MID ATLANTIC REAL ESTATE MARKETING ASSOCIATION

ANNUAL MEETING

ECOMMERCE IMPACT ON RETAIL REAL ESTATE

ROBERT WULFF

Rwulff@gmu.edu
703-587-7504

OCTOBER 20, 2017
INTRODUCTION. Real estate developers, landlords and commercial brokers have grown increasingly concerned about the health of the real estate market as Ecommerce sales seem to grow exponentially. In 2016 Ecommerce sales growth nearly quadrupled in-store sales growth in the U.S. In the clicks vs Bricks battle, clicks seem to be winning.

Are we watching the decline of the retail real estate industry? Should retail brokers start looking for another profession. Is retail development becoming extinct?

With this presentation I will try to get behind the headlines. I have mined the data on retail sales for patterns and trends to provide you with an educated analysis of the Ecommerce impact on retail real estate. This presentation will:

1. Breakdown online spending in the U.S.
2. Quantify the impact of Ecommerce on traditional retailers;
3. Explain retailers’ adaptions to Ecommerce;
4. Inventory real estate industry’s adaption to Ecommerce;
4. Evaluate specific impacts on retail real estate sectors with thoughts about competing with Ecommerce.
I. THE SCOPE OF ONLINE* SALES

A. Worldwide context: nearly $2 trillion and set to double.
   1. Snapshot. 2016 worldwide online sales totaled $1.9 trillion.
   2. Trend. Sales will double over the next 4 years to $4.1 trillion (1).

B. U.S. Sales: over $300 billion now and growing annually at 3 times the rate of bricks and mortar retail.
   1. Snapshot: In 2016 online sales were $322 billion and are projected to be $353 billion this year (2).
   2. Trend: U.S. Commerce Department projects 2021 online sales to reach $485 billion and Deloitte predicts online purchases will be 30% of all retail sales by 2030 and 50% if you exclude the restaurant establishments from retail sales.
   3. Growth. In the ten years between 2010-15 average annual online growth was 14% (3). In 2017 it is expected to be 12% (4).

*I am using Ecommerce and online shopping interchangeable. Both terms include shopping through a desk top computer or a smart phone—essentially any digital device.
C. Online Penetration. Ecommerce represents 8% to 10% of all U.S. retail sales (as defined by US Department of Commerce which includes automobiles and gas). For context, China is #1 at 28%.

83% of Americans have made an online purchase. It was 22% in 2000 (6).

67% of U.S. online shoppers buy once per month (UK is #1 at 76%); and 33% buy weekly—up from 21% in 2013 (7).

D. Distribution. Not all retail categories are impacted the same by Ecommerce. The list below ranks product category sales by percent of Ecommerce sales which are in parentheses (8).

- Electronics and Appliances (22%)
- Apparel and Accessories (21%)
- Auto Parts (9%)
- Books/Music/Video (9%)
- Furniture (8%)
- Toys and Hobby (5%)
- Health and Personal Care (5%)
- Office Equipment and Supplies (3%)
- Food and Beverage (2%)

To put a dollar value to the list, each of the top two categories produced $100 billion in online sales last year.
E. The Amazon Effect. It is impossible to understand the scope of online sales without also understanding Amazon’s impact on U.S. retail spending.

1. 2016 sales: $136 billion—a 27% growth rate from 2015
2. Penetration: 54 million Prime members, 1 in 5 homes (9)
3. Christmas at Amazon: Amazon sales up 11% (10) while Mall sales down nearly 10% during the same 2016 Christmas.
4. Amazon and Apparel: During 2017 Amazon should pass Macy’s as America’s largest retailer of apparel. Amazon’s apparel sales in 2015 apparel totaled over $16 billion. More than the next 5 bricks and mortar competitors combined—Macy’s, Nordstrom, Gap, Kohl and Victoria’s Secret (12).
II. IMPACT OF ECOMMERCE ON TRADITIONAL* RETAIL

A. Clicks vs Bricks*. The competition between traditional retail and Ecommerce for the retail consumer dollar has been eagerly covered by the media with mixed accuracy. The previous section clearly demonstrates that online sales are a headwind to bricks and mortar retail. The goal of this section is to quantify the impact on bricks and mortar retailers—the folks we depend on to lease our space.

