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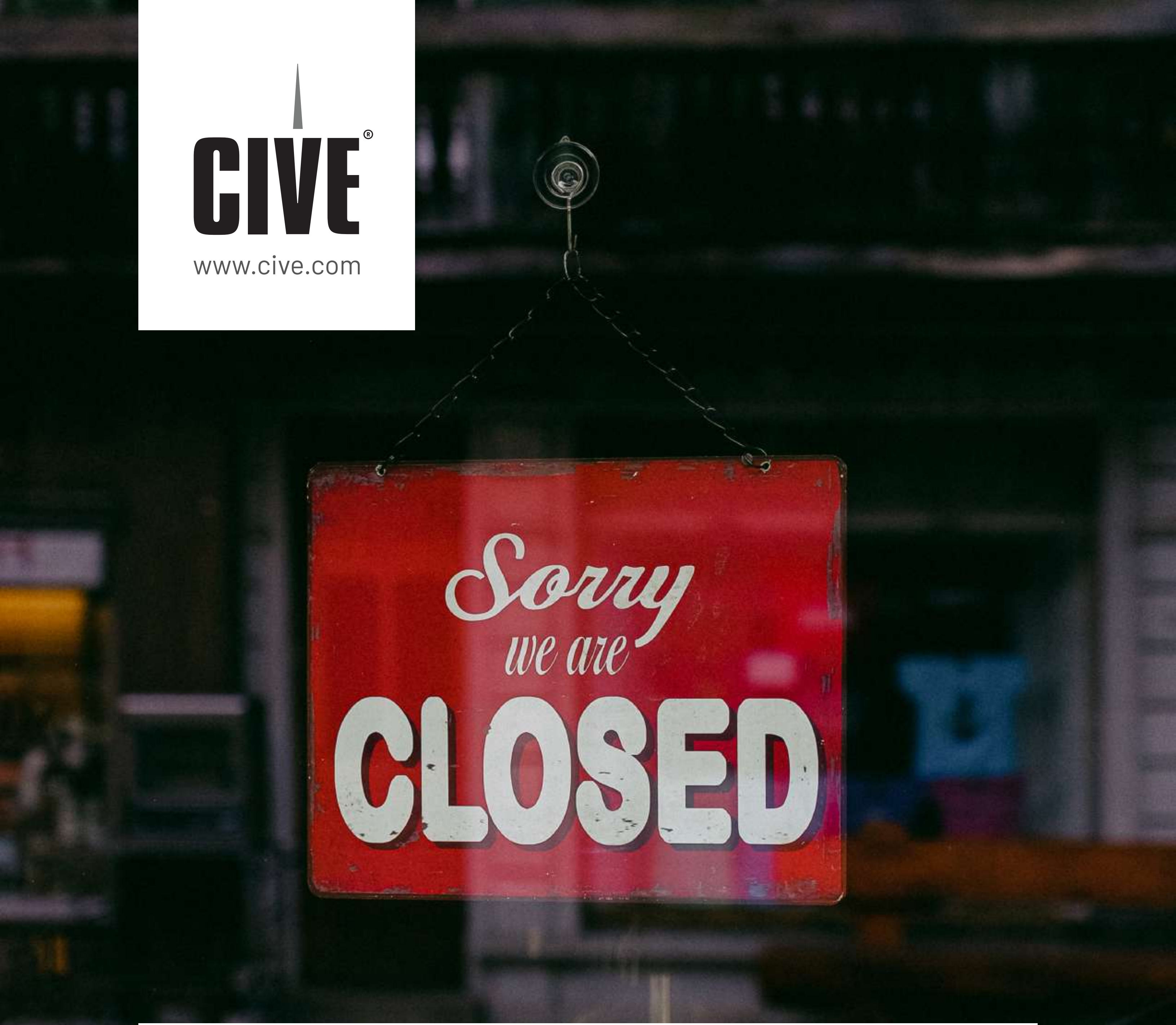

THE FUTURE OF RETAIL

LIFE AFTER THE PANDEMIC

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INTRODUCTION

Within the period of six months, the retail landscape has been dramatically altered. While many are hopeful that things will return to normal just as we left them, the reality is that the future of retail will not be the same.

