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It's Another Round of Adaptation for **Retailers**

The pandemic has pushed retailers into the next phase of evolution, including new trends in omni-channel and in-store experiences.

BY KELSI BORLAND

Over the last decade, the retail industry has experienced tremendous change. The popularity of online shopping forced retailers to adapt by adopting new in-store experiences and omni-channel platforms while property owners invested in internet-resistant tenants and dedicated square footage to common areas. Now, the pandemic is catalyzing a new phase of adaptation for retailers. Omni-channel and in-store experience are still front and center, but they are taking on a new meaning as consumers once again have new expectations.

Online and In-Store Shopping Collide

The line between physical retail and online shopping is blurring. Before the pandemic, omni-channel was rapidly evolving, and many retailers had developed a robust technology infrastructure to support online shopping. However, the digital segment of the business had little collaboration with the in-store experience. Now, that is changing.

“Due to the effects of COVID-19, businesses broadened the definition [of omni-channel] to include additional digital channels like marketplaces, social media sites and last-mile delivery partners,” Thomas Frank, executive director of marketing at Streetsense, a retail creative design and marketing firm, says.

Over the last year, in-store fulfillment of online sales, in-store delivery services for phone and online purchases and the seamless acceptance of online returns has been an early glimpse into how physical retail and online retail are colliding. “None of these things were particularly novel or new,” says Brenton Schrader, VP of retail leasing and marketing at Chicago-based HSA Commercial Real Estate. “A lot of these customer trends were moving in the direction towards the store operating in more of an omni-channel fashion as both a retail store and a fulfillment center. COVID accelerated those trends and amplified the need for retailers to adopt those programs because customers were more or less demanding them.”

Customer demand is really key. Once the pandemic hit, consumers required a new shopping experience. “These programs were in their infancy, but during the pandemic, there was rapid adoption on the customer side, and that really forced retailers to accelerate their plans for those programs,” says Schrader. “That is really an important point to emphasize; it is really the customer adoption that changed.” Retailers that had already invested in developing an omni-channel platform were easily able to adapt physical stores to better serve customers in the new shopping environment, which included limited operating hours and reduced in-store capacity to accommodate social distancing.

These changes aren’t without challenges. Operating a physical store as both a distribution center and customer-servicing center has triggered supply-chain issues. “This more holistic view of omni-channel has presented retailers with some difficulties in terms of inventory management and control over their brand and operations, especially in partnering with third-party marketplaces, last-mile delivery platforms and social media sites,” says Frank. “As this continues to evolve, it will be critical for retailers to map out each touch point to clarify purpose and interaction between each channel.”

Despite the challenges, this trend is only going to gain momentum. Frank expects retailers to expand social commerce, digital local marketplaces and custom and subscription retail over the next year. “Giving consumers the ability to immediately purchase an event off the videos they are watching on social channels is a growing trend, especially as we crave to consume more and more video content,” he says.

In addition, consumer habits have changed during the pandemic, not only in terms of requiring convenience and the seamless transition between in-store and online, the pandemic also renewed support for small local businesses. “We all got used to ordering everything from the comfort of our couches, but at the same time looked around at our neighborhood retailers and saw how much they were struggling,” says Frank. “Municipalities and retail centers will come together to create localized digital marketplaces.”

New In-Store Experience

Although the pandemic cemented the prominence of online shopping, it wasn’t necessarily at the expense of brick-and-mortar retail. Last year, online retail sales hit a peak in the second quarter, accounting for 16.1% of total retail sales, according to research from Moody’s Analytics. In the second half of the year, however, online sales fell to 14.3% of total retail sales as business closures and other restrictions were lifted. While this was still a record for online retail, the data suggests consumers’ desire to return to physical retail locations once they felt safe.

“I think the balance will be restored at some point. I think that eventually a lot of customers shopping online today will return to the store, and people are going to do the leisurely shopping that they did prior to COVID,” says Schrader. “I do think a certain amount of in-store pick-up and delivery will be here to stay, but I think at some point, we are going to reach a more natural equilibrium as things become safer on the public health side.”

Finding that balance will hinge on a progressive and thoughtful retail experience. Experiential retail had already become a cornerstone of successful shops before the pandemic, but the concept is increasingly important for survival. “If a store worked solely as a fulfillment center, then physical retail will cease to serve a purpose,” says Schrader. “Ultimately, retail can’t compete with the convenience and value that is offered online. That is why at it’s best, retail should provide the opportunity to engage with the customer through knowledgeable service, inspiring design and enjoyable experiences.”

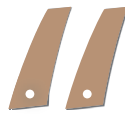
The in-store experience will have to adapt again to meet new health-and-safety concerns, including social distancing, better air filtration and touchless surfaces, all of which Frank says are here to stay. “We will have to address additional pick-up options, a higher volume of returns and greater distancing,” he says. “There will need to be a focus on air quality and safety and potentially more locations with smaller formats for helping both speed delivery and serving smaller pockets of customers.”

Technology will play a crucial role in delivering this experience. “Retailers know their customers better than ever due to their online habits,” says Frank. “We’ll continue to see more and more touchless and contactless integration, including integrating chips into products for scanning available inventory, other accessories to purchase with the product and payment itself.”