B. Negative Impacts. The growth of Ecommerce made comparison pricing and selection of goods transparent and convenient which and eliminated traditional retailing's pricing power. Consumers noticed and voted with their clicks.

   1. Reduced Shopping Trips. 34 billion visits to US stores in 2010. By 2013 the number plummeted to 7.6 billion (52).

   2. Public Retailers Lost Value: In just the first four months of 2017 S&P lowered ratings on 20 public retailers.

   3. Store Closings: In 2017 American retailers have been closing stores at a record pace including iconic retailers like Rue 21 (400 stores), Bebe (170), Payless (400), Limited (250), and Kmart (64). Macy’s and Sears alone announced store closings totally 28 million sf (14).

*Traditional retail is used interchangeably with brick and mortar, in-store sales and off-line retail.
Through April of this year, there have been 2,880 announced closing—more than double the number in 2016 (15). The estimate for all of 2017 is now ore than 8,600 locations—more than during the Great Recession (16).

C. Retailer Rightsizing. In addition to closing stores, many national retailers are reducing demand for future space in retail centers. It is not a coincidence that the same day Wal-Mart announced their quarterly online sales increased 40%; they also announced there were reducing their 2017 growth plan by 15 superstores. At the other end of the grocer spectrum, Trader Joes has decided to only build 13 stores this year instead of 28 (17).

D. Rightsizings Are Not Created Equal. Closings and cut backs by retailers are happening in areas that are least affluent and least densely populated. Retailers are disproportionately leaving poorer and rural areas (67%) as opposed to large/affluent cities (13%) (22).

E. Bankruptcies. Over the last 2 years, 15 national or super regional retailers have declared bankruptcy. They are heavily focused in just a few retail categories: women’s apparel/accessories, sporting goods, general merchandise (e.g. department stores) and electronics/appliances.
III. RETAILERS’ ADAPTIONS TO ECOMMERCE

A. Omnichannelling. Clicks will not replace bricks. Rather, clicks and bricks will coexist and converge. Both will become more like the other. This is the evolving retail future. It is omnichannelling.

Millennials’ preferred shopping experience perfectly illustrates how omnichannelling can work to merge clicks and bricks. Millennials often: (1) conduct product research online using mobile apps to connect to Amazon, retailer websites, etc; (2) search for deals on social media platforms like Google and Facebook; and (3) visit physical stores to make a purchase.

To complicate the omnichannel shopping experience, it also works in reverse to above. In 2016 consumers spent $119 billion online on products first browsed or researched in a physical store (showrooming) (45).

Omnichannelling is going full speed ahead and rapidly changing America’s retail landscape. Its classic creative destruction and there will be lots of winners and losers created in the retail space. As players in this space, the retail real estate industry must track the shifting winners and losers. They pay the rent.
Just as important, the retail consumer is adapting to the omnichannel future and understanding the consumers’ evolving retail experience must also be tracked to build successful retail projects that attract retailers consumers’ want.

To help you understand the complicated unfolding of omnichannel retail, below are real stories of how the clicks and bricks are converging.

B. Convergence Stories: Clicks-to-Bricks. Online retailers are starting to lease space in physical stores. Examples span an online contact lens seller (Lumen Optical) to pureplay Ecommerce darlings like Bonobos and Warby Parker. Most are moving to stores as just another advertising medium (to go with social media, blogs and TV) to make contact with their customers. They generally lease in high end malls or lifestyle centers rather than a grocery anchored center.

Amazon, Google and Facebook all rent pop-up space in malls to introduce new products. This is how Amazon launched their Amazon Locker concept (allows customers to pickup and return online purchases in person at the mall).

Amazon has opened three book stores (two in enclosed malls) and plans for more. They also unveiled AmazonGo—a convenience store format that eliminates the cashier (51).
Online boutique fashion retailers are placing very limited quantities of their clothes in stores with internet promotions, hoping for a quick sell out using the physical store to create exclusivity.

C. Convergence Stories: Bricks-to-Clicks. Out of the top 25 brick and mortar retailers, 16 have robust and growing Ecommerce sales that have consistently outperformed the broader Ecommerce retail market. Between 2010 and 2015, these retailers grew their Ecommerce business by an average of nearly 21%.

