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Retail Tenants, Landlords Grapple with Divergent Perceptions of their Future in Brick-and-Mortar

*Cynthia A. Nelson and Christa Hart**

A recent survey of 30 of the largest retail real estate investment trusts, and mall and shopping center landlords, as well as 90 U.S.-based retailers, examined how these two interdependent industries view the role of physical store locations in future revenue growth. The authors of this article discuss the results of the survey, which reveal the divergent views of the role of brick-and-mortar in the future of retail, and basic business issues.

Mall and shopping center landlords and their retail tenants differ on the role that brick-and-mortar store locations will play in the future, more digital world of retail sales. Understandably, landlords are more concerned about the very real impact of online shopping on the need for physical space and ultimately, on vacancies. Retailers, on the other hand, are looking for ways their landlords can help them better adapt and thrive in the face of retail's new omnichannel reality by adapting their stores to enhance the customer experience and meet evolving consumer demands.

This issue was explored in a recent survey of 30 of the largest retail real estate investment trusts ("REITs"), and mall and shopping center landlords, as well as 90 U.S.-based retailers, to examine how these two interdependent industries view the role of physical store locations in future revenue growth. The results of the survey not only reveal their divergent views of the role of brick-and-mortar in the future of retail, but also about basic business issues, including the shift to online shopping, evolving consumer demographics and preferences, and competitive pricing and promotional pressure. Because of this disconnect, retailers' and landlords' approaches to attracting shoppers and growing revenue differ significantly. But, change breeds opportunity.

For example, while landlords overwhelmingly (93 percent) agree or strongly agree that new stores are critical to retail sales growth, just 61 percent of retailers share their belief. In addition, 60 percent of landlords believe that customers are shopping in stores less

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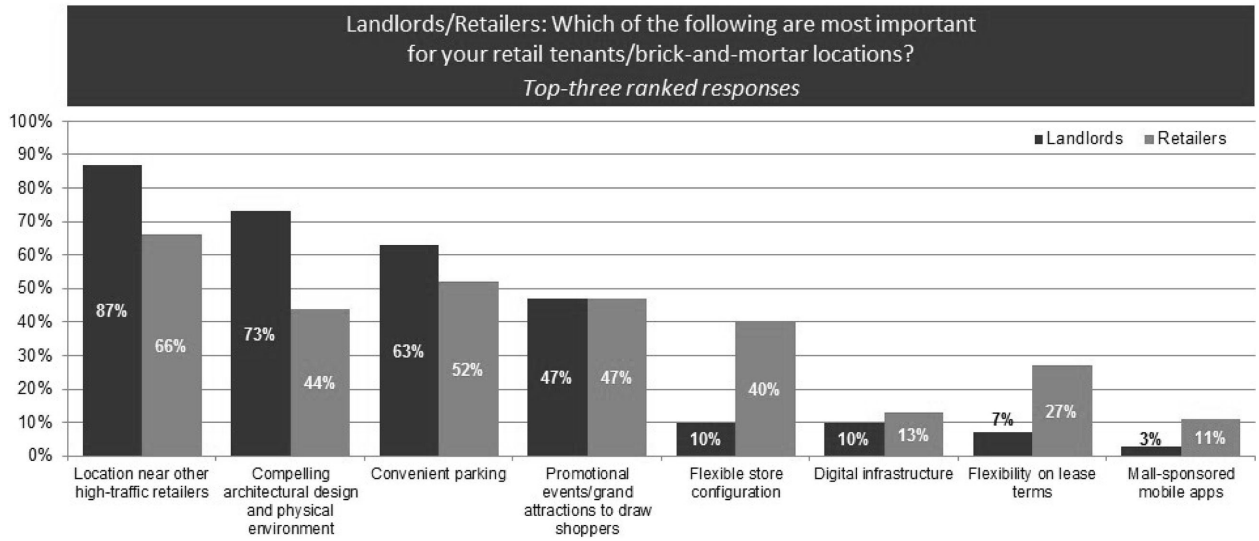
often, while only 37 percent of retailers agree, suggesting the landlords are far more aware and more concerned about the impact of online shopping than their tenants.