In the interest of public health and safety, the Centers for Disease Control and Prevention (CDC) has offered ways for businesses to open sooner. Some of these suggestions include checking the temperatures of all employees, seating arrangements should be 6 feet apart, face masks should be worn at all times and plastic shield should be installed for close interactions. In addition, they recommend off-setting work schedules to minimize staff, the removal of communal areas and use single-serve or prepackaged items. While some of these items seem like common sense, others might require a complete redesign of businesses. Most people expect these changes and practices to have a lasting impact on the retail space.

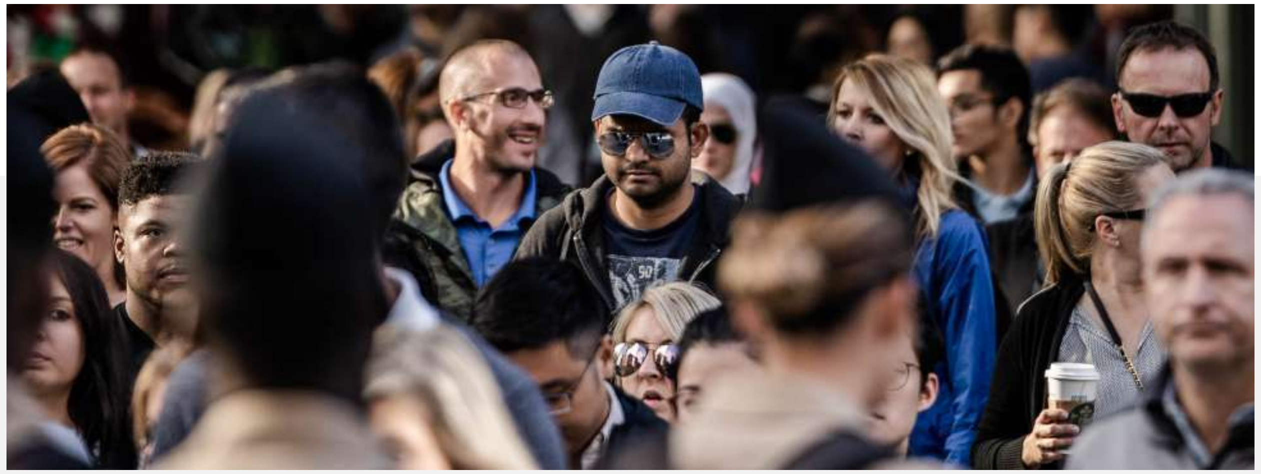
Let's take a look at this once in a lifetime event and how it has changed the future of retail.

RETAIL CONSUMER SENTIMENT

During this unprecedented time in American history, people are starting to go out and try to return to normal. They are once again shopping, visiting restaurants, and spending at retail stores. Overall consumer sentiment is understandably mixed, but the shopping behaviors of this year are becoming more apparent.

According to a May 2020 McKinney & Company report, consumers have conflicting impressions of the economic recovery. 33% of consumers are confident that the economy will rebound in a couple months, 49% are uncertain and expect that the economy will stagnate for the next 6 - 12 months and 18% believe that this pandemic will have longer effects on our economy. Americans are concerned about the economy, public health, and how long the COVID-19 crisis will last. Over 90% of people believe that it will take at least two months before we can return to our normal routines and nearly 70% expect their finances will be impacted.

Throughout the epidemic, people concentrated their spending with larger retailers and established, more familiar brands. After the COVID-19 pandemic has ended, half of the consumers are expected to continue this shopping behavior. This means that bigger retail stores will obtain a larger portion of retail sales and experience continued growth in their market share. When the economy does rev up again, consumers are expected to minimize direct contact and high-traffic areas like going to attend large events like concerts or sporting events, going to the mall, and travel. Digital connections and low contact activities are expected to continue, except for those interactions that are challenging to perform online.



