

## Executive Summary

The grocery business is one of the largest industries in the U.S. economy. In 2013, sales from traditional grocery stores alone totaled \$579 billion.<sup>1</sup> If grocery and other consumable sales from non-traditional grocery stores are included, such as from supercenters (e.g. Walmart Supercenter) and wholesale clubs (e.g. Costco), the total market exceeded \$1.13 trillion last year<sup>2</sup>, or over 20% of total retail and food services sales. As consumer preferences have evolved over the years, so has the list of operators and shopping venues. This article will address some of the news and trends impacting today's grocery industry. These trends not only impact grocers but also commercial real estate owners that depend on these businesses as shopping center anchors.

### Topics in this issue:

- Consumer Tastes – where they like to shop
- Grocery Business – multiple channels
- Corporate Moves – consolidation and growth
- Growth Plans – evolving retail concepts
- Sustainability – a growing trend

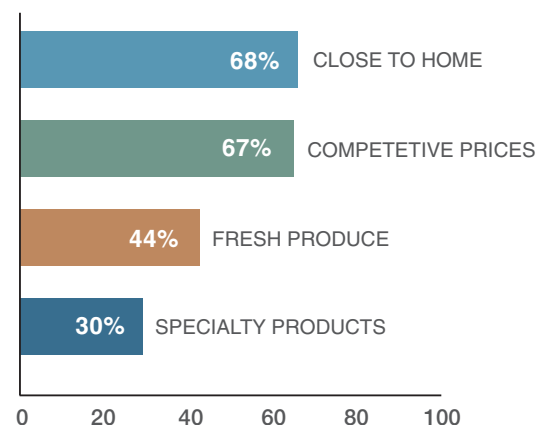
## Consumer Tastes

In June 2014, PricewaterhouseCoopers (“PwC”) released a [report](#) on grocery shopping habits and the future of the industry.<sup>3</sup> According to the report, most people like their traditional grocery store. Of the 1,000 people who participated in the survey, 83% considered traditional grocery supermarkets to be a preferred shopping destination (a top three choice). In contrast, only 5% of consumers included online grocery shopping in their top 3 choices, though 92% indicated they had access to it.

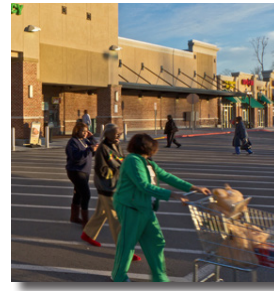
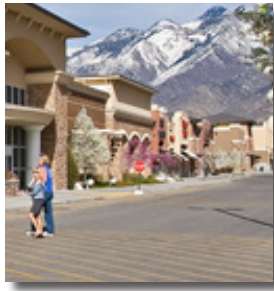
Grocery shoppers continue to value convenience, price and selection. Straight-forward attributes such as an accessible location, quick checkout lanes, low prices, and quality produce are considered to be highly desirable.

Though convenience and price top the list of most important features, consumers are also discerning about the quality and variety of foods available at the grocery store. According to the PwC survey, most shoppers would pay more for organic foods (64% of respondents), non-genetically modified foods (52% of respondents) and have an interest in ethnic foods (70% of respondents said they eat ethnic food 6 or more times per month). Furthermore, consumers believe grocery stores are a part of their community: 90% of respondents think stores should give back

*Percentage of PwC respondents who indicate these features most attract them to their grocery store:*



### In this Issue



to their neighborhood. This is why PwC concluded that “taking actions like community service, sustainable business practices, and carrying locally sourced products can make a difference in how shoppers perceive you- and how frequently they come back.”

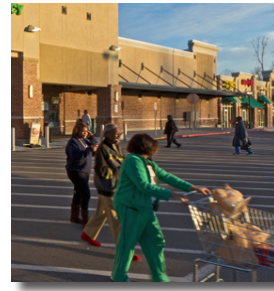
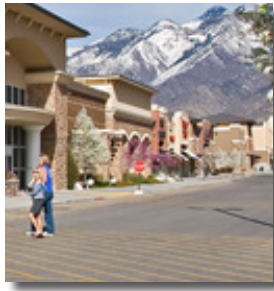
While online shopping for groceries is not considered to be a significant near term trend in most areas, technology is still expected to play an important role in the consumer-grocer relationship. Shoppers are looking for personalized connections to their favorite retailers through custom discounts/coupons, flexible loyalty programs, and information that promotes a healthy lifestyle - a good compliment to grocery stores.