Wal-Mart accounted for 7.8% of all online sales last year. By comparison, Amazon’s online share is 33% (49). Wal-Mart’s Ecommerce gross sales volume soared 69% in the first quarter of 2017 (47). This success is the result of an ambitious online expansion which included purchasing Jet.com for $3.3 billion to get access to their omnichannelling expertise/software. Wal-Mart now sells 50 million products on its website (46).

Home Depot and Wal-Mart are offering click-and-collect service to allow online purchasers a drive-thru lane to pick-up their order at the store. They report 50% of online orders were picked-up at the store (48).

Williams and Sonoma announced an augmented reality app which allows online shoppers to visualize many of their products as they would look in the shoppers’ home. Pottery
Barn added a 3D app for a similar purpose—to improve the online shoppers’ experience.

Many brick and mortar retailers are embracing mobile apps to allow shoppers to check prices and read product reviews in their home/car or while in the store. The goal is the holy grail of omnichannelling: a seamless click/brick shopping experience.
IV. REAL ESTATE INDUSTRY’S ADAPTIONS TO ECOMMERCE

This is a fertile field given the serious threats to retail real estate that Ecommerce represents. There are four successful strategies being employed by developers, landlords and brokers: retrench, rethink, revolt and reposition.

A. RETRENCH. When Ecommerce competition shrinks the number of retailers leasing space, stop building more space. Retail developers are retrenching. From the early 1980’s until the start of the Great Recession, developers built about 140 million sf of retail annually—peaking at 177 million sf in 2007. Recent retail construction has averaged about 50 million sf annually (22). Retailer rightsizing is forcing development rightsizing (43).

B. RETHINK. Ecommerce has created a new list of winners and losers in the retail space. Owners and brokers must rethink the traditional tenant mix to identify those bricks and mortar retailers who can sell against online retail.

Think bifurcation. Ecommerce has commoditized most mid-priced goods. Consumers see no reason to get off their couch to buy mid-priced goods (which include most items for sale from toilet paper to tires) when with a few clicks they can buy these goods cheaper and easier online. This rules out a lot of retailers. What is left are the discount and luxury retailers.
Examples of discount retailers that are successfully competing with Ecommerce include TJ Maxx, Marshalls, Ross, Nordstrom’s Rack, and Saks Off 5th. This “treasure hunt” shopping is popular with consumers and not easily replicable online (24). As a result, these type stores continue to grow so remain quality tenants. Nordstrom’s Rack added 47 stores over the last two years. Full price Nordstrom’s added one store. TJ Maxx and Marshalls current portfolio includes 2,173 stores with plans for about 800 more which would make this discounter larger than Macy’s.

The luxury retailers have resisted selling online because of the difficulty of separation and resulting taint. A $5,000 Italian Brioni suit can appear next to a $200 Kenneth Cole suit on Amazon (21). So luxury retailers have mostly refused to sell their goods online.

As a result, many luxury brands remain loyal store tenants. None of these retailers earn Ecommerce revenue more than 8% of their total revenue: Burberry, Tiffany, Luxottica, Hugo Boss, Ferragamo, Louis Vuitton, Prada, Gucci and Zegna (20).

Mall Mix problems. Malls are in trouble for a lot of reasons, but Ecommerce is a big one. Malls have not adapted their tenant mix to the new criteria forced by Ecommerce. The mall itself is not dead, but the traditional mall tenant mix is dying.
The traditional mall mix includes: 50% apparel (mostly women), 29% accessories, 5% restaurant, 2% home furnishing and 1% health and personal care. This mix must be flipped to compete with Ecommerce. Online sales dominate store sales for apparel/accessories. On the other hand, restaurant, health and personal care goods/services are resistant to online competition and should be emphasized in the new mall tenant mix (25).

C. REVOLT. Ecommerce has killed so many traditional store tenants, that there are no longer enough traditional retailers to fill all the existing empty space. As retail center owners and brokers we must EXPAND the concept of retail to fill existing vacancies and have any chance of developing new projects. This revolution will rely on attracting tenants who provide their customers with an EXPERIENCE beyond the basic transaction (52).

