

Revisiting Retail

THE EVOLUTION OF COMMERCIAL REAL ESTATE

For the last decade, industry analysts have labeled brick-and-mortar retail spaces as being on the verge of extinction. By 2017, numerous reports of [excess retail space](#) and [increased store closures](#) warned many business owners to prepare for the worst. Declaring an impending “death of retail,” however, was and continues to be an oversimplification. Retail, of course, did not die at the end of the last decade — but it was forced to evolve.

Savvy retailers took note of the success of the “clicks-to-bricks” movement of major e-commerce retailers and capitalized on storefront closings by negotiating redesigned, beneficial rental agreements. During this time, however, retail was hit with further interference: COVID-19. By late 2020, the pandemic had undoubtedly expedited an increase in retail closings, but as the world continues to consider alternative options, bankruptcies and empty storefronts are not predestined. E-commerce is providing new opportunities for properties, and commercial real estate owners, investors and renters have exciting opportunities ahead.

The Retail Evolution: The Impact of E-Commerce on Real Estate

Although e-commerce growth might be [beginning to slow post-pandemic](#), online shopping is still an undeniable contributor to store closings. In 2020, 30 [retailers filed for bankruptcy](#) and 9,500 major locations closed. Experts predict even more increases to these numbers, estimating [80,000 U.S. retail stores](#) will shut down within four years. Credit Suisse predicts that as many as 25% of U.S. malls could [close by 2022](#), and one-third could be gone by the [end of this year](#).

Assuming that e-commerce is killing retail and leaving only dead space behind is shortsighted, however. The expansion of online shopping has unique consequences that have the potential to offer significant real estate opportunities.

Logistics and Warehouse Space Needs

Within the last decade, e-commerce has propped up declining numbers of brick-and-mortar spaces as digitally native brands built physical shops (e.g., Amazon, Rent the Runway, Warby Parker), bringing clientele back to on-site shopping. E-commerce continues to have an even more significant impact on retail space today, however, with its need for logistics and warehouse space. Consider the following:

- Online retail typically needs three times as much [storage space](#) as brick-and-mortar stores. Internet shoppers expect a wider variety of goods, resulting in American firms in 2020 leasing 21% more logistics space than the year before.
- In 2020, Amazon increased square footage by an unprecedented [50%](#) throughout its fulfillment and logistics network.
- Retailers will need an additional [1 billion square feet of industrial real estate by 2025](#) to account for warehouse space for online sales.

Blending Brick-and-Mortar With Online Stores

As the pandemic limited interactive daily activities, it increased the popularity and frequency of the “buy-online-pickup-in-store” ([BOPIS](#)) and curbside pickup shopping models, providing minimal wait times, instant gratification for buyers retrieving purchases and a new normal that is likely to continue. Major chains like Target and Walmart have found great success in incorporating this “microdistribution model” into their business, causing retail giants like Amazon to take notice and catch up.

Mall Reinventions

Malls and shopping centers have been impacted particularly hard in the last decade. They are largely dependent on retail occupants for income, and increased store closings have hit revenue streams and decreased visitor appeal. While transforming [dead space into warehouses](#) is a viable option for some spaces, it rarely yields a strong return on investment for shopping centers and malls. Flipping these properties into large logistic operational centers is often unappealing to community members and can significantly decrease property value.

However, with the rise in popularity of BOPIS and curbside pickup options, malls have an opportunity to be repurposed as drive-up microdistribution and customer return centers, utilizing technology to track wait times, customer arrivals and updates for value-

add customer service. This transformation was well underway even before the pandemic. In 2019, the retail sector had a positive [net absorption](#) of almost 23 million square feet, nearly the same amount as the prior three years combined.

The future of mall space has even more possibilities. With spacious locations usually near major thoroughfares or public transportation, these areas could be turned into colleges or multifamily housing developments to provide opportunities for their communities. As of late, the concept of re-imagining malls as community gathering and entertainment spaces is picking up speed, with interactive art museums, climbing gyms and farmers markets attracting consumers to venture out again.

The Future of Real Estate Lease Negotiations

As commercial real estate has evolved, naturally so have its rental agreements. With numerous business shutdowns due to the pandemic, many rental contracts became murky. Renters with little or no business income who delayed or refused payments were met with frustrated and sometimes litigious landlords.

These circumstances, however, have encouragingly started a trend away from the “us versus them” approach to lease negotiations between landlords and renters. Both parties have begun preemptively outlining protections within their agreements to prepare for future unprecedented crises. Hard-hit retailers started negotiating [lower rents in exchange for extended lease terms](#), giving themselves financial breathing room and creating advantageous deals in the eyes of lenders — ideal for landlords.

As better-informed tenants work with more flexible landlords to create mutually beneficial agreements that redefine the status quo, expect standard leases to incorporate even more creative elements (or return to old standards), including:

- [Force majeure clauses](#), which add pandemics to the list of “major forces” within a lease that would absolve tenants of rent payments
- Shared services models to assist retailers with navigating BOPIS and curbside solutions for customers.
- Creative payment structures that give more flexibility (e.g., base rent plus [percentage rent](#) deals).

Including considerations like these in rental agreements is a win-win for both parties: Fostering a relationship with tenants promotes goodwill and leads to satisfied tenants who trust their landlords and renew their leases.

Looking Ahead

Retail is still transforming, and property owners should not give up on the prospect of the viability and profitability of these spaces. Astute retailers are continuing to identify even more ways to appeal to shoppers, including re-prioritizing brick-and-mortar stores from simply selling products to customer acquisition vehicles and bringing [digital experiences on-site](#). Investors who provide opportunities for these retailers and consider innovative, community-based and multipurpose businesses as long-term investments in their spaces can contribute to the evolution of commercial real estate and benefit from it.

Key Takeaways

To be successful in the evolving real estate market, organizations must:

Think differently.

Retail is continuing to evolve. Take doomsday generalizations regarding brick-and-mortar shops and malls with a grain of salt and explore new transformation opportunities created by this evolution.

Plan differently.

Use available resources and research to identify an innovative and repurposed business for your commercial property that capitalizes on the impact of e-commerce.

Act differently.

Be ready to negotiate out-of-the-box agreements that will attract renters and consumers to your space. Attract tenants by proposing flexible and mutually beneficial terms.



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