RETAIL EMERGING TRENDS 2019

November 1, 2018
New Era Demands New Thinking

“Real estate as an asset class has matured. Market participants need to realize this and make the appropriate adjustments.”

https://americas.uli.org/research/centers-initiatives/center-for-capital-markets/emerging-trends-in-real-estate/americas/
“RETAIL ... WHAT IS IT?"

Let’s start at the very beginning…a very very good place to start!
"RETAIL" DEFINITION

re·tail
/ˈrē,tāl/
noun: retail; plural noun: retails
1. the sale of goods to the public in relatively small quantities for use or consumption rather than for resale.

https://en.oxforddictionaries.com/definition/retail
WHO WANTS RETAIL?

1. Communities –
   a. Amenity
   b. Convenience
   c. Creates a central meeting or focal point
   d. Source of revenue
   e. Economic development / job creation

2. Residents and Consumers –
   a. Amenity
   b. Convenience
   c. Social aspect (gathering and meeting places)
   d. Leisure/recreation
   e. Entry level job opportunities

3. Retailers –
   a. Strive to achieve #1 or #2 market share
   b. Pressure from Wall Street to expand revenue and earnings

4. Property Owners
   a. Fill space/income/pay NNN’s
How Does Retail Organize Itself in Today’s World?

Let’s start with the basics!
TYPES: COMMODITY RETAIL

A retailer selling goods and services which are consumed without emotional connection by the consumer and for which the consumer's primary motivation is price and convenience.

Examples include grocery and drug stores, mass merchants such as CostCo, Target or Wal-Mart, office supply stores such as Staples or Office Depot, or electronics, books and music.
TYPES: SPECIALTY RETAIL

Retailers selling goods and services which are consumed on a discretionary or emotionally-driven basis using discretionary funds/income, and where experience and a sense of place is a primary component when deciding how and where to spend discretionary time.*

Examples include fine dining, clothing, luxury hard and soft goods, or electronic, books and music, and even specialty shopping districts.

* With the rise of platforms and influencers, the importance of “place is evolving.”
A VERY BRIEF HISTORY OF MODERN RETAIL

- In the early 20th century, without cars, no need for shopping centers…we had DT shopping districts.
  - Towns developed their own homegrown department stores which sold a wide variety of goods.
- ‘50’s: Post-war suburbanization (and a car culture) gave way to malls. These replaced downtowns in an increasingly decentralized urban landscape.
- ‘80’s/’90’s: First discounters (like K-mart) and then “big box” and “category killer” commodity retailers (like PetCo, Office Depot, and Best Buy) were the next step in retail’s evolution … more efficient and convenient … and everyday low prices.
- ‘90’s: Regional Malls began to contract – distinction between commodity and specialty retail becomes distinct.
- Today’s environment is about commodity vs. specialty … price/convenience vs. discretion/experience.
  - The only “A” malls are the ones that can distinguish themselves. Everything else is a “B” or a “C.”
  - Online retail is rapidly evolving … it’s now about convenience AND consistency of experience!
Retail Channels Explained
Search over 300 stores all at once and compare prices

deals from 5,000+ retailers and brands
Omnichannel retailing is an evolution of multichannel retailing BUT omnichannel means a **seamless approach to the consumer experience** through all available shopping channels: Mobile devices, internet, brick-and-mortar, television, catalog, and so on.

- Social media lets retailers (and landlords) build relationships with and track consumers.
- Omnichannel opportunity: Combine the **touch and feel** of the brick-and-mortar **experience with the excitement** and impulse of web/mobile shopping (e.g. tweet/food trucks, crowdsourcing...).
TECH TITANS . . . AND THE REALITY OF SHOWROOMING

“I’d Walk out of a Store and Purchase Online for a Discount of…”

[Bar chart showing percentages of people who would purchase online for discounts of 2.5%, 5%, and 20%.]

Source: Citibank Research/Weinswig
HOW ARE RETAIL CHANNELS USED?

Omnichannel strategies work differently for commodity and specialty retailers.

- For example, multiple retail channels might be used by a consumer in purchasing a particular COMMODITY like a television (e.g., research online at home, price checking on a phone while at a retail store).

- By contrast, a SPECIALTY retailer might use apps, ads, and social media strategies to drive customer traffic to a brick-and-mortar store, restaurant, or shopping district.
RETAIL — THE OLD AND THE NEW ORDER

- The Old Order is trying to figure out how to get an edge on the Titans.
- Influencers and Platforms are driving refinements.
- Interestingly, Titans are embracing some lessons from the Old Order’s playbook.

Broadlines and Food & Drug Technology Continuum

The Tech Titans

Source: CitiBank Research/Weinswig
HOW RETAIL IS EVOLVING

Generational Groups.
How do we spend our money?
What's different?
RETAIL FORECAST

- When I first started thinking about emerging trends, I thought about product types...
- Many product types are on a downswing since 2016 peaks.
- Interestingly, power centers and neighborhood centers – projects most closely associated with commodity retail – are thought to be the most stable at the moment.