Experiential retail has proven to be Ecommerce resistant because online transactions do not allow customers to taste, touch or feel as part of the transaction. Four versions of experiential retail have proven especially Ecommerce resistant: entertainment, personal services, eating/drinking and medical.

Entertainment: These users include movie theatres, black box theme rides/displays, bowling alleys and other recreation based activities. All these tenants require large volume space
so are generally limited to leasing mall or big box space or as stand alone space in lifestyle centers.

Examples of black box tenants that are relatively small are Dreamworks and Crayola which provide theme parks in a box of about 70,000 sf. With creative lighting, LED screens and VR these, tenants can create a variety of family-friendly worlds from Santa’s workshop to Barbie’s dream house (28).

Movie theatres sold 1.32 billion tickets during 2016 in North America. Unfortunately, until recently the typical movie theatre was a was the space-eating, heavy-parked, 14 screen mega plex that required a huge trade area. Very few retail centers could qualify for the movies.

The recent perfection of small format movie theatres allows a much broader range of retail centers to benefit from this strong traffic generator. Here are 4 providers with local installations: Alamo Drafthouse Cinema (One Loudoun), Showplace ICON (Navy Yard), Cine’polis (Kentlands), and iPic Theaters (Pike&Rose) (27).

Restaurant and Drinking Establishments. The eating out explosion is a cultural shift that is nearly ten years old but the pace has increased in the last five years. In 2015, for the 1st time, Americans spent more money on dining out than on groceries (23).
This shift has enormous significance for retail real estate because food has become entertainment, and as such, has become the savior for backfilling vacant retail space (23).

In fact, many neighborhood centers have become de facto food courts. But restaurants are dominant in all types of retail development from malls to lifestyle centers. Eating out is so popular that restaurants are now being collected into stand alone Food Halls.

Do not confuse the new Food Halls with the mall food court. Food Halls provide a curated cultural experience with a mix of tenants offering a food-cooking experience. They consist of local chef restaurants, classes and demonstrations. Most are stand alone operations in up to 100,000 sf; and usually single-operator owned who rents to tenants for $60-$120 per square foot (26).

There are about 110 existing food Halls with national brand examples selling a theme: Eataly, Latinicity and China Live. Two local examples are The Block in Annandale and Mike Isabella’s creation in Tysons Galleria.

Personal Services. Like restaurants, these real-estate-using businesses are strong growers (10%); but they represent only 4% of total retail spending so personal services will never be more than support-level tenants (13).
Nevertheless, these personal service businesses are valuable replacement tenants that are Ecommerce resistant because they are selling experiences rather than things. Examples of personal service businesses include fitness/recreational, pet care, salons/spas/barbers, dry cleaning/laundry, health/beauty and exam prep/tutoring.

Currently expanding personal service businesses are: (1) health clubs like Fitness International that are becoming viable anchor tenants in community centers and can also fill a shuttered Circuit City or Borders box; and barber shops which have morphed into men’s grooming salons (charging $45-$90 per cut/shave) with a 10% annual growth rate.

These personal service tenants exhibit strong synergy. A number of developments have subdivided a vacant big box into a health mix of yogurt shop, yoga studio, healthy eatery like SweetGreens, coffee shop, juice bar, boxing gym and retailers like LuLuLemon and GNC.

Medical. Innovative health care providers have gone retail as they have come to understand that they benefit from the same locational criteria used by retailers. To expand their reach, they need to be in highly visible locations that are well trafficked. Convenience to the patient is highly valued (30).
Given such locational criteria, it makes sense for these health facilities to move out of their traditional office homes and into existing community and neighborhood centers. What types of health care providers are making this move? The list includes: clinics, urgent care centers, dialysis centers and orthodontic practices (33).

Each of these four medical treatment foci have national providers that are strong credit tenants and fit easily into most retail centers. Clinics are strong growers led by CVS, Target and Kaiser as sponsors. Retail clinics like Minute Clinics are growing annually at 14% (from 350 to 800 nationally) (31). Urgent Care Center's growth is part of the general trend to treat people in convenient outpatient facilities rather expensive in-patient hospitals (32). Davita Dialysis is publicly traded and focused on growing through in-line shopping center locations. Orthosynetics operates 350 locations nationwide and plans 1,600 more in shopping center stores or repurposed big boxes.
D. REPOSITION. A significant minority of vacant retail space in the US will not be suitable for releasing by new retail tenants. As stated above, the impacts of Ecommerce are not spread evenly across the demographic and geographic landscape. Outer suburban, rural and low income areas are full of B and C buildings that may never attract new retailers given the growing market share of online retail.