Forget Back to Basics



The survey shows that basic brick and mortar attributes such as location, store design and parking are important for both; however, landlords and retailers prioritize these attributes differently. For example, 87 percent of landlords but only 66 percent of retailers cite location near other high-traffic retailers as being most important for their physical store locations. In addition, 63 percent of landlords and only 52 percent of retailers say convenient parking is the most important benefit a landlord can offer. Compelling architectural design and physical environment were also seen as a benefit by both, but there is a 29-percentage-point gap between how landlords and retailers view it — 73 percent of landlords cited these features compared to 44 percent of retail tenants.

In addition, while landlords seem to overestimate the importance of these fundamental brick and mortar attributes, they underestimate the importance of such benefits as flexible store configuration (10 percent of landlords versus 40 percent of retailers) and flexible lease terms (seven percent of landlords versus 27 percent of retailers). This disparity suggests retailers are more interested in providing the personalized in-store and omnichannel shopping experience now required to attract and retain customers.

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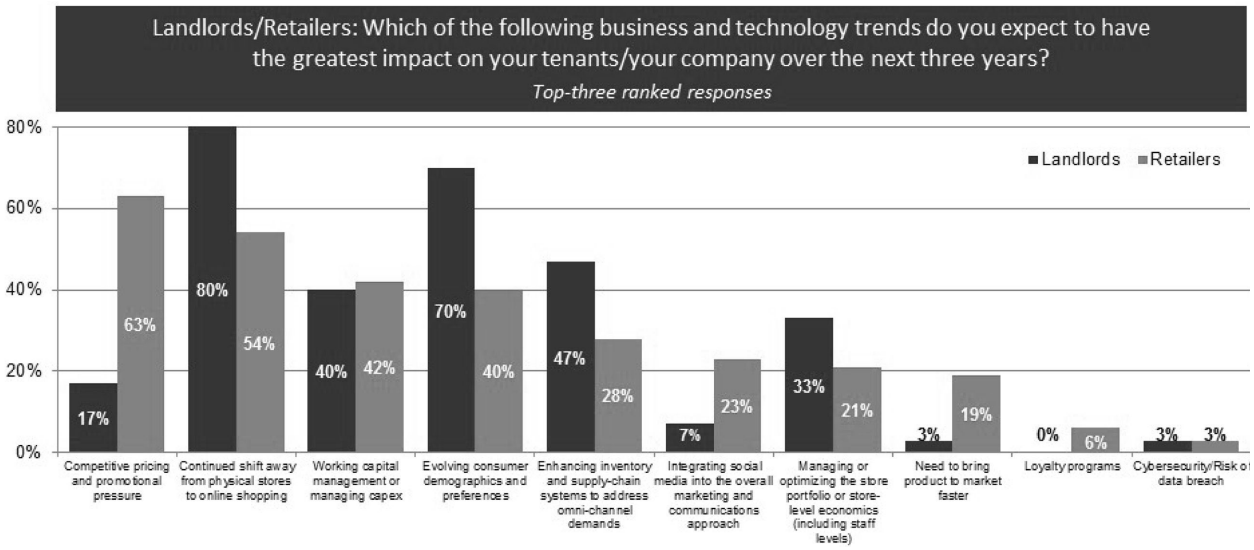
A Disconnect on Business Priorities



The survey also revealed a disconnect in how they viewed retailers' key business issues such as competitive pricing, advertising and marketing support, as well as the impact of evolving consumer demographics and preferences such as millennials and increased diversity.

For example, the largest gap in their perceptions concerned the impact of competitive pricing and promotional pressure on the retailer, with 63 percent of retailers expressing this concern versus only 17 percent of landlords. In addition, more than twice as many retailers, 73 percent compared to 33 percent of landlords, agree or strongly agree that shoppers demand a more personalized in-store experience. Further, 40 percent of tenants value their landlords' advertising and marketing support, while just 10 percent of landlords think it is important.