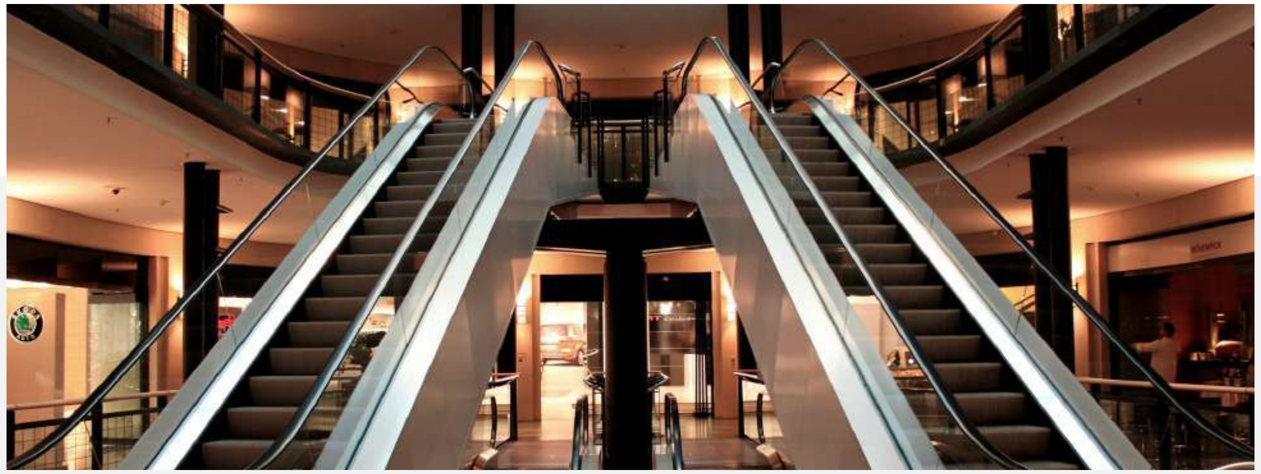
MALL PROPERTIES

With life after the pandemic, malls will be the biggest losers in the retail space. Malls were already in the process of losing stores as consumer demand has shifted away from large apparel operators such as JC Penny, Macys and Nieman Marcus. In addition, being in an enclosed environment with fewer opportunities for social distancing, consumers become apprehensive about visiting a mall any time soon. Their highly visible locations still make them viable, but they will need to transform their purpose and provide other services to the community.

There are several possible ways to repurpose so malls could keep their spaces occupied. The first is to use their buildings for healthcare facilities. Medical services require large amounts of space for all of their different functions and are generally well funded. These businesses also need large amounts of parking too. Another possible idea is to use malls for convention centers and showrooms. Malls can be easily transformed to accommodate conferences, car shows and event spaces. Transitioning malls into housing developments or mixed use space is another possibility that allows mall operators to provide the best use of space.

BIG BOX RETAILERS

The largest beneficiaries of the pandemic are the big box retailers. Target, Walmart, COSTCO and Home Depot all experienced significant increases in same store sales this year. The total combined real estate of the top big box retail stores is over 2 billion square feet! Companies like Walmart are aggressively growing and have stated publicly that they want to double their footprint over the next five years. This is great news for commercial real estate investors with an existing or potential big box retailer as an anchor tenant.



RESTAURANTS

Restaurants and food service make up a large portion of the retail real estate landscape. The pandemic changed the nature of their business for the conceivable future. Restaurants were one of the few businesses to remain open during the COVID-19 crisis, but were forced to significantly alter their operations. During the quarantine, most consumers relied on takeout and delivery services with quick service, fast casual restaurants and drive-thrus benefiting the most.

In addition to the high demand for delivery services, drive-thru services eventually become the most popular option for those opting to visit a restaurant. Drive-thrus offer convenience and a low contact method for service, and can be offered as a pick-up option for online ordering apps. Even though life seems to be getting back to normal, consumers are highly likely to continue social distancing and be wary of dining rooms. Restaurants that operate buffets or self-service food will find lackluster demand for these options.

