GENESEE / FINGER LAKES REGIONAL PLANNING COUNCIL

Coming to a Store Near You:

Four Approaches to Accomodate Retail's Next Normal

Genesee/Finger Lakes Regional Planning Council

[Prepared by MRB Group, G/FL Economic Recovery Coordinator]

MRB group

The retail industry has fundamentaly changed. Communities and businesses alike must take action to embrace this change.

Economic Recovery Series:
Four Approaches to Accommodate Retail's Next Normal

The retail industry is intimately intertwined with local economic health and performance. Generally, the industry is characterized by readily accessible jobs with low barriers to entry, providing critical employment opportunities to a diverse set of workers with a wide range of skills. For almost any region across this country, the retail industry is among the top five industries, by job count. In New York State, the retail industry is the third largest industry, employing over 850,000 workers statewide. In the Genesee / Finger Lakes Region, retail is the fourth largest industry, employing over 57,000 workers across the 9-county region.[1]

The retail industry is vital to the health of a regional economy, as it provides channels for local consumption, offers critical employment opportunities, supplements the local tax base, and ultimately supports the commercial real estate market. Retail businesses are located in the economic heart of all communities, no matter the size. Brick-and-mortar establishments, especially clustered in shopping centers and strip malls, are community staples that serve as a hub of local economic activity. From shopping centers to strip malls to main street mom-and-pop shops, the retail industry has significant influence on the real estate market.

Often shaped by ever-changing consumer behaviors and preferences, this industry demands continuous innovation for businesses to remain viable. Modern retail businesses must be flexible, creative, and resilient to meet the inevitably changing demands of the consumer. Every facet of the industry is susceptible to innovation, including the real estate demands of the industry. In recent years, there has growing sentiment around "the death of shopping malls," where traditional brick-and-mortar retail businesses have steadily, and persistently, declined. Several headwinds contributing to this decline include the growing prevalence of e-commerce, adoption of convenience-based services such as curbside pick-up, and the rise of targeted online marketing campaigns. Since the advent of online shopping, there has been widespread speculation that these headwinds would ultimately kill main streets and shopping malls. As the retail experience shifts towards online services and away from brick-and-mortar businesses, the industry's relationship with local

[1]: *Economic Modelling Specialists, International (Emsi) 2021 proprietary employment data.*

real estate will undoubtedly change.

Despite plenty of evidence to suggest the slow death of brick-and-mortar retail was imminent prior to 2020, the COVID-19 pandemic only made these trends more apparent. As consumers' day-to-day lives were transformed by lockdowns, retailers were forced to adapt to the new realities of the market. From large national chain stores to small main street businesses, all retailers must adapt to the industry's new normal and prepare for the industry's "next normal." As most of the pandemic-induced lockdowns and restrictions have been lifted and the economy starts to rebound, how will the retail industry adapt? What are the possible implications for commercial real estate given these adaptations?

This whitepaper evaluates some of the observed trends in the retail industry, including both changing consumer preferences and real estate market dynamics. Given the new realities of retail, we provide four separate approaches for retailers and communities to consider that are conducive to current trends. Each of these approaches has the potential to sustainably accommodate the new normal, the next normal, and whatever comes after that.

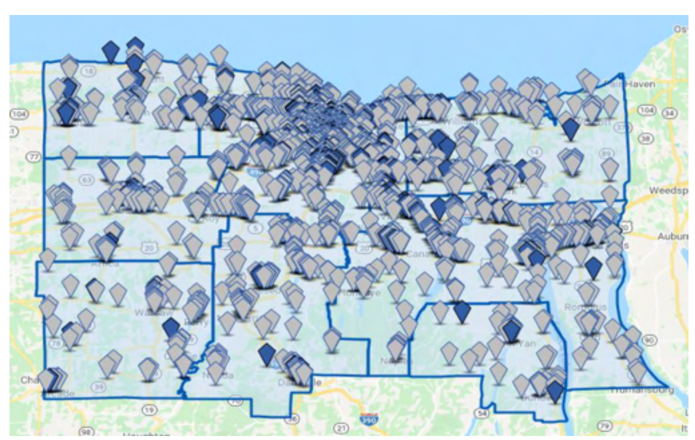
Retail in the Genesee / Finger Lakes Region[2]

57,269
Jobs

4th
Largest Industry by Job Count

86.3M
Square Feet of Inventory

5.0%
Regional Vacancy Rate (Q1 2021)



