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Shifts in the **Retail Industry** Have Changed Commercial Property Needs

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In an ever increasing digital age that fosters a continued surge in e-commerce, traditional trips to brick and mortar store locations are falling to the wayside in favor of the conveniences offered by online shopping.

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Beyond enabling consumers to peruse innumerable products with the click of a button, online retailers are continuing to shrink the waiting period between completing an order and receiving the product, bringing the instant gratification of in store purchases to the e-commerce sphere. Such changes in the retail market are resulting in changing commercial real estate needs, altering the face of both the real estate market and the legal counsel required by clients within it.

Amazon led the charge towards rapid-fire delivery when it began offering free two day shipping to customers who paid a fee for membership in the company's Amazon Prime service starting in 2005. Within the last year Amazon has stepped up their delivery speed offerings, expanding their Amazon Prime service to include Amazon Prime Now, which guarantees delivery of specific items in under an hour of ordering within certain Manhattan zip codes. While Amazon has lead the pack on the fast delivery front, the vast majority of online retailers guarantee delivery within a few days, and almost all offer next day delivery in exchange for increased shipping fees.

Effects of Rapid Delivery

An unavoidable consequence of these rapid delivery times is a growing need for accessible inventory. While traditionally online retailers have maintained warehouses with inventory in predominantly suburban locations, the advent of these speedier delivery guarantees necessitates the availability of warehouse space closer to major metropolises to ensure delivery within these ambitious timeframes. One area where this is particularly well demonstrated is the greater New York metroplex, attractive because of its accessibility to both Manhattan and major shipping ports. Owners of industrial sites in Queens saw their property values rise approximately 60 percent from 2013 to 2014. In the last year, owners of industrial space in the Bronx have inked deals with W.B. Mason, who leased 173,000 square feet for its first distribution center in New York City, and the online food and recipe delivery service Plated signed a deal for 84,000 square feet in Hunts Point. FreshDirect, the online grocer that delivers fresh groceries to your doorstep, is currently in the process of constructing a new 500,000 square foot distribution center in Harlem Yards.

Increasing e-commerce has resulted not only in a higher demand for industrial sites adjacent to major metropolises, but also a decrease in demand for more "traditional" retail storefronts. E-commerce constituted 6.4 percent of all U.S. sales in the second quarter of 2014, with growth in this sector expected to increase to 10.3 percent of all U.S. sales by 2017. Increased preference for online shopping has resulted in a staggering decrease of more traditional storefronts—with traditional open air strip malls taking the hardest hit. Even more traditional shopping malls are seeing a decline, with the website deadmalls.com dedicated exclusively to reporting and documenting abandoned shopping centers. The malls taking the hardest hit are those anchored by "non-luxury" department stores, with companies like Sears closing over 300 locations since 2010. Of the roughly 1,000 malls in the United States, approximately 400 cater to "upper-income" shoppers, and it is these malls that are withstanding the growing pressure from online retailers. Those who study retail habits by consumers are unsurprised by this trend, finding that those making a higher price "luxury" purchase are more inclined to go into a physical store—as the consumer is paying for not just the item they're purchasing, but the experience associated with the purchase.

Even though a great deal of consumers still visit physical store locations, online shopping also influences the behaviors of consumers during in store shopping trips. Many consumers who continue to patronize brick and mortar locations are participating in the phenomenon known as "showrooming," a process by which customers go to physical retail locations to look at products and then go home and actually purchase the items from an online retailer. This phenomenon coupled with a steadily growing number of online retailers eliminating shipping costs is further increasing patronage of online retailers, driving the need for (and price of) industrial property sites up.

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For those clients who own industrial sites and are looking to sell, the market is continuing to heat up. Beyond the opportunities to lease space to companies specializing in online retailing at positive rates, the opportunity to sell such property at a significant profit is also a very attractive one. Within just the last two months, Prologis signed a deal to buy KTR Capital Partners, owner of approximately 70 million square feet of industrial property, for $5.9 billion, the largest real estate deal of the year thus far. Blackstone Group announced in December 2014 that it has agreed to sell IndCor Properties to GIC Pte. Ltd. for $8.1 billion. While Blackstone initially had plans to sell IndCor in an initial public offering, the high demand for industrial site space made IndCor's portfolio of 117 million square feet of industrial space a highly profitable sale.

As the demand for industrial space continues to increase, rates of construction and development of these types of space are also continuing to rise. Such new projects are particularly competitive as the large blocks of space for development are becoming more difficult to find, making new industrial development projects, particularly those near major metropolises and shipping ports, highly coveted. Unlike the traditional shopping center industry, which has seen a significant drop in new construction and development projects, the increasing demand for industrial space spurred by growing reliance on e-commerce has only caused construction and development of industrial sites to increase. Indeed the specialized needs of online retailer companies (specifically customized space for stacking systems and highly advanced HVAC and power systems) will only push the need for more newly developed industrial spaces forward as societal reliance on e-commerce advances.

Clients presently leasing industrial site space who maintain a right of first offer in their lease agreement might find they're priced out of making a bid to purchase the space, as the increasing demand for industrial sites will continue to drive prices up. As online retailers continue to shrink delivery times and consumers participate more exclusively in the realm of e-commerce, the idea that traditional shopping centers will fall extinct in favor of industrial warehouses and customer fulfillment centers is not a far-fetched one. The effects of this shift can be seen both in the legal issues facing the real estate market and viewed online in the photographs of once grand shopping centers left abandoned.