NEW JERSEY REALTOR®

MAY/JUNE 2018: VOLUME 4 ISSUE 3

THE TECH EFFECT

NJREALTOR.COM

A RETAIL REVOLUTION

PROTECT YOUR PRIVACY

THE RISE OF DRONE MARKETING

A Retail Revolution

By **Pamela Babcock**

The bad news for retail marches on: Sears is closing 103 stores. Walmart's Sam's Club plans to shutter 63 stores. Macy's is closing 11, and J.C. Penney is closing 8, according to CNBC. And in March, Toys 'R' Us, the nation's leading toy retailer, said it would go out of business entirely, closing more than 700 stores across the U.S.

jax10289 / istockphoto.com

Make no mistake that the avalanche of e-commerce and evolving consumer market is knocking the traditional brick-and-mortar business model to the ground, taking commercial retail real estate with it.

New Jersey is not immune. The exodus of major retailers has left growing vacancies and many traditional malls, strip centers, and smaller retailers that counted on big-box anchors to drive traffic struggling to stay afloat. What will become of these properties? Do they have a chance of being filled? What kind of tenants could make the properties Internet-proof? And is there an upside to any of this?

A Closer Look

Karly Iacono, associate director of the national retail group Marcus & Millichap in Saddle Brook, said she expects limited development in the New Jersey commercial retail market and new construction on big-box retail to be "very limited." Instead of looking for build-to-suit sites, tenants will be infilling space at lower rents and landlords will be willing to take reduced rents to backfill the space, often under $10 a square foot.

"It won't make sense to develop big box unless it's an A location," Iacono said. The supply of retail centers will also increase because vacancy will squeeze landlord's mortgage payments. Increased supply, coupled with the rising interest rates, will drive down prices, she added.

"Most clothing and big box tenants are not performing well, which is opening up options" for other types of tenants, Iacono said. Service and entertainment concepts are faring far better than most retail, as are neighborhood centers in lower income areas and centers with "treasure hunt" tenants such as HomeGoods, Big Lots, and T.J. Maxx, according to Iacono.

Kevin Riordan, executive director of Rutgers Center for Real Estate at Rutgers Business School, said he's not surprised stores such as T.J. Maxx, HomeGoods, and TJX's relatively new-to-the-U.S. store Homesense are weathering the storm because their pricing makes them "almost like the brick-and-mortar version" of Amazon and many people still seek the "tangible, physical retail experience." They are willing to go to them knowing "it's hit-and-miss."

Whether existing space should be leased whole or divided often depends on the market, front of the property, available parking, and how receptive local officials are to a drive-through "end cap" businesses such as Starbucks would need if it wanted a drive-up window. Another big factor is the landlord's aptitude for redevelopment. "Dividing it up will always yield a higher return, but there is significant site work and carrying costs to do so," Iacono said.

Since a lot of long-time former tenants are likely paying below-market rates, Jason Pierson, president of Pierson

Deeper Dive

Some argue traditional, physical retail stores aren't dead but just need to readjust their ideas about consumers and their habits.

"Amazon has, and continues to, define what the consumer should expect from a brand, online and offline," said Maria Haggerty, CEO of Edison-based Dotcom Distribution, which provides fulfillment logistics for B2C & B2B e-commerce and multichannel brands. "The ease of online ordering, the fingertip and even voice-based access to an unlimited catalogue of products, combined with quick and cost effective delivery has changed retail forever. Day-to-day businesses that don't adapt quickly to Amazon, e-commerce, and the impact of the 'Internet of Things'" on consumers will be left behind."

In April, Target plans to open a small-format store in a former Pathmark in the Troy Hills Shopping Center in Parsippany. Executives have said the smaller stores are more profitable per square foot than Target's larger locations. Meanwhile, many competitive brick-and-mortar retailers are trying to strengthen their online presence.

Some once-only online retailers are even opening physical stores, such as New York City-based eyeglass manufacturer Warby Parker, and Amazon itself, which now has a growing number of small, brick-and-mortar bookstores with limited inventory based in part on shipping trends for that geographic area.

Haggerty said in addition to immersive activities such as virtual reality experiences and escape rooms, divided space could also attract kiosk-based showrooms and fit or "try on" centers where consumers could touch and feel a product before ordering it on a kiosk, through an artificial intelligence (AI) attendant or via a mobile device. Other shuttered stores could become local distribution centers for brands and service companies looking to improve their direct-to-consumer experience, she said.