Finding nonretail tenants is the goal of the reposition strategy. There are many examples nationwide including conversions to call centers, office space, and high schools (29). Fortunately, in the DC Region the health of our retail markets has not required any significant repositioning.
V. EVALUATION OF SPECIFIC IMPACTS ON RETAIL REAL ESTATE AND THOUGHTS ON COMPETING WITH ECOMMERCE

A. THERE IS AN ECOMMERCE-DRIVEN BOOM IN INDUSTRIAL REAL ESTATE. Ecommerce is creating a boom in the industrial real estate market—especially the warehouse/distribution sector and a new type building called the FULFILLMENT CENTER: where online retailers store, pick and pack items to be delivered to online buyers’ homes.

Using fulfillment centers, online retailers have gained a pricing advantage over bricks and mortar retailers by eliminating or reducing the costs of space necessary for a physical store’s two main functions: displaying products and storing inventory. The former is accomplished online for free (almost) and storage is shifted from high rent space in the bricks and mortar store to the low rent fulfillment center.

This all-important advantage provided by fulfillment centers is why online retailers are building them rapidly and everywhere.
Measuring the Boom. The national numbers are very strong for industrial real estate.

1. Investor sales: $100 million in equity looking for industrial buildings could not be placed in 2016, pushing cap rates to a 5.3% average (34).

2. Construction/Absorption: Colliers estimates that developers will build and brokers will lease over 250 million sf in 2017 (34).

3. Vacancy: Industrial vacancy is predicted to hit a record low of 5% in 2017 (36).

4. Rents: Effective rents last year averaged $4.66 per sf, a 10% increase over 2015 (34). 2017 is expected to see a 7.3% increase for a string of 16 quarterly increases.

5. Demand for fulfillment center space will remain strong driven by Amazon’s plan to occupy 46 million sf of additional space (on top of their current 94 million sf in 247 buildings) (38).

Same Day Delivery Creates the City Warehouse. Amazon just announced their first fulfillment center project (855,000 sf on Staten Island) in New York City. This will be the first of many. The competition among online retailers to speed the delivery of goods to buyers means shortening the last mile. This requires getting inventory closer to where customers live which means locating fulfillment centers in the city (35). This unmet demand for infill space is just beginning to be understood by the development and brokerage communities.
Local Industrial Market Opportunities. The DC Region’s industrial real estate market is relatively insignificant (ranked 27th nationally). But significant growth in the industrial sector seems on the horizon based on a recent confluence: our 6 million MSA population, powerful retail sales, increased demand for fulfillment centers and a local industrial market that is growing organically (due to falling supply and rising absorption creating decreasing vacancy, increasing rents and lower cap rates).

This confluence strongly suggests that local brokerage firms that do not have an industrial practice should start one like Cushman and Wakefield who just created an Electronic Fulfillment Group. Then send your new industrial brokers out to look for on land along the I66 corridor and vacant office buildings on the Rt 28 corridor and south of the Beltway.

B. LOCATION IS EVEN MORE IMPORTANT. Ecommerce’s commoditization of most retail goods makes B/C retail locations less competitive and a riskier retail investment. Most B/C locations will only go down in value as Ecommerce continues to grow market share.

Conversely, A locations—especially the rare trophy segment—are now more valuable due to Ecommerce. As national retailers close underperforming stores in B/C locations and
concentrate store growth in A locations, Class A landlords will be raising rents and the A vs B/C spread will widen.

C. MOST MALLS WON’T SURVIVE ECOMMERCE. The A mall will survive but with a total remix of tenants that keeps them Ecommerce resistant. This may mean replacing department store anchors and moving toward a collection of specialty stores, entertainment and food.

Ecommerce is killing off the B and C malls which account for 1/3 to ½ of all malls. Ecommerce is like the wolf pack culling the deer herd by only catching the old and sick.

