28% of a company's total supply chain costs. Amazon now has the potential to reduce this cost through "click and collect," which involves the purchaser collecting the goods at a pick-up location as opposed to the retailer having to ship the items to the purchaser. Think of it as self-service kiosk at a grocery store versus a full-service checkout line. With the addition of more than 400 potential pick up locations, Amazon has the potential to significantly reduce its average last-mile delivery costs.

Positioning

The acquisition is also a natural response to the actions taken by brick-and-mortar retailers augmenting their physical presence with an online one. Walmart has purchased online retail platforms Bonobos, Jet.com, ModCloth, Moosejaw, and Shoebuy, and other traditional retailers have been racing to create an online presence as well, with some more successful than others. We expect this convergence to continue, but the acquisition of Whole Foods puts Amazon in a strong strategic position to dominate omni-channel purchasing options.

Validating the Strategic Role of Brick and Mortar Retail

From a pure real estate perspective, the Whole Foods acquisition is a validation of the strategic role that a physical retail presence can play in selling goods to consumers. Rather than viewing this as an either/or proposition, Amazon recognizes that strategic acquisitions of brick-and-mortar retailers can be accretive to the company's profitability and strategic positioning.

Amazon's action may also portend an acceleration in the merging of the online and physical and online retail worlds. It will place pressure on other online retailers to consider a physical presence to match Amazon's reduced choice-to-consumption speeds. It should also force traditional retailers to build out their online presence and capacity, which will require significant capital investment. Thus, the best capitalized retailers with the greatest access to capital markets should have a competitive advantage in successfully making the transition.

Conclusion

What does this mean for real estate assets in the retail space? Although the traditional physical shopping experience is not disappearing, the landscape is changing, especially for shopping centers - long the dominant players serving the retail consumer. In this new world, centers populated with highly-levered anchor tenants will be at a disadvantage relative to those anchored by stronger retailers with more financial capacity to make the investments necessary to compete effectively with their online counterparts. The pillars of what makes a great shopping center have not changed – locations in dense trade areas proximate to high income consumers, strong retail brands with the financial wherewithal to adapt to remain competitive, and centers commanding superior strategic positions within the trade area, allowing them to retain and attract the most successful retailers will all reinforce on-site shopping and the success of traditional centers.

Retail continues its historical pattern of evolution and disruption and Amazon's acquisition of Whole Foods is a definite game-changer, creating both opportunities and threats. How the consumer responds will impact traditional retailing and lay out a whole new path for investors in this sector of the real estate space.

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