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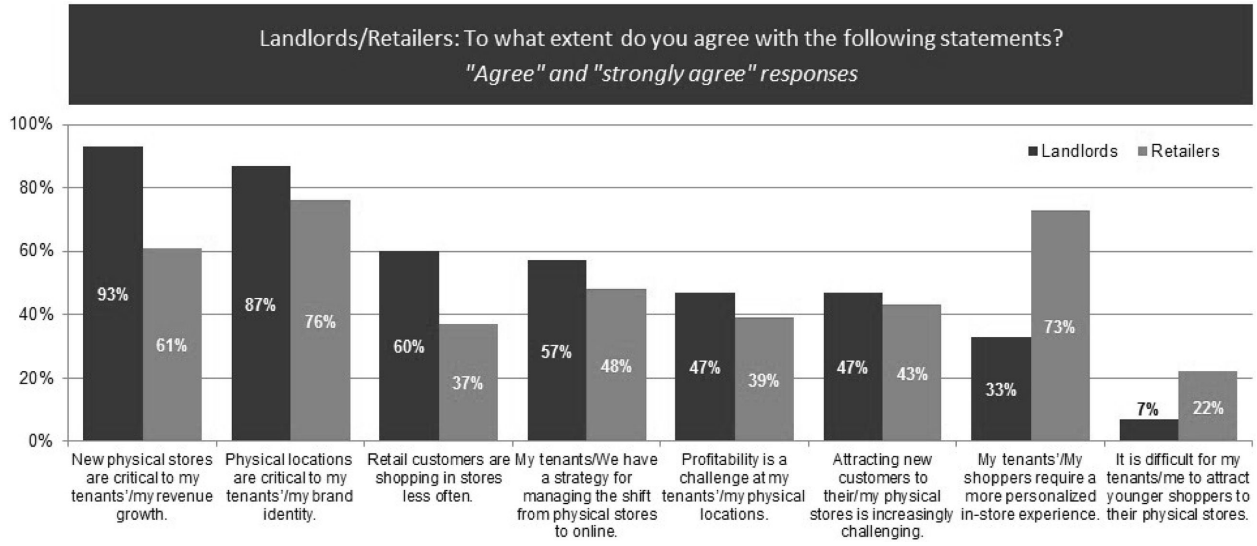

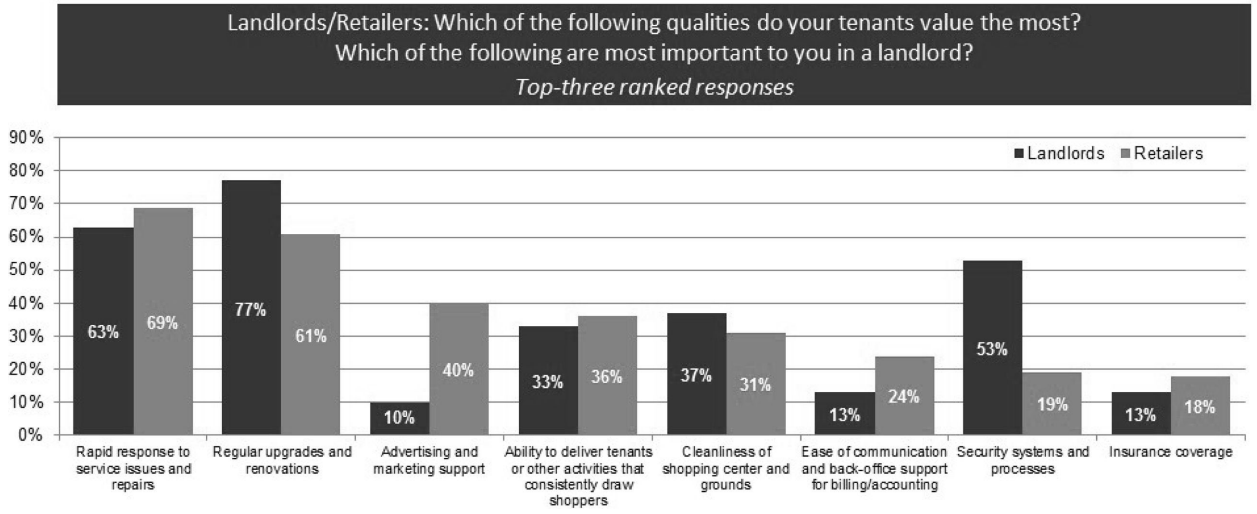

On the other hand, landlords are far more concerned than their retail tenants about such issues as the shift to online and the new shopping behavior of millennials (70 percent of landlords versus 40 percent of retailers). This, presumably, is because of how they will impact investments in and changes to the physical space.