Weakened over the last 20 years by shifting consumer preferences away from department stores anchors and competition from new super regional malls, B and C malls have been old and sick for a long time (44). Ecommerce just put the last nail in their coffin.

D. SYNCH YOUR TENANT SELECTION CRITERIA TO ATTRACT ECOMMERCE RESISTANT TENANTS. This will mean adopting two tenant selection criteria.

1. Flip the mix. Whether a 120,000 sf neighborhood center, a 420,000 sf lifestyle center, or a 720,000 sf mall, reject the traditional mix of 70% shopping and 30% food. Ecommerce resistance requires 70% food, 20% shopping and 10% personal services/medical (25).
2. Shopping tenants must be especially Ecommerce resistant which means discount, luxury or experiential retail.

E. THE GROCERY ANCHORED CENTER IS IN PERIL. Grocers are losing market share to restaurants. Restaurants are eating America’s food budget. What is left of that food budget is being siphoned away from traditional grocery stores by Wal-Mart, convenience stores, and dollar stores. In 2005, 66% of shoppers said their local supermarket was their primary destination. In 2016, fewer than 50% think this way (41). STRIKE ONE.

To date Ecommerce has not successfully taken market share from bricks and mortar grocers. Attempts have been made to create eGrocery platforms in over 100 cities and all have failed. Even the recent roll out of AmazonFresh was disappointing. Legacy grocers have not been seriously threatened by Ecommerce.

But the eGrocery threat has changed with Amazon’s purchase of Whole Foods and its 430 stores. NOT because Amazon will lower prices and improve selection like it did to put so many book/apparel/electronic retailers out of business. Margins in the grocery business are too thin for that to work.

The legacy grocery brands remain safe. The real estate threat from Amazon is to all the inline retail tenants in Whole Foods anchored centers. Because Amazon bought Whole Foods for
three reasons. (1) To get access to Whole Foods’ customers who now don’t use AmazonFresh. (2) To secure a beachhead in the grocery business. (3) Most importantly, for its existing supply chain infrastructure which includes 430 retail stores plus Whole Foods’ distribution centers.

I predict Amazon’s next step will be to expand its grocery sales in 3 ways. (1) Build additional Whole Foods stores (least important step). (2) Build-out their new small format convenience store—AmazonGo. (3) Most importantly, grow their online grocery sales buy using Whole Food stores as fulfillment centers to both pick/pack/deliver to online customers and to act as drive-thru/pick-up locations for a click-and-collect service Amazon will add to all stores. STRIKE TWO.

This online ramp up will frighten all the brick and mortar grocer chains who will soon copy Amazon’s new omnichannel strategy. Wal-Mart--America’s #1 grocery seller--has already announced it will increase their grocery click-and-collect service from 1,000 to 2,000 stores (out of 4,600 stores). Online grocery sales through click-and-collect means a dramatic jump in grocery buyers who never go into the grocery store because the groceries are delivered or picked-up without the customer ever getting out of their car. STRIKE THREE.
To be clear, this improved omnichannel sales strategy will NOT hurt the grocer. No sales are lost and margins may actually improve.

But the strategy will likely be devastating to the economic health of all grocery anchored shopping center of which there are 42,000 in the US. If the anchor grocer’s in-store traffic is significantly reduced, then all the center’s inline stores will lose traffic, customers and sales. Many stores will fail and close and the center’s very existence will be threatened. And back filling the vacant space with nonretail tenants will be problematic with chronic low traffic to the center.

This scenario is a very real possibility as there are no real barriers to existing grocer stores adapting to fulfilling online orders via curbside pick-up (click-and-collect) using their existing real estate footprint.

1. Adapting parking lot space to curbside pick-up.
2. Devote a portion of the existing store to staging delivery and pick-up orders.
3. No new warehouse space is required; just more employees to pick/pack groceries and the technology to set up the online order process.

F. ADAPTING TO ECOMMERCE MAY CHALLENGE TRADITIONAL RETAIL LAYOUT. Nontraditional tenants will pose special space problems. Retail design formulas will not
work for many new shopping center tenants—especially entertainment businesses like movie theatres and black boxes.