## Grocery Business – Multiple Channels

As consumer tastes have evolved, the grocery business has changed to meet their needs. Given the preferences discussed above, it should come as no surprise that traditional grocery stores remain the consumer’s favorite place to buy, with a 46% market share of all grocery and consumable retail formats.<sup>4</sup> Within the traditional grocery trade, fresh format stores that specialize in produce, such as The Fresh Market and Sprouts, have been one of the fastest growing segments in the entire industry. Consumers’ strong preference for fresh fruits and vegetables, including organic foods, helped propel sales within this channel by 10.4% in 2013.<sup>5</sup>

Non-traditional channels have also been growing and increasing market share. The non-traditional market includes large format supercenters (e.g Walmart Supercenter, Super Target) that offer a wide variety of goods and grocery products as well as wholesale clubs (e.g. Costco, BJ’s Wholesale Club) that promote their warehouse style approach to attract cost-conscious shoppers. On the other end of the spectrum, drug stores and dollar stores have leveraged their convenience to become significant non-traditional grocery retailers as well. In 2013, overall grocery sales in non-traditional stores exceeded \$442 billion, representing 39% of total grocery and consumables.<sup>6</sup>

As the PwC research suggests, buying groceries online is a relatively new and limited phenomenon. However, the growth of this business has been significant. In 2013, grocery e-commerce increased by 13.7% to \$21.1 billion, or 1.7% of total grocery and consumable sales.<sup>7</sup> Though Amazon is considered a leader in this business, industry consultant Willard Bishop believes that established brick-and-mortar operators such as Kroger, Ahold, and Shop-Rite are accelerating their efforts to compete online with the Seattle based company.<sup>8</sup>



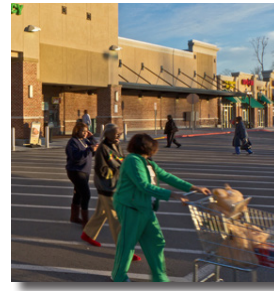
## Corporate Moves

Though traditional supermarkets remain the most popular destination for grocery shoppers, increased competition from specialty stores and non-traditional vendors has put pressure on some traditional operators to consolidate. Many of the recent merger and acquisition deals appear to be less defensive in nature and are instead designed to propel growth. According to Chain Store Age, “current M&A activity is very different from the past, and in many cases, current [M&A] strategies are more effective at building a strong and sustainable business.”<sup>9</sup> While shopping center owners must remain alert to the risks of M&A related store closings, the lack of new supply and the growth orientation of many recent mergers is creating forward momentum for rents and occupancy.

In January 2014, Kroger acquired Harris Teeter Supermarkets in a \$2.48 billion deal.<sup>10</sup> By purchasing Harris Teeter’s 227 stores in the Southeast and Mid-Atlantic, Kroger added a prestigious name to its roster of national supermarket brands and bolstered its position against other upscale grocers such as Whole Foods. Furthermore, with a combined total of over 2,640 stores,<sup>11</sup> the acquisition will strengthen Kroger’s position as the second largest grocer in the country after Walmart.<sup>12</sup>

Another merger was announced in March when Safeway, Inc. agreed to be acquired by Cerberus Capital Management LP’s Albertsons in a transaction estimated to be valued at \$9.2 billion. This acquisition comes on the heels of a \$3.3 billion deal by Cerberus last year that resulted in the purchase of Albertsons, Acme, Jewel-Osco, Shaw’s, and Star Market grocery from Supervalu, Inc.<sup>13</sup> The combined Albertsons and Safeway portfolios total over 2,400 stores and include shops from New England to Alaska. However, given some overlap in markets, the FTC may require divestitures prior to a closing that is scheduled to occur in the fourth quarter of 2014.<sup>14</sup> Nonetheless, the combined firm will have significant market share along the West Coast and be better positioned to compete with the other large nationals including Walmart and Kroger.

In a smaller, more surgical transaction, Bi-Lo Holdings announced in June that it completed its \$246 million acquisition of Delhaize Group’s Sweetbay, Harveys, and Reid’s supermarket chains.<sup>15</sup> All 134 new stores are located in the Southeast and will thus expand Jacksonville, Florida-based Bi-Lo Holding’s regional portfolio. The tactical acquisition may also be designed to help Bi-Lo Holdings prepare for another corporate move. In September of 2013, Bi-Lo Holding’s owner, Lone Star Funds, formed a new entity, Southeastern Grocers, which has filed for an initial public offering.<sup>16</sup>



## Growth Plans

2014 appears to be an active year for the grocery store industry. Growth is expected from the niche gourmet fresh foods supermarkets like The Fresh Market all the way up to the large national operators, including Walmart and Kroger. Below is a list of some of the fastest growing grocery brands in the country.