Retail Properties of the G/FL Region - CoStar - Q1 2021

[2]: *Emsi 2021 proprietary employment data; CoStar.*

1. Location, Location, Location

This mantra is often the very first lesson in evaluating any type of real estate, and retail businesses are no exception. The physical location of a store must meet the needs and preferences of the consumer, often locating at the crossroads of convenience and opportunity. In other words, successful post-pandemic retailers must locate where customers are willing and motivated to travel to. In many cases these desirable locations are increasingly competing with their customers' couches as the preferred place to shop. Traditional strip malls and large regional shopping centers continue to face declines in foot traffic.[3]

Retailers must pick a location that can offer much more than the comfort of one's home, but is also distinct enough from a traditional shopping mall, to provide a whole new experience. Experiential retail attracts customers to the holistic shopping experience, rather than simply to the product. Shopping malls often lack this experiential element that is progressively becoming more important to the average everyday consumer. Steering demand away from traditional retail locations is one approach to adapt.

Downtown main streets are an excellent place to steer consumer demand away from shopping malls. Supporting the development of retail clusters within underutilized 'main street' properties is a common practice in economic development and downtown revitalization. What dying shopping malls often lack in character, downtown main street districts often possess in spades, instilling pride in one's community once again. From produce to coffee shops to clothing stores and apparel, the impact of "local" is more important than ever.

[3]: https://www.cnbc.com/2019/04/15/malls-see-tsunami-of-store-closures-as-foot-traffic-declines-further.html

Consumer preferences toward locally-based retailers has grown significantly as a direct result of the pandemic. A 2020 survey by ZypMedia, interviewed 550 consumers across the U.S. on spending habits during the pandemic. The survey found that over half (53%) of the consumers surveyed were more likely to shop at local businesses over a national retailer given the impact of the pandemic.[4] Of these respondents, 68% stated they plan on maintaining their increased preference for shopping at local businesses even when the pandemic has ended.

This shift in consumer preferences is likely due to the strong connection local businesses have with their communities that national retailers might lack. This survey showed that fostering a deeper connection to the community is quantifiably important to consumers. While national retailers play a role in community development and service, the inherent uniform nature of national chain stores can be a barrier to adopting the quirks and spirit of a community. Smaller hyper-local retailers are able to connect and engage with the community on a deeper more sustainable level.

Therefore, communities and retailers alike should leverage their abilities, to the extent possible, to steer demand away from malls, strip malls, and shopping centers, towards retail clusters at the heart of their community. Real estate developers have a wide range of incentives available to revitalize 'main street' properties. Historic tax credits, adaptive reuse incentives, deeper ties to the community, and other incentives can be used to develop main street properties ripe with retail potential.

[4]: https://www.cnbc.com/2019/04/15/malls-see-tsunami-of-store-closures-as-foot-traffic-declines-further.html

2. Repurpose Out-of-Date Retail Centers

Shifting retail demand toward online sources and main street properties will have one unfortunate consequence. Old-format retail centers like malls will continue to be vacated and lie dormant. But vacant, large-footprint buildings such as former malls, big-box stores, and department stores also present a community with a plethora of options for ambitious adaptive reuse projects. As demand continues to decline, these properties will become available at a steep discount. Investors, developers, and municipalities alike can capitalize on these discounted properties for community-strengthening adaptive reuse projects. Additionally, given the spiking costs of lumber, aluminum, steel, and other building materials, repurposing large-footprint retail centers may be more cost effective for developers than starting from scratch.

Malls and commercial centers are often located in close proximity to public transportation, major highways, and significant population centers. As such, the land itself is quite often in high demand, and the advantageous location increases the redevelopment possibilities.

Malls in particular are best positioned for adaptive reuse projects. According to a study from the Certified Commercial Investment Member (CCIM) Institute, the adaptive reuse of mall and retail centers will be the most impactful retail real estate trend through 2025. The CCIM study also asserts that New York, California, Florida, Texas, and Pennsylvania will see the greatest number of mall closings through 2025 based on the magnitude of these states' mall inventory coupled with persistently deteriorating performance metrics.[5] As such, New York State is extremely well positioned to capitalize on ample adaptive reuse opportunities.