Commercial in Englishtown says, "some landlords are actually pretty excited" about the prospects of getting higher rents with strong-credit tenants. Pierson Commercial clients include Starbucks, 24 Hour Fitness, and Jersey Mike's Subs.

"The consensus is that a lot of the landlords are chomping at the bit to get some of these spaces back because they are under market, they are a little tired, and they can get a newer, more modern operator in the spaces," Pierson added.

Divided properties might appeal to quick-service restaurants (QSRs) such as Dunkin' Donuts and Panera, which Iacono said are "expanding like crazy" in New Jersey. Fast casual concepts such as Buffalo Wild Wings and Texas Roadhouse "could also be a good fit," she added. With large rectangular shells, there's often an issue if a restaurant takes the frontage because that leaves square footage behind it less visible if it's at the rear of the building. Good options for that space might be medical office, self-storage or warehouse, according to Iacono.

Entertainment concepts are another focus for big-box expansion. Growing businesses such as Sky Zone Trampoline Park and iFLY indoor skydiving could help soak up the space, but height could be an issue since these types of businesses typically require 18 to 20-foot ceilings.

Repurposing and Reinvention

The departures of big-box stores could give some landlords the opportunity to reinvent failing malls and shopping centers. John Boyd, principal of location consulting firm The Boyd Company Inc. in Princeton, said "repurposing vacant retail is one of the most exciting areas in commercial real estate today."

Boyd noted the successful rebirth of the once-faltering Bergen Mall in Paramus, in 2009, into The Outlets at Bergen Town Center, with a 200,000-square-foot addition of retail that now offers contemporary retailers such as Whole Foods, Target, Century 21, and Nordstrom Rack surrounding an enclosed mall. Built in 1957 and one of the first shopping malls in the Northeast, the former mall even has a listing on deadmalls.com, a website that catalogues demolished or repurposed American malls. An 80,000 square-foot addition, which will include a Best Buy, is now underway.

There are also plans to transition once-languishing malls into mixed use—with smaller retail stores, entertainment, and even residential and office space. Kushner Cos. and Rouse Properties have proposed to reconfigure the Monmouth Mall in Eatontown, for new retail, recreational and commercial uses, and to add 700 rental apartments. At an April planning board meeting, the applicant's attorney spoke about a "national crisis" in retail and the need for a new vision at the 1960s-era shopping center, which has been upgraded several times, according to the Asbury Park Press.

Debra Tantleff, founding Principal of Tantum Real Estate in Jersey City, said municipalities should think holistically about depressed centers and whether stores should be repurposed or torn down and the property redeveloped, particularly since mixed-use with ground-level retail and residential units above it could help satisfy the state's affordable housing mandate.

"I think there's a significant opportunity," said Tantleff. "The execution of these properties is going to be very dependent upon the willingness to think outside of the box, be creative, and recognize that the future user is not going to necessarily reflect the past use."

Turning retail into office space may be another solution. In 2017, Lord & Taylor's iconic flagship store on Fifth Avenue was bought by WeWork. Boyd said co-working firms such as Regus and WeWork are expanding in high-growth markets such as New York City, South Florida and Chicago, and he expects both to increase their footprint in New Jersey and increasingly target vacant retail, including shopping centers such as The Shoppes at Foxmoor in high-growth Robbinsville, which is home to one of Amazon's largest fulfillment centers, and has struggled for years to attract a signature tenant.
Boyd said lawmakers should work to provide incentives to not only make repurposing affordable, but also to attract high-profile developers to work on such projects.

In the end, Riordan, who previously was CEO of Crexus Investment Corp., a public commercial mortgage REIT and a senior managing director at TIAA-CREF overseeing structured securities, said he sees the glass as half full. As he tells students, the real estate business is always evolving. Sure, these are buildings and "buildings have almost their own hearts." But when things change, such as peoples' lifestyles, buildings have to adapt.

"There are opportunities here," Riordan said. "I wouldn't say they're today or maybe even tomorrow, but that's what real estate is about. And if you stick with the fundamental tenets that if something is well-located, accessible, and in population areas, with the right mousetrap, you will attract the mice." ■