Source: Emerging Trends in Real Estate surveys.
*Third year in survey.
URBAN VS. SUBURBAN

Source: John Burns Real Estate Consulting LLC calculations using U.S. Census Bureau data. *projection
RETAIL TRENDS

- The shift toward enjoying experiences more than purchasing goods (commodity vs. specialty) will continue to move retail stores toward selling experiences rather than selling goods.

- Both consumers and cities want retail that is walkable from housing.
  - Retail and residential developers, and cities will need to work closely to create cohesive developments to satisfy this evolving consumer.
  - Suburban developments will replace shopping centers.

- There will be an 86 percent surge in household formations to 12.5 million households over the coming decade in comparison with the prior decade.

- This surge will drive purchases in all stores that cater to new households, particularly renters (58 percent of the net new households).

- Stores and services catering to older buyers will flourish too, thanks to a 38 percent surge in the country’s population 65 and older from 2015 to 2025.
# Generational Clarity

## Life Stages

<table>
<thead>
<tr>
<th>Stage</th>
<th>Silent (Early)</th>
<th>Silent (Late)</th>
<th>Baby Boomers (Early)</th>
<th>Baby Boomers (Late)</th>
<th>Generation X (Early)</th>
<th>Generation X (Late)</th>
<th>Millennials (Early)</th>
<th>Millennials (Late)</th>
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</thead>
<tbody>
<tr>
<td>Young Singles (≤45)</td>
<td>22%</td>
<td>38%</td>
<td>9%</td>
<td>13%</td>
<td>4%</td>
<td>21%</td>
<td>35%</td>
<td>8%</td>
</tr>
<tr>
<td>Young Childless Couples (≤45)</td>
<td>6%</td>
<td>9%</td>
<td>4%</td>
<td>14%</td>
<td>14%</td>
<td>25%</td>
<td>35%</td>
<td>25%</td>
</tr>
<tr>
<td>Young Families (Oldest Kid ≤9)</td>
<td>1%</td>
<td>5%</td>
<td>21%</td>
<td>39%</td>
<td>25%</td>
<td>39%</td>
<td>35%</td>
<td>25%</td>
</tr>
<tr>
<td>Mature Families (Oldest Kid 10–18)</td>
<td>1%</td>
<td>5%</td>
<td>25%</td>
<td>39%</td>
<td>25%</td>
<td>39%</td>
<td>35%</td>
<td>25%</td>
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<tr>
<td>Mature Couples and Singles*</td>
<td>13%</td>
<td>95%</td>
<td>95%</td>
<td>95%</td>
<td>95%</td>
<td>95%</td>
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</tbody>
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Note: Percentages less than 1% have been left out, and rounding adjustments were made to make totals 100%.

*Household head is either 46–65 years old or has an adult child living with him or her. Data for 2014 rolled forward to 2015.
SOCIETAL SHIFTS BY DECADE

EVERY DECADE SINCE THE 1940s HAS 40–44 MILLION PEOPLE LIVING IN AMERICA

FIGURE 1.1 2015 Population by Year Born

Source: John Burns Real Estate Consulting, LLC calculations of US Census Bureau 2014 National Projections
4-5-6 RULE FOR THINKING ABOUT DEMOGRAPHIC SHIFTS

**The 4 Big Influencers**
1. Government
2. Economy
3. Technology
4. Societal shifts

**During People’s 5 Main Life Stages**
1. Childhood
2. Early career
3. Family formation
4. Late career
5. Retirement

**Help Answer the 6 Key Consumer Questions**
1. How many will there be and how much money will they have?
2. What will they purchase?
3. When will they purchase?
4. Where will they live and spend?
5. Who will buy, and who will they live with (spend money on and share expenses with)?
6. Why will they buy certain products and not others?

Example: (4) Millennials getting older/having kids → (5) Moving to burbs → (6) Buying furniture as they form households.
Consumers are interested in what their peers and friends are buying, and not buying.
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When an “influencer” buys, endorses, or rejects a product, that message can have a wide-ranging impact, particularly when the influencer has a wide social network.

This phenomenon is particularly true with consumables like beauty products.

