Reading the tea leaves:

Why you can't blame the internet for the decline of department stores

BY BRANDI SMITH

"If you add it all up, it's really because it's a fascinating business. You have to know a little bit about construction. You have to know a little bit about finance. You have to know a lot about geography. You have to know a little bit about human behavior. Then, you have to be able to change what you know about it every day."

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Do not try to suggest to Nick Egelanian that most brick-and-mortar stores, especially big-box stores, are soon to be a thing of the past.

"Big boxes are not downsizing or shutting down. There's a small number of them that are downsizing, but to make a general statement is not really accurate," he says, instead pointing to the explosive growth of discount stores, such as Ulta, Sephora, Ross, etc. "They're the fastest-growing part of retail."

Nick Egelanian

A leading expert on retail and the shopping center industry, Egelanian teaches retail real estate development at the University of Maryland. He's also a faculty member at the ICSC's University of Shopping Centers in Philadelphia and Riordan School in Miami. He was asked to write the retail chapter of the Urban Land Institute's primary real estate book, Professional Real Estate Development, as well.

Egelanian got his start in retail in the late '80s as the head of real estate for the third-largest bookseller in the U.S., Crown Books. He moved on to a similar position at Zany Brainy a few years later before forming his own company, SiteWorks Retail Real Estate Services, in 1991. Since then, he's worked all over the country, including site analysis in Dallas, Austin, Houston, Galveston and El Paso.

"Retail never stops evolving. Also, there's a lot of misinformation about how it evolves. I found myself attracted to the idea of really studying how it works and why it works the way it does," Egelanian explains. "Also, it has other aspects that are interesting to me. It's got a geographic element. Every shopping center, every market has a bit of a puzzle that you have to solve and merchandising shopping centers is very interesting. If you add it all up, it's really because it's a fascinating business. You have to know a little bit about construction. You have to know a little bit about finance. You have to know a lot about geography. You have to know a little bit about human behavior. Then, you have to be able to change what you know about it every day."

Egelanian's passion for retail and his impressive background made it no surprise that he was tapped to speak at May's ICSC RECon in Las Vegas. The topic? Leasing strategies for difficult spaces, a subject for which Egelanian says it's important to provide context.

"This is the end of a 30-year process of deconstructing the department store. That goes back to the 1970s and '80s when we started to see big-box retail emerge. Big-box retail sought department stores and put them out on the road, allowing the merchants to sell more for less, basically," he says. "If you look at a chart of the volume of department stores in the past 30 years, you'll see that for department stores as an industry, the volume has come down from $300 million or $400 million down to well less than $100 million at this point."

Egelanian says that's a primary indicator that department stores are nearing the end of their retail life cycle. As a result, many of the malls they anchored are also in need of an energy infusion.

"The B and C malls that are out there have already been weakened. These malls were built for trade areas of 250,000 to 500,000 people when department stores were a primary mechanism for delivery of everyday goods," he says. "Now that that's changed, the primary delivery method of everyday goods is the power center."

There's also a radical change underway in the apparel industry, Egelanian says. Instead of the traditional two-season fashion cycle, consumers are turning to fast fashion and cheap fashion, available at stores such as TJ Maxx and H&M.

Another factor in the decline of malls is their deterioration - not physical deterioration, but structural deterioration.

"The structural damage to the model is too great," points out Egelanian. "You simply can't support the number of malls we have, so that means about 80

percent of them are probably going to go away as malls. Some of them will be recycled into power centers or strip centers. Some of them will be recycled into mixed-use centers."

In other cases, he suggests keeping some parts of a mall, but adding other uses such as office and residential to create a mixed-use environment.

"It's a very case-by-case discussion," Egelanian stresses. "It's nothing like the formula that was used to create 3,000 malls back in the '60s and '70s."

What's behind these changes? You can't blame the internet entirely, he argues emphatically, pointing out that only about 8.5 percent of retail transactions are happening online. The majority of those purchases, Egelanian suggests, aren't made to save money; consumers are looking for something they can't find locally.

He even points out a very recent example of an online retailer investing in brick-and-mortar stores.

"There's a tremendously high correlation between the Whole Foods customer and the Amazon Prime customer," Egelanian says. "Amazon doesn't really make any money shipping its products. It makes money on its web services and it's started to monetize its data, but it does not make money in retail distribution. What was lost in the whole Amazon purchase of Whole Foods is that Amazon bought a bricks-and-mortar retailer."

Egelanian equates online retail with something many of us have all but forgotten: catalogs.

"Catalogs topped out at greater than where internet is right now. They got about 8.5 percent of retail sales in their heyday. People forget that there was a Sears catalog that was three inches thick and it's the equivalent of today's internet. Consumers shopped those," he reminds us.

What has changed is quite simple, Egelanian says. Customers have more options and can weigh the value of cost over convenience. That, more than anything else, has changed shopping norms in America.

"What's really happened is that the ability to buy your everyday goods, what I call commodity goods, has become a very fluid process in the United States," says Egelanian. "The consumer has six or seven different choices about where to buy a roll of Bounty paper towels, for example. What they're really doing is subconsciously trading off a lower price versus convenience."

The consumer can buy those paper towels at a drugstore, he argues, or at a Walmart or warehouse store. If you keep that in mind, he says, you will be able to determine where there's growth and where there isn't.

The new challenge facing the retail CRE market is what to do with the giant spaces those stores leave behind, as well as the malls they anchored.

"A big portion of the malls that are out there, perhaps as much as 75 percent, will not be repurposed as retail," Egelanian says. "We know that there's about 8.5 billion square feet of retail in the United States. By our estimate, we think that there's roughly 3 billion excess square feet."

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He says you'll find approximately 1 billion square feet of that in regional malls with the remainder coming from fully anchored or unanchored strip centers.

"We try to help the people who own these properties to look realistically at what they have," explains Egelanian. "Depending on what they have, there are different strategies for either anchoring them or repurposing them."

A lot of focus today is on restaurants and attractions, such as theaters or enhanced retail. Whereas most malls devoted less than 5 percent of their space to restaurants when they were built, Egelanian predicts that number to climb to 15 or 20 percent in the near future.

"Be open to more options," he encourages. "Just because it's always been a retail space doesn't mean that's how you have to do it for eternity."