This is just a small sample of all the redevelopment opportunities vacant malls can provide. When considering an adaptive reuse project in your community, it is important to note that these projects are susceptible to a number of financial, political, and legal challenges. A coordinated approach involving all relevant stakeholders is vitally important to a project's success. Each day there are more and more case studies highlighting how communities across the country are able to mitigate these challenges.

Adaptive reuse projects can be scaled to fit the needs of a community. In some cases, repurposing an entire mall may be impractical given local market conditions and the aforementioned challenges. In this scenario, adaptive reuse projects have been limited to single sections of a mall, even down to a single store. Refreshing the tenant mix may be a more feasible solution for your community's retail center. Allowing innovative and experiential businesses to occupy old mall space can also have positive externalities for the surrounding tenants. According to CBRE, department stores and clothing and accessories stores collectively occupy 79% of mall space on average.[6] These retail categories represent some of the slowest growing categories in recent years. In response to this trend, many malls are replacing department store anchor tenants with more experiential occupants like health and beauty stores, concert venues, and trampoline parks, for example. Establishing a new tenant mix is likely to increase foot traffic, sales, and ultimately tax revenue for the community.

An adaptive reuse project in Irondequoit, NY is transforming the former Medley Centre mall into Skyview on the Ridge - a contemporary community center featurings a fitness center and community gathering space. This ambitious project breathes new life into the otherwise vacant mall. The project broke ground in 2020 and construction is ongoing.

OTHER EXAMPLES OF ADAPTIVE REUSE PROJECTS

- Senior housing
- Student housing
- Mixed-use housing
- Medical offices
- E-commerce fulfillment center
- Warehousing
- Distribution centers

5: https://www.connectcre.com/stories/for-surplus-malls-adaptive-reuse-is-the-future/

6: https://www.cbre.us/real-estate-services/real-estate-industries/retail-services/retail-innovation-hub/rih-mall-evolution

3. Redefine Physical Space

Physical space plays a major role in the successes of all retail businesses. Redefining the physical layout and aesthetic feel of a store can ensure a viable retail business for years to come. One proven approach to redefining physical space is to transform retail real estate into quasi-public space where retail businesses provide a venue for social interaction. Quasi-public space, in the most general terms, is defined as space that is easily accessible to all, but owned by a private entity. This type of space supports the social infrastructure of a community by providing a venue for residents to interact. Examples of quasi-public space may include local public art installations, public gathering spaces, contemporary designs, and other features that provide incentives to gather, irrespective of consumption.

Traditionally, malls and large commercial shopping centers have supplied this type of space to communities. As retail demand shifts away from larger shopping centers and toward smaller-footprint main street-type businesses, it is important for quasi-public space to be preserved. This amenity no longer has to be restricted to larger-footprint retailers. Small boutique retailers are increasingly adopting this approach to redefine the physical layout of their properties.

Lux Restaurant and Bar - Rochester, NY.

Linden Street Mural - Geneva, NY.

Troy Beer Garden - Troy, NY.

The formation of pocket parks in front of new businesses, inviting local artists to transform building facades, and providing a venue for community events are all examples quasi-public space. These initiatives can collectively establish a more substantial destination for shoppers to enjoy and connect with their community. Leveraging local public artists to create unique "Instagram-friendly" public art installations will drive foot traffic and foster a deeper sense of place for a community. Many studies have shown that introducing art into retail environments has powerful influences on consumers' decisions to enter a store.[7] Especially in the age of social media, art can turn an everyday ordinary consumption experience into a more memorable one.

Businesses located in close proximity to walkable neighborhoods are best positioned to capitalize on the synergies of increased foot traffic and quasi-public spaces. Adopting sustainable urban design principles such as accessibility, walkability, and pedestrian-friendly environments will also be an important influence on new retail businesses.

Prior to the pandemic, the physical dimension of the retail environment received little attention. Going forward, the physical space of a store will have significant influence on the retail experience of the future. Communities and retailers should consider the physical layout of their retail clusters to create an impactful experience for consumers.

Mill Station Conceptual Plan - Owings Mills, MD - Kimco Realty Corp.