Landlords and retailers also differ in how much impact inventory supply chain enhancements will have on retailers' businesses; 47 percent of landlords versus 28 percent of tenants cited it among the trends they expect to have the greatest impact on retail companies over the next three years. Surprisingly, the need to bring products to market faster is a trend that neither landlords nor their tenants see as pressing, with just three percent of landlords citing that concern compared to 19 percent of tenants.

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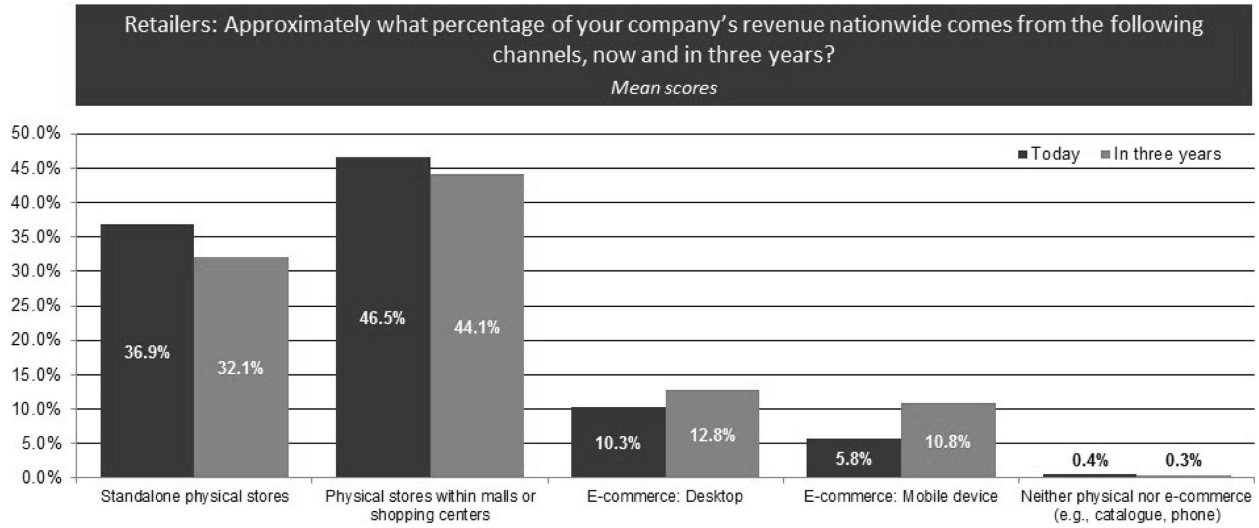
These responses underscore the need for landlords and retailers to develop a better understanding of each other's needs and how the changing nature of retail in an increasingly internet-reliant culture will impact them both.

Are Retailers in a State of Denial?

Research suggests that many retailers are in a state of denial about the depth and pervasiveness of shifts in consumer buying trends, even as they expect e-commerce to account for 23.6 percent of their sales in three years, up from 16.1 percent today. In spite of this, they anticipate only small declines to in-store sales at malls and shopping centers — from 46.5 percent of sales now to 44.1 percent of revenue in three years. They also expect sales at stand-alone stores to decline from 36.9 percent to 32.1 percent of revenue over the three-year period.



As further testimony to retailers' lack of awareness, 60 percent of landlords agree or strongly agree that retail customers are shopping in stores less often, but only 37 percent of retailers agree or strongly agree. Also, landlords are more concerned than their tenants about the continuing shift away from physical location to online purchases, 80 percent compared to 54 percent of retailers.

It is not surprising, then, that landlords are more concerned about the continuing shift to online sales since e-commerce threatens their *own* business models. Their concern is understandable since landlords' real estate assets cannot be modified to succeed in the digital era as readily as retailers can modify their businesses to become omnichannel merchants.

The survey showed that in spite of these shifts in shopping patterns, occupancy rates are still holding steady, at least for now. When asked to describe their occupancy rates today, 60 percent of landlords report their occupancy rates are on target and 23 percent report above-target occupancy, compared to just 13 percent who report occupancy rates below their goals. None of the landlords reported occupancy significantly below their targets.