Restaurant owners and retail real estate operators will need to redesign their space to adapt to the new demands of customers. Some of these changes may include the dining area layouts, adding drive-thrus, designated takeout areas and possibly even the design of their kitchens.

EXERCISE FACILITIES

The exercise and fitness industry was saturated with mid-tier fitness centers before the pandemic hit and was prime for consolidation. In good economic periods, fitness is big business. In 2018, there was $32 billion spent on fitness with a total of 71 million consumers in the United States. Since 2010, the number of workout facilities increased by 24% to 111,000 and was previously expected to be over 120,000 by 2024. However, after the COVID-19 pandemic the age of large exercise facilities has ended.

Consumers are expected to cut back their spending on discretionary items like fitness expenses. Due to the COVID-19 lockdown, many people found other ways to work out while at home, including online or on-demand classes, at-home gyms and exercising outside. The future of the fitness industry will need to be on small studios, fitness boutiques and personal trainers. These businesses will need to provide other products and services, like at home exercise equipment, fitness accessories and on-demand classes to stay competitive.

Fitness center 24 hour Fitness has 430 clubs in 14 states, declared bankruptcy. Fitness centers have a low margin business and typically only charge around $10 a month for their memberships. In most states, gyms are still not allowed to operate and don't have a definitive date when they can open up this year. After being shut down for nearly half of the year, fitness related businesses are not going to be able to cover all of their expenses. The new strict protocols of testing and social distancing will prevent them from the ability to accommodate all of their members. The new requirements of disposable covers, shields, social distancing, and masks is simply too big of a hurdle for large fitness centers to overcome.

BUSINESSES THAT ARE EXPECTED TO SURVIVE AND THRIVE

The financial crisis of 2008-2009, the Great Depression and the 1918 Spanish Flu epidemic all have lessons to impart upon investors who are looking to find companies and industries that have the potential to grow. While each crisis has its own unique components, there are some insights that can be gleaned from examining the businesses and industries that thrived.

One of the most important lessons from the past is diversification. Investors of all types should take the time to make sure they are fully diversified. For real estate investors in particular, they should review the kind of tenants they lease to and the type of structures they own. After the financial crisis of 2008, several prominent commercial real estate companies shifted away from apparel tenants and focused on attracting a higher percentage of tenants offering services and basic goods.

Investors should always have a portfolio allocation of hard assets and real estate is the ultimate hard asset. It is a proven investment that can continue to provide a steady stream of income. While the healthcare industry certainly isn't immune to an economic downturn, small medical clinics, pharmacies like CVS and Walgreens, and other health care related retail have done well and are expected to thrive under these circumstances. Finally, as an escape from their daily lives, people also want to be entertained during an economic downturn. While movie theaters may not work well during this crisis, there are other viable entertainment options for investors to capitalize on.

WHAT DOES THIS MEAN FOR RETAIL INVESTORS?

While the future is uncertain, one thing is clear. The retail commercial real estate landscape has changed significantly over the past year. The economy has dipped and there are certainly bargains to be had in the retail market. Commercial real estate properties are always a great long-term investment and with historically low interest rates, it truly becomes a buyers' market right now. New retail space buyers have more leverage and can lock in cheaper long-term financing.

With the rise of telecommuting, work from home and online services, downtown retailers will be forced to reduce their existing presence or move to other locations. Developers and real estate investors should expect a surge of demand in the suburbs where workers typically live and commute from. Consumers are more likely to shop in their own neighborhood rather than travel longer distances for the goods they want.

For those building owners content with their existing holdings, they should take a look at their existing tenants to see if they need to "reallocate" their mix of businesses. For instance, if they are too heavily reliant upon apparel retailers, consider adding a pharmacy, small medical clinic, or basic goods provider. The ideal retail tenant would be to add a big box retail if they have the space to accommodate a new anchor tenant.

2020 has certainly been a historical year and the future of retail has been altered dramatically after the pandemic.

ABOUT CIVE®

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