What's REALLY Happening to Retail?

By Amy Wolff Sorter

Anyone reading commercial real estate retail headlines in 2023 can be forgiven for potential mixed-message confusion. On the one hand, there is continuous talk about retail bankruptcies following that of Bed, Bath & Beyond in April. Yet other reports classify retail investments as "the new darling of the CRE industry."

The reality is somewhere in between. Like most other commercial real estate asset classes, retail CRE consists of a broad mix of many product types. This, combined with certain fundamentals, prompted experts to tell Connect CRE two things.

Retail isn't necessarily the"new darling" for investors. On the other hand, it's nowhere near any sort of state of collapse. "Despite the pandemic and current economic situation, the retail industry, with the exception of regional malls, remains fairly strong and is doing much better than other product types," commented Grant Gary with The Woodmont Company.

However, retail commercial real estate is also experiencing the same headwinds impacting other CRE sectors and asset classes.

First, the Fundamentals . . .

All the experts agreed on two things: Consumers continue to spend. And they're continuing to spend in person.

"Retailers aren't saying, 'we're losing sales or sales are down,' or anything like that," said The Providence Group's Jay Hagerman. "There still appears to be strength in the economy from consumers that have money to spend. They're still going out to restaurants. When you look at drive-through lanes of various QSRs, consumers are still wrapped around the building now."

According to Scott Grossfeld with Cox, Castle & Nicholson, core fundamentals continue supporting retail spending – like low unemployment and "key elements of the population with significant amounts of disposable income."

And those "key elements" like the experience of in-person shopping. "Although consumers like the convenience of online shopping, they also like to physically go to the stores," said Northmarq's Chad Byerly. "As a result, brick-and-mortar remains a primary point for consumer shopping."

But in many cases, the brick-and-mortar space might not be available for increasing tenant demand. "There's been a lack of new retail centers being constructed," said Pam Goodwin with Goodwin Commercial. "Because of this, retailers are searching for existing built-out locations. Especially in demand are free-standing buildings with a drive-through component."

Some are Doing Better . . .

"Retail" includes everything from the million-square-foot regional mall to the net-lease Starbucks down the street. As such, it goes without saying that not all retail classes are exhibiting the same performance.

"Neighborhood/grocery-anchored shopping centers seem to be doing well, because the staples sold by grocery stores and drugstores are always in demand," Grossfeld said. Also doing well? Luxury retail. "This appeals to consumers at a higher income level that are less impacted by higher interest rates and inflation," Grossfeld observed.

NewMark Merrill Companies' Sandy Sigal pointed to strong growth and spending in areas like fitness, movie theaters, quick-service restaurants and value segments. Delving more deeply into those "value segments," "treasure hunt value retailers with the likes of Burlington, Ross, TJ Maxx, Kohl's and Five Below continue to see very strong consumer interest prompting the acceleration of a strategic growth plan across the United States," Gary said.

On the other hand, it's probably not surprising that regional malls, especially older stock in non-A-level locales continue to struggle. Also having problems are certain big box retailers. "Those who haven't adopted to a model of ecommerce complementing brick-and-mortar, and vice versa, continue struggling to attract new consumers," Gary said.

Goodwin agreed, explaining that consumers are increasingly migrating toward mobile commerce and omnichannel experiences. "Retailers that invest in technology, provide seamless online experiences and leverage data analytics have a greater chance of success," she added.

And, the Headwinds

The main challenge facing retail investors, owners and builders probably isn't a surprise. It's interest rates. "This makes it tough to match sellers' expectations with investors' expectations of what a retail property can sell for," Hagerman explained.

Hagerman went on to suggest a degree of skepticism from investors. "It's just a bit of a hangover from the pandemic," he said. "I think investors are concerned about the economy, and the financials of deals right now are what's hurting the investment market."

Narrowing the discussion down to net lease properties, that ongoing uncertainty is running against available cash and inventory. "Buyers in this space want strong tenants, typically with long-term leases," Byerly explained.

Finally, the ongoing work-from-home trend, combined with higher crime rates in several cities are taking their toll on more traditional department stores. "People seem to have less time," Goodwin pointed out. "They want to get in, get out – and they want an easy place to park."

Adding to all of this is ongoing competition from a variety of sources. Said Goodwin: "An increase in specialty retailers and fast-fashion brands, along with a lack of differentiation and outdated business models, have contributed to many retailers' struggles."