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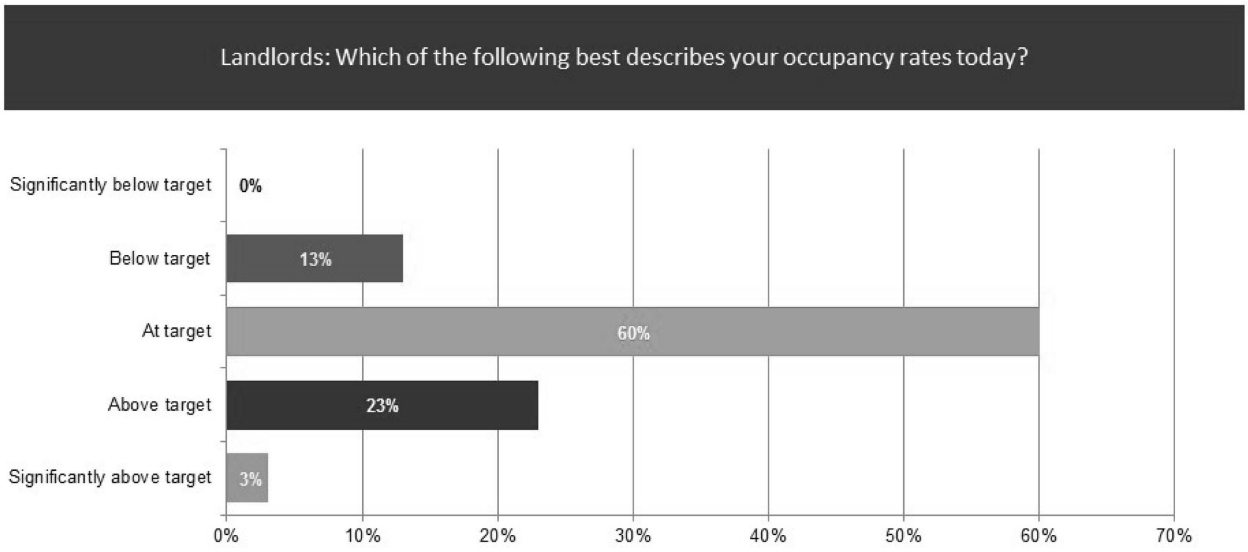

Looking Ahead: Plans to Boost Traffic

Looking ahead, retailers are keen to embrace an omnichannel approach for growth and, as a result, expect all in-store sales to decline to 76.2 percent of sales in three years from 83.4 percent now.

So what do landlords plan to do to boost in-store traffic? Overall, landlords are already improving the things their tenants value most such as marketing (93 percent), physical access (93 percent) and the environment (97 percent), as well as security. And almost all (97 percent) of mall owners plan to add more food and entertainment options, increase social media and mobile apps (97 percent) and add more non-retail options (43 percent) to increase mall traffic in three years.