The traditional 30'x30’ grid with two 120’ deep buildings divided by an enclosed 60’ wide common area will not fit with entertainment uses that require 50,000 to 100,000 sf floorplates.

Click-and-collect online ordering requires carving out drive aisles and curb side pick-up areas that may need special traffic control spacing to not disrupt shopping center customer traffic. While much of these alterations will be by-right, the devil is in the details.

F. TRIPLE NET (NNN) PROPERTIES REMAIN SAFE HAVENS. NNN is a specialized—but significant—niche within retail real estate. NNN accounts for 66% of total retail sales volume; and single tenant/NNN buildings account for nearly 80% of retail construction (39).

This enormous asset class has not been impacted by Ecommerce.

Typical NNNN tenants are national retailers with strong credit operating in largely Ecommerce resistant retail categories like fast food restaurant, pharmacy, discount/convenience general merchandise, and auto parts. Typical tenants are: Walgreens, CVS, O’Reilly, Dollar Store, Chick-fil-A, Starbucks, and 7-Eleven.
Private investors are attracted by NNN’s bond-like stability and consistency. Most investors are motivated by 1031 exchanges. Top urban locations with a strong credit NNN tenant achieve sub-4% cap rates.

This predictable retail market is insulated from much of the creative chaos of the Ecommerce-impacted retail markets.

One caveat: If Ecommerce threatens the sales and credit of NNN tenants, the picture could change. For example, Amazon recently hinted it might enter the prescription drug business. The stock of Walgreen and CVS immediately dropped 5%. If these important NNNN tenants stop expanding and/or see their credit rating reduced, a big sink hole will appear in the NNN marketplace. Not good for NNN cap rates and investor confidence.

G. ECOMMERCE WILL REQUIRE OCCASIONAL TINKERING WITH THE STANDARD RETAIL LEASE. As Ecommerce forces retail developers and landlords to secure non traditional tenants, the standard retail lease may need revising.

1. Medical tenants coming out of office buildings to deliver health care out of a retail store front will require TLC from the broker and maybe a shorter lease term.

2. More co-tenancy flexibility will be needed as developers and landlords increasingly depend on non-retail tenants. Current lease restrictions are probably too limiting on this
tenant category and will inhibit retail center owners from releasing vacant stores to the only tenants in the market which are non-retail.

3. Experiential retailers will become more common tenants in all types of retail centers and these retailers are often short term users of space requiring Specialty Leases. Such leases are used for attractions brought to mall and lifestyle centers like car partnerships (a Tesla setup), product sampling stations, rotating carts/kiosks, pop up theme stores, and community partnership like charity events. Specialty Leasing will increase and broker expertise in this niche should pay dividends
SOURCES

(1) eMarketer, cited in USA Today, March 13, 2017
(2) U.S. Department of Commerce, Census Bureau Business Survey
(3) REIS
(4) U.S. Department of Commerce, Census Bureau
(5) U.S. Department of Commerce, Census Bureau
(6) Pew Research Center
(8) Department of Commerce, Census Bureau
(9) Consumer Intelligence Research Partners
(12) Cowan and Company
(13) REIS, “Is the Retail Real Estate Industry Doomed?”, Barbara Denham, 2016
(14) Costar
(15) Credit Suisse
(20) BNP Paribas
(22) Costar, cited in Washington Post, April 9, 2016, p.A10
(33) Rebusniness Online, “Medical Office Tenants Strengthen Retail Centers”, John Tennant, February 28, 2013
(34) Colliers, “Big Box Market Report”, in Real Estate Forum, March/April 2017
(36) Marcus & Millichap, “US Industrial Mid Year Outlook, 2017
(39) Real Estate Forum, “Net Lease Forum”, Carrie Rosenfeld, July/August 2017
(41) The Atlantic, “Why Do Millennials Hate Groceries?” Derek Thompson, 2016
(43) Dodge Construction Outlook, October 2016
(44) Costar Group News Blog, “Disparity in Mall Values Driven By Powerful Combination of Forces”, Mark Herschmeyer, August 31, 2016
(45) Globe Street Miami Retail Blog, 5 Retail Sectors Set for Increase”, Jennifer LeClair
(46) Bloomberg Blog, WalMart’s Online Sales Soar”, Mathew Boyce, May 18, 2017