The Future of Retail

A look at the evolving nature of the retail real estate industry

LAI Baltimore Chapter – June, 2019 meeting

Michael Cordes – Scribe

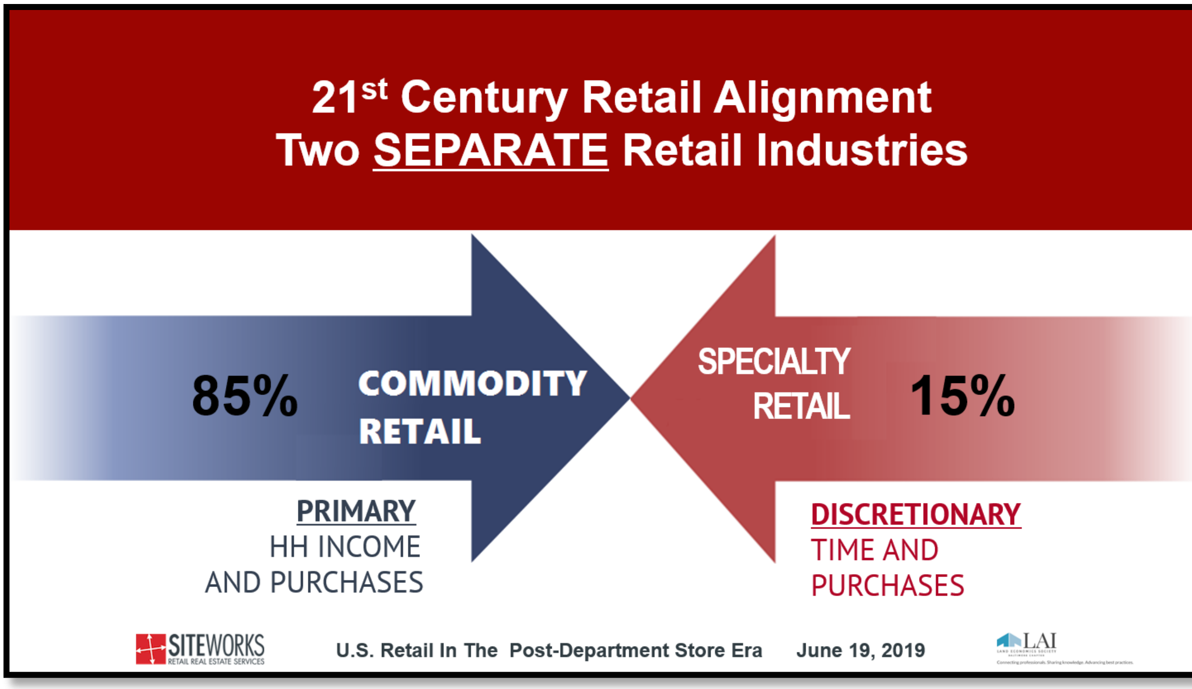
On June 19th, Nick Egelanian, head of Siteworks Retail Real Estate Services, and Dana Valenti, Director of Development at Kimco Realty Corporation, provided their take on the ever-evolving nature of retail in the U.S. Nick provided a "big picture" overview of retail's evolution, while Dana provided a deep dive into how the macro trends in retail have resulted in the redevelopment the Owings Mills Mall.

Nick began with a fascinating overview of how retail has evolved in the U.S., taking obvious pleasure in skewering many common misperceptions of the retail industry's past and present. He asked the LAI audience "How many here believe Amazon is a major force in retail today?" When everyone raised their hands in agreement, Nick grinned as he retorted, "You're wrong". He promised to explain his reasoning later in his presentation.

Providing some context to start, Nick reviewed retail's beginnings in downtown America with large Department stores like Macy's, Gimbel's, Hecht's, Bloomingdales' and so many other regional urban department stores providing the bulk of the U.S. consumer's shopping needs. These downtown department stores attempted to provide everything the average consumer needed by combining clothing, kitchen wares, jewelry, appliances, sporting goods, hardware, etc., etc., all under one roof. However, the development of major highway systems in the 1950's sowed the seeds of the urban department store's demise. The highway systems enabled the Middle Class's move to suburbia and the era of the Regional Mall was born, where the department stores all migrated, and expanded, for the convenience of Mr & Mrs Consumer. Nick advised that total sales volume in traditional department stores was in the range of $300 to $400 billion (in today's dollars) in their heyday, in the 1960's & 1970's. But in the 1980's, what Nick has coined as the "Post-Department Store Era" began. This new era saw the components that made up the traditional Department Store "deconstructed" as each component moved to its own "Big Box" store. Thus Toys-R-Us, TJ Maxx, Best Buy, Dick's Sporting Goods, Bed, Bath & Beyond, Lowes and Home Depot (and even Jiffy Lube) to name a few, began offering specialized merchandise in suburban shopping centers and effectively killed the traditional department store. Department store sales volume is now "a $65 billion business", a small fraction of what it once was.