Food Retailer	Estimated FY 2014 Capital Expenditures *	Estimated 2014 New Stores *	Comments
Walmart U.S.	\$6B-\$6.5 billion	402-437	Includes 115 supercenters, 160-180 Neighborhood Markets; 110-120 Express units; 17-22 Sam's Clubs.
Aldi U.S.	\$4 billion	100	Discount oriented chain with German based parent.
Kroger Company	\$2.8 to \$3 billion	55-60	New store count includes relocations and expansions.
Costco Wholesale Corp.	\$2.3 to \$2.4 billion	30	Wholesale club with significant grocery sales.
Publix	\$875 million	32	Private operator based in Florida. New store totals include some replacement stores.
Whole Foods Market	\$600 to \$650 million	33 to 38	One of the industry leaders in promoting natural and organic foods.
Wakefern/Shoprite	\$400 million	6	Capital expenditures total likely includes significant renovation budget.
Meijer Inc.	\$333 to \$400 million	10 to 12	Private company based near Grand Rapids, Michigan, operates a regional chain best known for its hypermarkets.
The Fresh Market	\$125 to \$145 million	23 to 25	Growing fresh foods oriented gourmet supermarket.
Sprouts Farmers Market	\$110 to \$120 million	22 to 24	Growing fresh foods oriented gourmet supermarket.
Mariano's Fresh Market	\$90 to \$95 million	17	Capital expenditures total is for Mariano's parent company, Roundy's.
Trader Joe's	\$88 million	34	Smaller format grocer that offers a limited assortment of mostly private label goods. Parent company is Germany based ALDI.

\* Source: Supermarket News, "Gallery: The fastest growing food retailers", May 19, 2014.



The growth of various grocery formats is welcome news for the retail real estate market. Not only is there demand for large anchor spaces (e.g. greater than 40,000 square feet) but there is also healthy demand for smaller junior anchor spaces from the niche supermarket operators such as The Fresh Market and Trader Joe's who typically lease under 30,000 square feet.

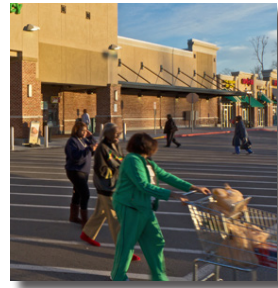
## Sustainability

As a major user of energy and other natural resources, as well as a generator of waste, the grocery industry has the opportunity to make an important contribution to sustainability in our communities. Below are some examples of sustainability initiatives from the country's two largest grocery retailers.

In July, Kroger published its 2014 Sustainability Report and indicated that it will accelerate its plan to achieve greater sustainability by 2020. The company has reduced energy consumption by 34.6% since 2000, saving 2.5 billion kilowatt hours ("kWh"), through a combination of measures including the installation of LED lighting, variable speed ventilation fan drives, distributed refrigeration systems, nighttime lighting control and updated building and refrigeration control systems.<sup>17</sup> Kroger also operates its own wind energy turbines and four of its stores have approximately 400 KW of solar energy capacity that generates nearly 585,000 kWh per year.<sup>18</sup> Water has been a focus as well with the company setting a goal to decrease water usage by 5% in 2014.<sup>19</sup> Kroger has also pledged to transition toward zero waste in construction, including remodeling and new stores. Since the zero waste program was initiated, the firm claims to have diverted 34,447 tons from the landfill.<sup>20</sup>

Walmart is also a significant player in renewable energy and sustainability. According to a research report published in October of 2013 by the Solar Energy Industries Association,<sup>21</sup> Walmart was ranked the nation's top commercial solar energy user based on total on-site installed capacity, with over 89 megawatts installed at their facilities. The company's U.S. division has installed a total of approximately 250 solar energy systems, each providing 15% to 30% of a store's electricity, and 42 fuel-cell sites, with each site providing 40% to 60% of store needs.<sup>22</sup> In May of 2014, Walmart announced that it plans to double the number of on-site solar energy projects at its U.S. stores, Sam's Clubs, and distribution centers by 2020.<sup>23</sup> Globally, 24.2% of the firm's electricity needs are supplied by renewable sources, equaling 2.2 billion kWh of renewable electricity.<sup>24</sup> The company reports that it is committed to increasing that total to 7 billion kWh of renewable energy globally by the end of 2020.<sup>25</sup> Furthermore, in May the company signed the Department of Energy's Better Buildings Initiative, supporting the firm's goal of decreasing the energy intensity of its buildings by 20% by 2020 (compared to a 2010 baseline).<sup>26</sup> Walmart has also embarked on a strategy to reduce waste: the company claims to have prevented more than 80% of store waste from going into landfills in 2011 and has a stated goal of eventually creating zero waste in its operations.<sup>27</sup>

As more real estate companies adopt sustainability policies, the fact that many of the largest retail anchors are also devoting attention to these issues is welcome news. Given the traditionally close relationship between a grocery store anchor tenant and the landlord, especially with regard to matters such as utilities, roof access, and parking areas, closer collaboration on sustainability and efficiency measures is an advantage.



