

Emerging evolution:

How retail is adapting to the changing market

BY BRANDI SMITH

It was the merger that made international headlines: Amazon purchasing Whole Foods, a marriage of e-commerce and brick-and-mortar that acknowledged and leveraged the power of both kinds of retail.



Marshall Mills,
President & CEO,
Weitzman

Grocery being the largest category of consumer retail, the move is being viewed by experts as a power play for Amazon, a way for the giant online retailer to tap into a new revenue stream. It was also a public and financial admission by an e-commerce behemoth that it is still worth investing in a physical store to win the war of retail.

"To paraphrase Mark Twain, the reports of the death of brick-and-mortar retail are greatly exaggerated," says Marshall Mills, President and CEO of Weitzman.

"... retail's alive and well ..."

It certainly isn't dead, but modern day retail looks wildly different than it did even a couple decades ago.

"It's changing and adapting. This is not the same shopping center that your grandparents or even your parents used," says Ronnie Miranda, Director of Asset Management for NewQuest Properties. "Retail's alive and well. It's not going to go anywhere."

Mills points to power centers as an example of retail evolution. Between 1999, at the peak of the "power retail decade," and 2011, at the depths of the recession, Mills says vacancy in power retail increased from 861,000 square feet to 3.5 million square feet.

"Today, power retail statewide reports an occupancy rate of 95 percent or better," he says. "So what happened between 2011 and 2017 that leased up all of those vacancies created by Circuit City, Linens 'n Things, Borders and the like? Basically, the market followed the first rule of holes: When you're in one, stop digging."



Jeff Hayes,
Managing Director,
NewQuest



Ronnie Miranda,
Director of Asset
Management,
NewQuest

Mills says that until the market stabilized, power retail construction all but stopped. With few new-space options, strong box stores (such as Burlington, Nordstrom Rack, Ross, etc.) began competing for the existing space.

As an example, Mills offers up a power center Weitzman leases in San Antonio.

"A couple of years ago, it was 77 percent occupied. Today, it's completely full with new tenancy from concepts like F21 RED and Spec's Wine, Spirits, & Finer Foods that

joined the project's existing retailers, such as Barnes & Noble, Marshalls, Old Navy, DSW and ULTA," he says.

Just as it does with human DNA, evolution is changing the fundamental makeup of retail, determining what survives and what doesn't.

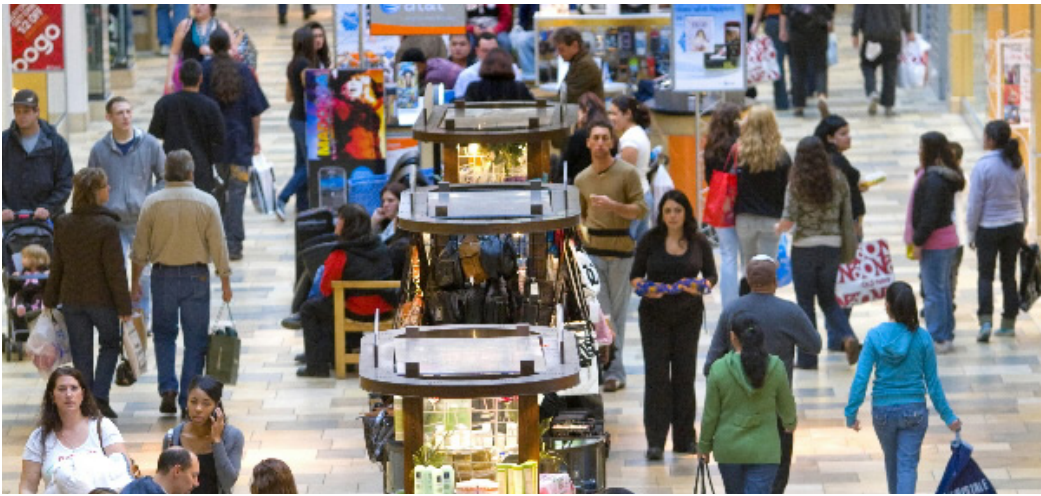
"It's forced everyone to reevaluate their business models. It's forced the better to get even better and the weak ones are going to go by the wayside," says Jeff Hayes, NewQuest's Managing Director of Tenancy Representation Services. "That's just Mother Nature at its finest."

"... the formula for continued success ..."

Mother Nature may not have been kind to Texas this year when it comes to weather, but it has delivered for retail.

Hayes, who says NewQuest typically turns over 225 to 250 transactions at its owned projects in a normal year already has more than 200 active transactions in the pipeline.

"It'll end up being another great year for us," he adds. Weitzman is also celebrating a strong 2017.



"Our Texas major-metro markets of Dallas-Fort Worth, Austin, Houston and San Antonio are as strong as I've ever seen them, though construction has remained conservative," Mills says. "That drives demand to existing centers. It boosts occupancy and justifies re-developments."

Austin, he points out, has a 96 percent occupancy level for its 48.9 million square feet of retail. Even so, Mills says the city will only add approximately 890,000 sf this year.

Boasting its highest retail occupancy in three decades (93 percent), Dallas is only adding 3.2 million sf, according to Mills.

"For an inventory of 193 million sf, that's a rounding error," he says.