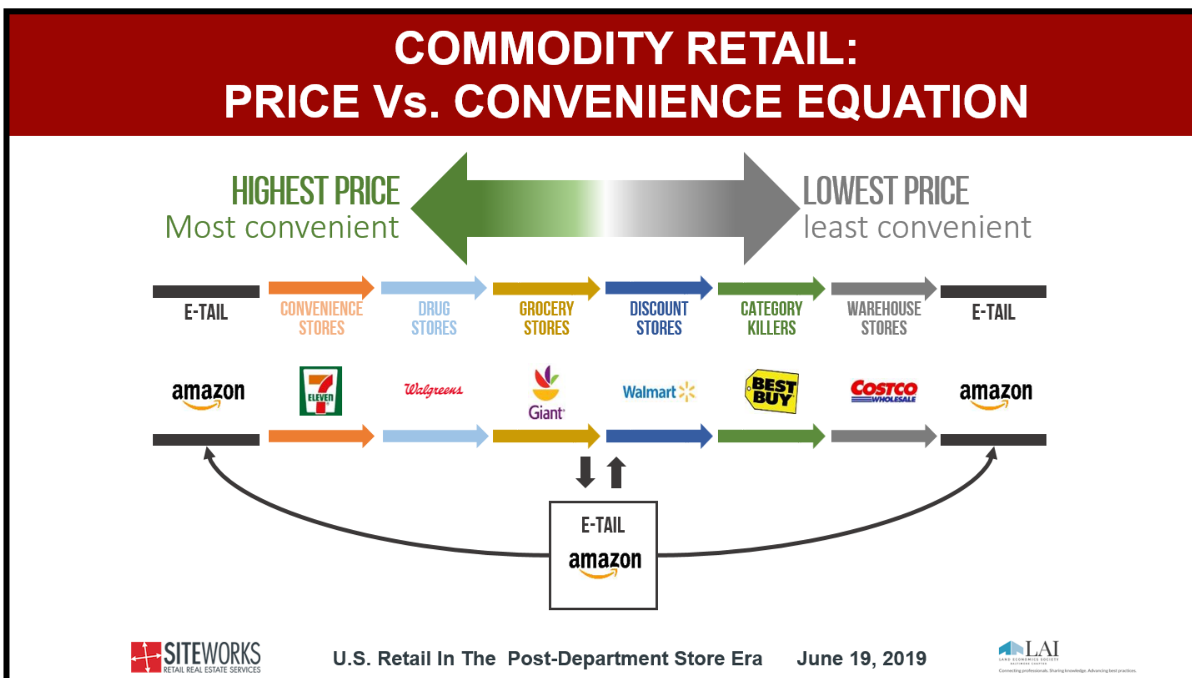
Although we have been in the "post-department store era" for decades, when Nick coined this phrase and started using it "about 10 years ago", the International Conference of Shopping Centers (or ICSC as its commonly called), wouldn't allow Nick to use this phrase in his presentations to the ICSC's retail conferences. It's been only in the recent past that the industry (and the ICSC) has adopted Nick's phrase as appropriately descriptive of the state of today's retail environment.

So what does the post-department store retail world look like? Or in Nick's vernacular, what is the "21st Century U.S. Retail Alignment"? Nick provided the following slide that provides some useful context when considering the world of retail:



This graphic brings home the point that the vast majority of retail sales are not optional for the consumer. Rather, 85% of retail sales are necessities such as food, clothing, and other commodities/staples of everyday life. The remaining 15% of retail sales are discretionary and purchased at "Specialty" retailers.

Nick made the point that all commodity shoppers make a conscious (or unconscious) choice between price and convenience when buying necessities. This tradeoff is nicely illustrated in the following slide:



We can walk to the corner 7-11 and pay $1 each for a banana, or drive across town and buy an entire bunch of bananas for about a buck, depending on what's more important to you at the moment, convenience or price.

With respect to discretionary spending at specialty retailers, Nick opined that this is an activity principally concerned with deriving pleasure from the experience. Pleasure could be derived from buying a luxury good on Rodeo Drive for oneself, or could be a function of "place" as in shopping in Disneyworld. Retailers who have discovered that it behooves them to create an enjoyable experience for shoppers, are those retailers catering to specialty or pleasure-seeking shoppers. Venues for specialty retailers are well described by this slide Nick provided:

Interestingly, traditional malls are still a viable venue for specialty shopping, although Nick opines that the number of malls who survive using this approach will dwindle from thousands today to approximately 250. This small number of malls that do survive will do so "because they have best in class product offerings".