Social commerce also has particular significance for the resale market where, for example, someone might put or see something on-line, and then tell their friends about it...creating hype.
Retail isn’t dying, it has reoriented to more efficient platforms that give consumers one-stop shopping.
ULI EMERGING TRENDS 2019 — PLATFORMS

- Retail isn’t dying, it has reoriented to more efficient platforms that give consumers one-stop shopping.
- The media routinely conflates all on-line shopping with Amazon, however, this is not the case.
- Retail is as or more robust and diversified than at any time in memory.
  - For example, the Canadian e-commerce platform Shopify started in 2004. As of 2017, it had 600,000 sellers.
  - Even five years ago, there were over 2 million Amazon third-party sellers worldwide, accounting for over 40% of total units sold.
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ULI EMERGING TRENDS 2019 – NEW EQUILIBRIUM

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- A new equilibrium with less square feet of retail per capita is likely being established as space devoted to retail is being repurposed or replaced with new uses.
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Even the strongest retail projects need broad reasons for customers to visit.

Uses ranging from medical and educational services to distribution activity, with mixed-use or dense settings adding further support.

The headlines should be ‘What kinds of Brick-and-Mortar Retail Will Survive” and “How will we repurpose unneeded retail space?’”
The customization and localization of the shopping experience is more important now than ever.

Successful landlords will ask “WHY?” … a lot!
- Why should a tenant be in a project?
- Why does the consumer care?
- Why should a LL want it be in a project?
- What is the retailer’s plan?
- How they will complement co-tenants to create a mix that’s pertinent today?
ULI EMERGING TRENDS 2019 — LANDLORD-TENANT RELATIONS

- We can now measure footfalls in projects, and a center with a higher rate of increase of footfalls (think comp store sales), should generate a higher rent.
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- We can now measure footfalls in projects, and a center with a higher rate of increase of footfalls (think comp store sales), should generate a higher rent.
- A retailer with a larger social following will be sought after just as a retailer with high sales per square foot was in the past.
- Every 5 years tenants are reinventing themselves....what tenant lasts for 20 years?
- How are LL’s protecting themselves?
- A long lease term on a new tenant is a risk when there is no way of knowing if the tenant will be relevant in 5-10 years.
Location remains critically important for retail, however, traditional “beacons” are changing from traditional monument signs to influencers and social media.
ULI EMERGING TRENDS 2019 – LOCATION

- Location remains critically important for retail, however, traditional “beacons” are changing from traditional monument signs to influencers and social media.
- For example, reviews on Yelp and Google Maps drive bricks-and-mortar visits, often to locations other than at the traditional 100% corner or bottom of a freeway off-ramp.
- Traditional retailers need to find new and better beacons than traditional signage for consumers to find and patronize them, and to continue to compete.
PLANNING ISSUES
◆ PUBLIC VS. PRIVATE SECTOR

Balancing competing interests.
There are implications for those who design public policy:
- Rise of e-commerce has made retail planning more complex.
- E-commerce will impact urban places.

Need to look for solutions that:
- mitigate negative impacts, and
- take advantage of opportunities.

Retail is NOT dead, however...
- it is undergoing a period of reorganization
- it is changing because of social commerce
- it is changing because of evolving retail platforms
RETAIL PRUNING

- Retail consolidation means that there is an increasing amount of underutilized space.
- Increased vacancy in more marginal projects is creating blight for communities, and fiscal problems for both local governments (sales and property taxes) and landlords.

“Retail isn’t over-built, it’s under-demolished.”

- Support the adaptive reuse, renovation, or redevelopment of older shopping centers or commercial uses that are no longer viable due to changing market conditions, demographics, or retail trends.

- Such reuse or redevelopment should be planned to help sustain other retail centers, provide opportunities for more intense uses while ensuring that residents continue to have convenient access to goods and services.

- Support rezoning of such centers to other uses based upon evidence justifying the conversion, such as high vacancy rates, poor sales, and/or lack of reinvestment.

Source: City of Fremont, CA
FOOD HALLS

According to the National Restaurant Association:

- 2 in 5 consumers say that restaurants are an essential part of their lifestyle.
- 7 in 10 consumers say their favorite restaurant foods provide flavors they can’t easily duplicate at home.
- 8 in 10 consumers say dining out with family and friends is a better use of their leisure time than cooking and cleaning up.

Source: CushmanWakefield and Greensfelder Commercial Real Estate
FOOD HALLS

CONSIDERATIONS FOR DEVELOPMENT

➢ Who is the core consumer?
  ▪ Urban / suburban
  ▪ How far will the consumer travel: car, public transportation or walk?

➢ “Cool street” location: Where is the area in its cycle?

➢ Size? Tenant mix? Single or multiple operators?

➢ New construction, existing development or historic rehab?
  ▪ Base building: What does it provide and/or cost?
  ▪ Historic building: real costs of upgrades; hindrances; local incentives available?
  ▪ Economic incentives?