In Houston, as 96 percent of retail spaces is leased, the market is only adding 2.7 million sf to its existing 150 million sf of inventory, says Mills.

In an extreme example of conservative construction, San Antonio, which has 94 percent occupancy, will only add 360,000 sf of new retail space.

"I've been in stores with more square footage," Mills says, adding, "The formula for continued success can be summed up as healthy economy + low construction = healthy retail market."

"... stores create a billboard ..."

A substantial, though difficult to measure, benefit of having a brick-and-mortar location is visibility.

"A store front is, from a branding standpoint and recognition, a billboard. Approximately 100 Kroger Stores & more than 60 H-E-B's throughout the Houston MSA can't be replicated on the internet. It's in every neighborhood; it's in every major intersection," says Hayes. "It's hard to put a value on that kind of good quality real estate."

Mills echoes that, saying, "Stores create a billboard

"The tenants that
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- Ronnie Miranda

for the brand, offering a sense of stability and familiarity. Brick-and-mortar locations make shoppers comfortable with brands in a way that an online-only presence can't match. That's why we see e-commerce pioneers like Warby Parker and Suit Supply now opening in brick-and-mortar centers."

Traditionally physical stores such as Best Buy, Costco, Home Depot, Nordstrom, Ulta and TJX offer "strong competition" for websites such as Amazon, says Mills. The same can be said for grocery stores, which Mills describes as "resistant to online competition.

"That's why we see Amazon's recent purchase of Whole Foods as proof that brick-and-mortar is

critically important to a successful retail strategy," he adds.

Additionally, as popular as online retail may appear as e-commerce expands into markets such as grocery, there are still service-based retail needs that can never be fulfilled via the web.

"People still need to have their hair cut. They still need to get their nails done. On the grocery side, some people still want to pick their produce by hand and not have someone choose it for them and deliver it. Some people just enjoy shopping. They like that as part of their experience," says Miranda. "The tenants that are coming in are coming in aggressively. We're seeing a lot of action from service-oriented tenants, ranging from doctors, to dentists, to stylists, to spas, to restaurants."

"... experiences you can't get online ..."

Another element consumers can't access via

e-commerce is an experience, which is the latest part of retail's evolution.

"Our leasing focus for new and existing centers today targets retailers offering services or experiences you can't get online. In the current market, expanding retail

categories are dominated by food, fitness and entertainment. Those concepts are complemented by strong demand from beauty and wellness, as well as medical and dental," Mills says.



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Entertainment and activities are helping to bolster the NewQuest portfolio, according to Hayes, who points to a concept called Pinstack that is growing in popularity.

"It includes a restaurant, full-sized bowling lanes and an array of indoor games and attractions, such as laser tag and a ropes course. It's not meant only for children, but also for adults. They do a lot of corporate events," Hayes says. "Topgolf is another great example of destination experience-type activities."

Miranda adds that "action sports" are filling up what used to be traditional retail spaces as well. Those activities can include indoor rock climbing, ropes courses, bounce houses and more, offering an air-conditioned venue for exercise.

"It's a pretty good adaptive use for some of these second generation boxes," says Miranda. Obviously in Houston, sports are important, as are kids' activities. A lot of these retailers and sports services are focused on off-season training too."

Experiential retail is not only geared toward the needs of more sophisticated and demanding consumers, but also toward a new generation of the spending public: millennials.

"They have a different shopping approach and expectation of the experience than somebody who's

40 or 50 years old," Miranda points out. "They also communicate differently, so we're discussing a lot of marketing efforts internally that go beyond a traditional brokerage community."

"... space just isn't there ..."

Though evidence shows brick-and-mortar retail is thriving, that's not to say online retail poses no competition. The best and most successful retailers learn how to fuse the two to their advantage.

"Walmart and other box retailers are creating amazing omnichannel options designed to make shopping easier whether you're in the store, at your desk or on your phone," Mills says. "All things considered, I think technology will be a positive. Take Walmart. DFW is their number one market for customers who order online and pick up at the store. Many stores here each see more than 900 online orders a week!"

Looking ahead, Texas retail experts foresee few obstacles, though there is one issue hampering growth: the lack of considerable new construction in the state's largest markets.

"From my perspective as tenant broker, I think the challenge is finding quality space. There are very

few quality spaces available in the class A and class B centers where our clients want to be," Hayes says.

Even from the opposite perspective, that limitation poses problems for retailers.

"There are centers I have where I wish I had another 50,000 square feet to lease. The problem is that space just isn't there. If I had it, I know I could lease it tomorrow," says Miranda.

"... strategic partnerships ..."

As for how the retail landscape keeps up its growth in Texas, experts say it's as simple as continuing to evolve as needed.

"I think you'll continue to see more of the strategic partnerships between brick-and-mortar retailers and web retailers, i.e. acquisitions that benefit both companies," Hayes says.

Don't expect to see those retail centers disappear any time soon, no matter how much traffic gets redirected online.

"Despite years of e-commerce competition, neighborhood centers as a category are posting their healthiest occupancy numbers in years. These centers act as 'town squares' for their neighborhoods, with a mix of restaurants, services, fitness, medical and dental and other categories where e-commerce does not or cannot compete successfully," Mills says.

Just as any species needs to adapt to survive, so too does retail as the landscape changes and consumers' tastes and needs evolve. ■

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