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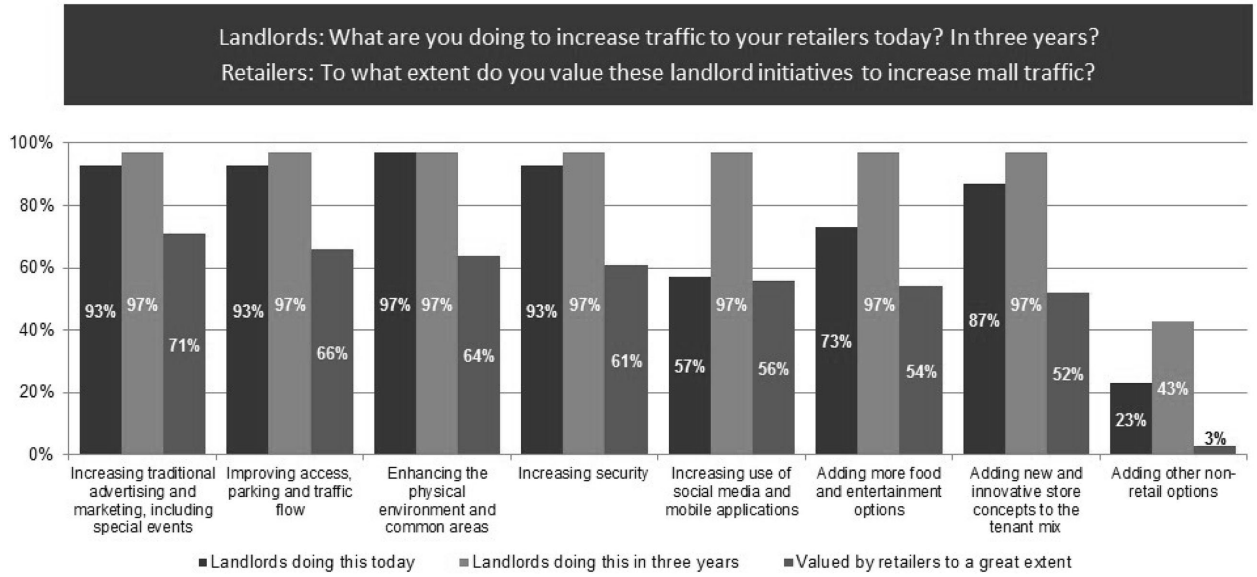
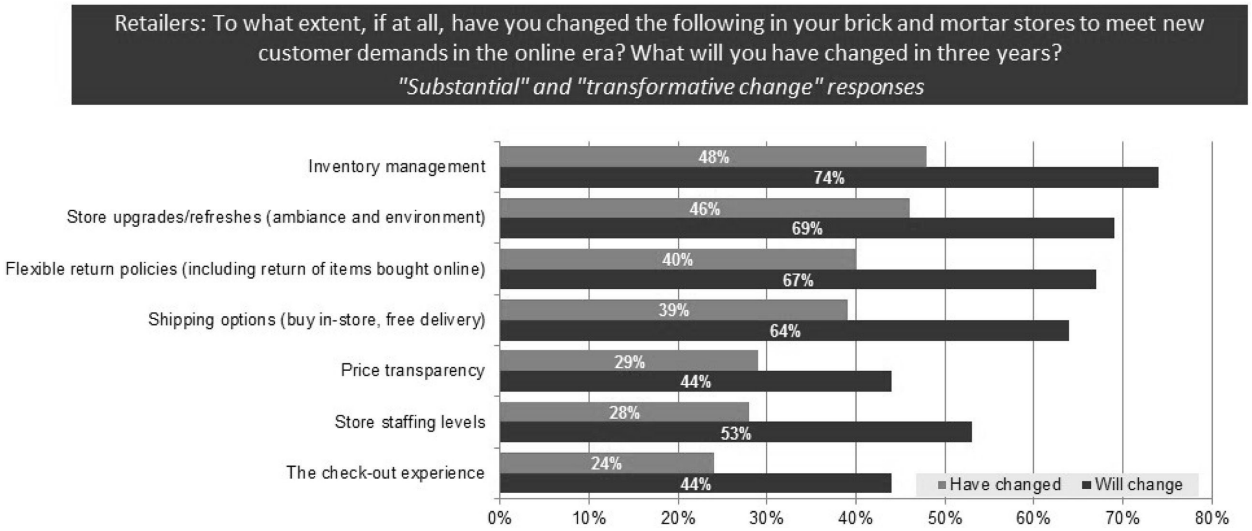


Even so, retailers do not seem to value their landlords' initiatives commensurate with these efforts. For example, only 52 percent of retailers value their landlords' efforts to drive store traffic by adding new and innovative store concepts to the tenant mix, and only three percent of retailers valued their efforts to add other non-retail options.

How are Retailers Embracing an Omnichannel Future?

Not surprisingly, retailers are making changes to enhance their omnichannel business, and most plan to do even more in the next three years.



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Almost half of the retailers, 48 percent, say they have altered store inventory management and nearly three-quarters of them plan to do so in the next three years. A total of 40 percent of retailers have instituted flexible return policies which allow online purchases to be returned to a store, and 67 percent plan to have such policies in place within three years. A growing number, 39 percent, offer delivery of in-store purchases (including free delivery), while 64-percent intend to add this option. In addition, in the next three years, 44 percent of retailers plan to improve both price transparency and the check-out experience, while more than half (53 percent) plan to adjust store staffing levels.

Perhaps, the most important finding to come out of the survey is the mandate for landlords and their retail tenants to develop a better understanding of each other's needs and how the changing nature of retail will affect them both. If this can be accomplished, mall owners and their retail tenants can more purposefully focus on working together to compete with the existential threat posed by retail game-changers such as Amazon and Walmart. This challenge must be met while continuing to find ways to meet evolving customer tastes and demands for new shopping experiences in the years ahead.

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