## About The Inland Real Estate Group of Companies, Inc.

The Inland Retail Property Fund, LP<sup>28</sup> ("IRPF"), sponsored and advised by Inland Institutional Capital Partners Corporation ("ICAP"), will be supported by the Inland integrated operating platform to create an efficient, reliable and unique investment opportunity in institutional real estate for today's investors. IRPF will seek to draw upon Inland's extensive resources, values, and expertise to build and manage its core retail portfolio.

ICAP is part of Inland, headquartered in Oak Brook, Illinois. Inland is one of the largest commercial real estate companies in the nation, representing more than 40 years of expertise and integrity in the industry. Inland is a fully integrated group of companies that is engaged in multiple facets of the real estate industry including property management, leasing, marketing, brokerage, acquisition, disposition, development, redevelopment, renovation, construction, finance, and sponsorship of investment products. Inland affiliates and related parties cumulatively have more than 1,400 employees, own property totaling over 74.6 million square feet located in 49 states,<sup>29</sup> and manage assets of approximately \$20.2 billion.<sup>30</sup>

For over 40 years, Inland's primary mission has been to serve its investors. This long tradition of investor focus is manifest in a corporate infrastructure that emphasizes dedication and service to Inland's individual and institutional investors. Its commitment to investor satisfaction is one of the key reasons why Inland has been successful in creating hundreds of real estate ventures and REITs over many decades. As of December 31, 2013, Inland had raised more than \$19.7 billion in capital from investment securities sales.

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<sup>1</sup> U.S. Department of Commerce, Census Bureau.

<sup>2</sup> Data from article published by Marketing Daily, "Traditional Grocers Lose Share; Fresh Formats Gain", June 25, 2014.

<sup>3</sup> PricewaterhouseCoopers, "Front of the line: How grocers can get ahead for the future", 2014.

<sup>4</sup> Willard Bishop LLC, "The Future of Food Retailing", June 2014.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Chain Store Age, "Retail grocery real estate: Optimizing returns in the new world order", April 17, 2014.

<sup>10</sup> Food World Food Trade News, "It's Official: Kroger Completes \$2.48 Billion Harris Teeter Acquisition", February 2014.

<sup>11</sup> Kroger Press Release, "Kroger Completes Merger with Harris Teeter", January 29, 2014.

<sup>12</sup> Supermarket News, "Top 75 retailers and wholesalers in U.S. and Canada", Downloaded on July 17, 2014.

<sup>13</sup> Bloomberg, "Safeway to Be Bought by Cerberus's Albertsons", March 6, 2014.

<sup>14</sup> Supermarket News, "Divestitures possible in Safeway-Albertsons deal: Edwards", March 6, 2014.

<sup>15</sup> Supermarket News, "Delhaize, Bi-Lo complete deal", June 2, 2014.

<sup>16</sup> Supermarket News website July 2014.

<sup>17</sup> The Kroger Company, "2014 Sustainability Report", July 8, 2014.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

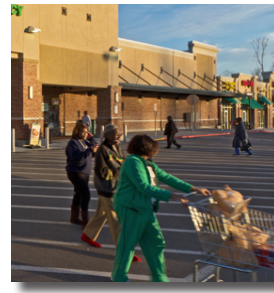
<sup>20</sup> Ibid.

<sup>21</sup> Solar Energy Industries Association, "Leading U.S. Companies Make Big Investment in Solar Energy", October 15, 2013.

<sup>22</sup> Walmart's website, information downloaded on July 17, 2014.

<sup>23</sup> Walmart press release, "Walmart Puts Price of Solar on Rollback", May 9, 2014.

<sup>24</sup> Walmart's website, information downloaded on July 17, 2014.



<sup>25</sup> Ibid.

<sup>26</sup> Walmart press release, "Walmart Puts Price of Solar on Rollback", May 9, 2014.

<sup>27</sup> Walmart's website, information downloaded on July 17, 2014.

<sup>28</sup> Additional information regarding the Inland Retail Property Fund, L.P. would be made available to qualified accredited investors upon request.

<sup>29</sup> Includes all property types, not solely retail.

<sup>30</sup> Statistics as of December 31, 2013.

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