Hudson Heritage Conceptual Plan - Poughkeepsie, NY - Charter Realty & Development

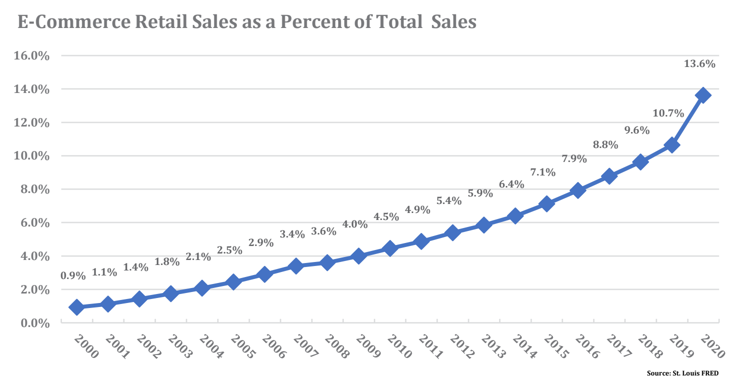
[7]: *Oh, Hyunjoo & Lee, Ha & Kim, Jimin & Choo, Ho. (2018). Effects of art in retail environments. The International Review of Retail, Distribution and Consumer Research.*

4. Embrace E-commerce and Digital Transactions

It's no secret that some of the biggest retail winners throughout the pandemic were virtual retailers that did not have to rely on foot traffic to maintain sales. Large national retailers were able to leverage extensive resources to build robust distribution networks and convenience-based services like curbside pick-up. As a result, e-commerce sales have exploded during the pandemic and haven't showed significant evidence of slowing down any time soon.

E-commerce sales rose through 2020 and accounted for 13.6% of all retail sales in 2020—the largest share of total retail sales to date. Even prior to the pandemic, the shift in preferences toward e-commerce was apparent.

Quite often "non-store retailers" of the e-commerce industry are associated with large online juggernauts like Amazon. These businesses require extremely large distribution centers, often of 1,000,000 square feet or more. As such, demand for commercial properties of this magnitude is likely to persist. From 2002-2017, the dimensions of an average new warehouse space increased by 108,665 square feet in size and 3.7 feet in height.[8] According



to CBRE, this growth is directly linked to the prevalence of e-commerce sales over the same time period. From 2017 to today, e-commerce has become even more prevalent, continuing to drive up the size of new warehouse facilities.

But the pandemic has also stimulated the growth of small and midsize online retailers. Widespread unemployment and lockdowns induced by the pandemic fueled a rise in online retail businesses using platforms like Etsy, eBay, Poshmark, etc. Many of these businesses are operations where sales, marketing, distribution, and storage are all run by a single ambitious entrepreneur. As these businesses expand, they require greater support to meet the demands of the

[8]: *https://www.cbre.us/real-estate-services/real-estate-industries/omnichannel/the-definitive-guide-to-omnichannel-real-estate/real-estate-impact/how-has-e-commerce-shaped-industrial-real-estate-demand*

market. Co-warehousing is an innovative approach to enabling and leveraging the economic success of these businesses.

Co-warehousing provides operational solutions to small-to-midsize e-commerce businesses by eliminating the common growing pains associated with expanding a business. These spaces often occupy industrial real estate to provide e-commerce businesses support in the form of storage, office space, logistics support, marketing, and other services. Co-warehousing companies like Atlanta-based SaltBox allow e-commerce entrepreneurs to rent out office and storage space for all their needs and include on-demand amenities such a professional photography studios and fulfillment services.[9] This company couples high-end quality office space with small-scale warehouse facilities.

The co-warehousing business model is highly aligned with the new market realities shaped by the pandemic, and also has characteristics that support resiliency to future economic shocks. The key to the model's success is the inherent flexibility that growing e-commerce businesses require to remain economically viable. As e-commerce businesses of all sizes continue to increase retail market share, communities should consider fostering the development of co-warehousing and related assets. Though this approach will largely impact industrial real estate, as opposed to retail real estate, it still enables communities to capitalize on the changing nature of retail.

The Loading Dock - Raleigh, NC.

SaltBox - Atlanta, GA.

[9]: *https://www.saltbox.com/about-us*

Traditional brick-and-mortar retailers face many obstacles in a post-pandemic economy. However, the retail industry as a whole, especially e-commerce businesses and their related warehousing needs, are likely to grow significantly in the coming years. Flexibility and adaptability will be vitally important to ensure a sustainable retail environment. The evolution of retail is just beginning. Forward-thinking business models and approaches to accommodate changing consumer preferences will continue to drive innovation within the industry. A coordinated effort between communities, retailers, and other stakeholders is essential to prepare for the next normal.

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QUESTIONS?
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