Frank has seen the transition first-hand. Streetsense is working on The MoCo Marketplace in Montgomery County, Maryland. The property has transitioned into a seamless shopping experience. “This was a site that launched last holiday season to gamify the local shopping experience, and is now in the process of evolving into a one-cart shopping experience plugged into the participating retailers point-of-sale systems to control inventory, pricing and eventually local delivery,” he says.

According to Schrader, the in-store experience should provide customers with an added value through customer service, knowledge, selection and interaction. Total Wine and More and William Sonoma, two tenants within HSA’s roster, are prime examples, offering information, samples and unique products that would otherwise be challenging and even overwhelming for consumers to find, select and purchase online. “If you are just processing orders, the retail will not serve a purpose to the customer,” he adds.

Retailers aren’t alone in adapting to new consumer needs. HSA has invested in providing a shopping center environment



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EXECUTIVE DIRECTOR OF MARKETING AT STREETSENSE

that supports a unique in-store experience. “Just as merchants need to offer a compelling value proposition to draw customers to the store, we need to create an environment in the center that is equally convenient, comfortable and fun,” says Schrader. “We want to make sure that we are encouraging customers to come to the center, shop from store-to-store and have an overall enjoyable experience.”

The Mayfair Collection is HSA’s most recent example. The 400,000-square-foot property includes dual anchors Whole Foods Market and Nordstrom Rack, along with co-working and corporate office space, a 146-room Hilton Homewood Suites, and Synergy, a 269-unit luxury rental community. During the pandemic, the property attracted PetSmart, which signed a 15,600-square-foot lease, signaling both the strength of the asset as well as the strength of the pet store market through the pandemic.

Upgrades and Adaptive Reuse

Although many retailers are finding ways to innovate through this dramatic market shift, some retail won’t make it through the turmoil. Indoor malls, for example, have struggled. Research from Moody’s Analytics shows a surge in indoor mall vacancy, growing 10.5% in 2020. Investors are finding opportunities to convert obsolete retail into a higher and better use. During the pandemic, distribution has moved to the top of that list, but these conversions are often infeasible due to city zoning and land use regulations.

“I haven’t seen much property conversion into pure fulfillment facilities. Cities lose that tax revenue, and I have seen a lot of resistance to that. Cities are hoping that things will return to life as usual once the pandemic is over,” Gary McKitterick, a partner at Allen Matkins and an expert in adaptive reuse projects, says.

However, cities have also witnessed the unique proliferation in online shopping, and the demand to locate fulfillment facilities close to population centers. Many local municipalities have issued temporary-use permits for the conversion of retail to distribution or logistics centers during the pandemic. “Cities are more willing [approve the conversion], but they are reluctant to do it long-term. They are issuing more temporary-use permits versus long-term conversion, but they are not yet doing a wholesale conversion,” says McKitterick, adding that he has never before seen temporary-use permits issued at this scale.

Some owners are taking a novel approach by converting only a portion of a retail facility into distribution during the pandemic. This hybrid approach could be an early look at long-term strategy. “Many of the changes directly tied to the pandemic ultimately led to a better, more modernized customer experience, so I do believe many will remain permanent,” says Frank. “Things like curbside pick-up, the transformation of the back room to

mini-warehouses, smaller footprints, digital integration and larger areas dedicated to returns are here to stay.”

Other investors are finding a better opportunity in converting vacant retail into office and medical—but even these assets face challenges passing city approval. Like distribution, the loss of retail sales tax gives cities pause to approve these conversion projects. “Cities are not supportive of those changes,” says McKitterick. Lease provisions are also prohibitive to changes in

use, particularly for owners looking to transition into mixed-use. “The CC&Rs in many retail leases may prohibit alternative uses,” adds McKitterick. “This happens because when the property was developed, they wanted foot traffic and to move people in-and-out. When you convert retail into medical or office, there is the issue of people staying for longer at the property.”

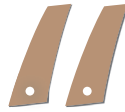
Despite these challenges, investors are finding ways to move forward on adaptive reuse projects. “Medical is moving into retail. There is a big movement and it has accelerated during the pandemic because it is a good use and you still get foot traffic,” says McKitterick. That is occurring frequently. Another trend that is emerging is conversion to refrigerated distribution because there is currently a shortage of refrigerated warehouse space.”

More adaptive reuse projects are likely to come as well, especially as cities face pressure to allow for the redevelopment of vacant and obsolete retail. McKitterick reminds that it often takes time for governments to respond and adapt to new environments. “Land use changes happen over time,” he says. “There are a lot of people looking to convert uses, but the question is will it follow through or not. That is just a matter of betting on the recovery.”

Retail Recovery Is Eminent

The National Retail Federation expects retail sales to grow 6.5% to 8.2% this year, reaching \$4.3 trillion. Online sales will grow as well, reaching a new record of \$1.9 trillion. The combination of retail adaptation and increased retail spending bodes well for the swift recovery of physical stores. “Brick-and-mortar retail will absolutely recover. It will evolve and although at this moment we are seeing a much higher volume of online shopping, it will never completely replace the in-store experience,” says Frank.

Thanks to 2020, retailers are in a better position to respond to consumer needs and drive revenue at the physical store. “If anything, the last year will reinvigorate brick-and-mortar for years to come, as shoppers are able to return to the stores and retail experiences they love,” says Frank. “People love experiences, people love to go places and people love to interact with products and services. That will never change. The impact of e-commerce on brick and mortar retail will transform it, as opposed to replacing it. The retailers that do it well will flourish.” ♦



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