Source: CushmanWakefield and Greensfelder Commercial Real Estate
THRIVING RETAIL DISTRICTS

- Create a Vision - Public/private partnerships, specific plans.
- Think Big - Corridors, city blocks, aggregate parcels.
- Create connections.
- Create pedestrian friendly environments.
- Encourage active building facades & outdoor uses.
THRIVING RETAIL DISTRICTS

- Manage for change.
- Be an Advocate – Every revitalization effort needs a champion.
- Stand Firm – Know when to say no.
- and ... be extremely lucky! (...in an opportunity meets preparation kind of way)
LAST MILE — DEFINING THE ISSUE

- Last mile delivery is the movement of goods from a final distribution hub to a final delivery destination, typically a residence or office.
LAST MILE — DEFINING THE ISSUE

- Last mile delivery is the movement of goods from a final distribution hub to a final delivery destination, typically a residence or office.
- It’s the most significant trend in real estate today!!!
  - Consider that the New York MSA is home to about 20 million residents.
  - There are about 2.4 million commercial deliveries daily in the New York MSA, or about 0.12 per resident.
  - Nationwide approximately ten years ago, about 0.04 private deliveries (such as on-line purchases) were made per person per day.
  - Today, the rate is about 0.12, a 3X increase in private deliveries … a nearly 2X increase in total deliveries…in less than ten years.
  - In Manhattan proper, as many as ¼ of all ZIP codes do not have enough street space for deliveries!
LAST MILE — WHAT TO DO?

- We live in a world where customers do not pay for the full cost of the convenience of deliveries.
- There is a conflict between the need to facilitate easy and inexpensive returns (in order to generate consumer confidence and in turn sales), and the economics of those returns.
- On-line retailers and delivery companies subsidize deliveries and returns in order to generate top line sales growth, a common side effect of Wall Street’s demands.
Externalities and Market Failure

Externalities are a major cause of market failure and occur in nearly every market – be clear on effects for producers and consumers.

- Externalities are **spill-over effects** arising from production and consumption for which no appropriate compensation is paid.
- Externalities lie **outside the market transaction**.
- Externalities cause **market failure** if the **price mechanism** does not take account of the **social costs** and **social benefits** of production and consumption.
- Externalities can be **positive** and/or **negative**.

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**Diagram:**
- Negative Production Externalities
- Negative Consumption Externalities
- Positive Production Externalities
- Positive Consumption Externalities
LAST MILE — WHAT TO DO?

- City planning departments need to start developing policy to address supply chains.
- There will be an increasing contest for space of all sorts, in particular public space.
- Should a city’s general plan add a demand management element?
  - Should deliveries be aggregated and delivered to each household once or twice a week (how many deliveries truly are urgent)?
  - Public works departments need to address managing deliveries holistically, as part of their overall transportation management plan
- **The solution lies in managing externalities!**
IMPLICATIONS OF ONLINE RETAIL

Traditional retail that cannot find a point of differentiation (think: Macy’s, Sears) is on a slow but inevitable path towards extinction.

- **Implications for landlords (and cities):**
  - Increased vacancy.
  - Reduced NOI, unreimbursed NNN expenses, loan covenants.
  - “CC&R and lease covenant dominoes”

- **Implications for all but the best retail projects:**
  - Reduced occupancy levels.
  - Lower effective rents.
  - More marginal tenants with lower credit.
  - Redevelopment and repositioning opportunities (even old retail is well located, after all).

- **Redevelopment opportunities for retail projects that no longer have a reason to be.**
  - Substantial reduction in amount of retail space; replace with other commercial and residential uses.
  - Focus on the best locations for retail in any given market; do long-range planning for use conversion on less viable locations.
CITIES VS. OWNERS

- Retail consolidation means there are fewer retailers to fill existing space.
- Landlords are backfilling space with non- or quasi-retail uses, some of which do not generate sales tax.
- Municipalities are seeing hits to their general funds as sales tax revenues decrease.
- Codes and SP’s often demand project design attributes that the market may not demand and that may not be viable economically.
  - Vertically integrated vs. horizontally integrated mixed-use.
  - Ground floor retail in amounts and locations that don’t make sense.
SOCIAL/RETAIL ENGINEERING

- Are our expectations about vibrant areas realistic?
- The most vibrant areas are the most organic. Examples: Pearl District (Portland), Ballard (Seattle), SF retail streets, College Ave (Berkeley/Oakland), Willow Neighborhood (Phoenix), Bucktown (Chicago), Healdsburg and Sonoma Square.
- Encourage natural retail evolution and do not force retail where it does not meet basic retail criteria.
CONCLUDING THOUGHTS

Thought he’d never get here!
LUCK IS NOT A STRATEGY

In the real estate industry, competitive strategies tend to focus on ways to perfect imperfect markets, products and/or services.

Words and phrases such as “build it and they will come” exemplify expectations whilst highlighting strategic insanity.

Roman philosopher and statesman Seneca said: “Luck is what happens when preparation meets opportunity.”
“That’s all Folks!”
QUESTIONS AND ANSWERS

RETAIL RESILIENCY CONSULTING

- Strategy and Planning
- Market/Location Intelligence
- Development Management

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