Nick next addressed eCommerce sales, advising that as of Q3 2018 eCommerce sales comprised just 9.7% of total retail sales. Hardly the "death of traditional retail" that the media is fond of espousing these days. Although the growth of eCommerce was a healthy 15.6% during 2018, it remains a very small fraction of overall retail sales. And circling back to Nick's initial question about whether Amazon is a major force in retail today, he revealed that its sales totaled approximately 1% of all retail sales during 2018. Hardly the retail powerhouse that we all assume they are!

Nick's info-packed presentation continued with much more detail on the dynamics of the retail industry, including the following highlights:

- Amazon’s shipping costs are estimated at $29.5 billion in 2018, making its online retail business basically a breakeven endeavor. Amazon makes almost all its profit in its cloud computing business.
- The retailers opening the most stores annually in the U.S. are Dollar General, Dollar Tree/Family Dollar, Aldi and Lidl. All low-price competitors.
- Although Amazon’s purchase of Whole Foods garnered tremendous media coverage, its share of the U.S. food retail market is a tiny 1.4%. Comparing this to Walmart/Sam’s Club’s 21.4% share of total grocery sales, exemplifies how overblown the media coverage of the Whole Foods acquisition was.

Looking forward, Nick expects:

- The accelerating decline and closure of malls and traditional department stores as they become increasingly obsolete.
- Commodity retail (think Best Buy, Pets Mart, Home Depot, etc.) will remain dominate but are mature and not likely to show substantive growth.
- Physical retail space, aka the “retail footprint”, will shrink dramatically from 8.5 billion SF to 5 billion SF (but not due to sales declines – rather industry maturity brings efficiency).
- Fashion retailing is changed forever. There will be no more two season pricing cycles.
- Outlet centers between cities will become obsolete as new outlet centers (and mixed use projects, including big box retailers) are increasingly developed near cities and airports.
- Demographics will keep retail sales growth slow in the near term as baby-boomers are no longer big buyers, and Millennials have not yet begun to get married, move to the suburbs and spend big on household goods. “Biggest trend of all”, opined Nick.
- Entertainment retail will be on the rise. Water parks, indoor skiing, Lego themed attractions, and music events will increase as retailers try to appeal more effectively to specialty goods buyers.
- 5G technology will allow retailers to track and focus specials and ads with pinpoint accuracy. This will “allow retailers to manipulate us in ways we can’t yet imagine”.

For his final prediction, Nick opines that Walmart’s foray into internet sales will be one of the biggest mistakes in retail history. Walmart will be distracted by, and make no money on, its internet sales, while Dollar stores open at a frenetic pace, eating into its market share, and Target focuses on opening smaller, successful stores in cities and universities.

Moving from the macro to the micro, Dana next presented an overview of the lifecycle and history of the Owings Mills Mall. The mall opened in 1986 as a “traditional mall” with many of the major department stores as tenants, including Sacs, JC Penny, Macy’s and Sears. At that time, the mall’s grand opening was a “happening” with approximately 100,000 people in attendance. And until the mid-1990’s the mall was still “the place to be”. But in 1996, Sacs departs, and the “de-malling” of America begins in earnest, such that by the mid-2000’s the mall is only about 50% occupied. The Rouse Company put the mall up for sale in 2012. Kimco purchased the site in 2015 and has been working on its redevelopment since. Kimco broke ground on constructing its new development plan in January, 2017.

Dana provided a slide of the current site plan which is still under construction, but which already includes anchor tenants Lowes, CostCo and Giant Foods. The redeveloped site is now comprised of single story retail improvements in a “U” shape surrounding ample surface parking. The project is now “90% leased” according to Dana and also includes Burlington, Marshalls, Home Sense, and 5 Below as tenants. “What you see today is what the community wanted”, opined Dana. Clearly the community wants commodity retailers with price sensitive offerings. Kimco created a “green space” as a key amenity, that “creates a sense of place” for retail shoppers, and tenants of the office complex next door, to enjoy. Kimco is “doing this at all of our centers”, advised Dana. The takeaway here appears to be that power centers with price sensitive, necessity retail offerings, in an amenity rich environment, can succeed where old school malls, anchored by traditional department stores, have failed.

Dana’s micro example of the Owings Mills Mall demise and its redevelopment comports with the Nick’s macro overview wherein commodity retail remains dominant but needs an entertainment or attractive amenity component to be fully successful.

The members of the Baltimore LAI Chapter thank Nick and Dana for a fascinating and prophetic overview of the rapidly evolving retail industry!