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## Retail real estate strength defies shopping patterns

by Jonathan Gordon & Jessica Munzel

Two of the more pervasive strengths of the Westchester County's retail real estate market remain its population's impressive buying power and the relative supply and demand balance of its inventory of retail properties. Augmenting those factors are the last two years' gains in employment and consumer confidence.

On the negative side, retailers are under great pressure from the internet, and leasing deals, while picking up momentum, remain difficult to bring to the finish line. The opportunities in this market revolve around finding ways to harness changing consumer spending patterns in a market with strict zoning regulations.

**Buying Power.** Westchester's population, just shy of 1 million, includes a high percentage of families, and of Baby Boomers. Population growth is modest, but income levels are exceptional. Westchester's 2013 average household income of \$123,110 is 9% higher than Manhattan's and over 70% higher than that of the entire U.S. (Source: U.S. Census Bureau, ESRI forecasts).

**Remarkable Stability.** In relation to many other markets in the Northeast, Westchester County has remained a remarkably stable retail market. The County's proximity to New York City, affluent population, limited land availability and high construction costs help keep inventory and vacancy levels within a narrow range, even during periods of great volatility nationwide.

Over the last eight years, which includes the entire span from the height of the retail market prior to the Great Recession, to the lows of 2008-2012 and finally to the current quiet rebound, vacancy has varied only between 5.0%-6.2% according to CoStar, an independent commercial real estate research firm. Similarly, CoStar reports total gross leasable retail area in Westchester increasing less than 5% over the same eight-year period, from 47.2 million SF in 2006 to 49.4 million SF at 2Q14.

Market	# Bldgs	Total GLA	Total		YTD Net	Quoted
			Vacancy	Vac. %	Absorp.	Rents NNN
East I-287 Corridor	643	5,662,409	170,918	3.0%	-20,076	\$35.46
North	339	4,465,204	280,295	6.3%	1,762	\$26.28
Northeast	27	229,221	0	0.0%	12,000	---
Northwest	482	5,008,922	449,149	9.0%	-44,419	\$23.05
Southeast	1,369	12,326,024	811,894	6.6%	121,212	\$26.40
Southwest	1,074	11,569,171	559,815	4.8%	2,598	\$29.80
West I-287 Corridor	583	4,938,459	141,798	2.9%	25,199	\$28.88
White Plains CBD	209	5,228,150	275,285	5.3%	-65,515	\$24.69
Totals	4,726	49,427,560	2,689,154	5.4%	32,761	\$26.70

Source: The CoStar Retail Report - Westchester County Retail Market, Mid-Year 2014

While the numbers here have generally been trending positive, and Westchester County has fared far better than much of the U.S. over the last 10 years, several trends in our retail market bear watching closely.

### **Retail – Changed by Technology**

Improved Operations. On the positive side for retailers and developers/investors, technological advances have enabled many retailers to greatly improve their inventory control. Some have also benefited from lower product costs attributable to deflationary pressures in the countries manufacturing their products. The lower cost of goods sold brought about by these factors has provided some retailers the ability to support higher rents without decreasing their profit margin.

Internet Pressures. The rise of the internet is probably the most disruptive development retail has experienced in generations. The most recent data from the U.S. Department of Commerce shows \$70 billion of internet sales during 2Q14, out of total retail sales of \$1,174 billion, representing 6% of total sales. Continued internet sales growth has of course put pressure on the bricks and mortar retailers that comprise the Westchester market. Hard and soft goods retailers have been much harder hit than those uses that can't easily be sent in the mail, such as food, services, medical and recreation. Accordingly, the aforementioned retail categories are expanding the most.

Our recent deals at Admiral are evidence of this trend. Of the 220,000 sq. ft. of transactions our firm has closed to date in 2014, 70% were in food, service, medical or recreation. Likewise, our office is currently representing Salsa Fresca Grill (a growing chain of healthy, fast casual restaurants), Peachwave (a franchisee of upscale frozen yogurt/entertainment provider) and Flywheel Sports Studios (health/lifestyle) to open additional locations in Westchester County.

Sales Tax Disadvantage. Avoidance of sales tax has been an unfair advantage for internet retailers, with the added problem of diminishing the coffers of municipalities who depend on sales tax revenue as a funding source for such services as police and fire protection and EMS services. To support a level playing field for all retailers, our company participates in initiatives spearheaded by the *International Council of Shopping Center's* Government Relations Committee and the *Real Estate Board of New York*. These initiatives educate and lobby City, State and Federal legislators to enact legislation that restores the right for states to enforce sales tax collection by internet retailers.

The Power of Data. As in the larger business environment, decision making by retailers has become much more empirical and less intuitive. Retailers and their site selection teams want to be shown detailed demographics to assess the viability of potential sites, supported by hard data.

### **Consumers Rebound & Redirect \$**

Higher Confidence, Better Bonuses. Consumer confidence has rebounded significantly, and is now at its highest level since the Great Recession. As a bedroom community for those working in New York City, Westchester's overall economic health is intricately tied to the FIRE (Finance, Insurance and Real Estate) industries. These industries were at the epicenter of the subprime financial crisis, and FIRE employment and salaries suffered accordingly. Subsequent improvements in the stock market and residential real estate markets have fortified employment in these industries, also affording bigger bonuses and most important to the retail sector, higher discretionary income.

Changing Spending Patterns. The aging and retirement of the Baby Boomers – a large and wealthy demographic - has amplified the transformation in bricks and mortar spending triggered by internet sales. Spending is shifting away from hard and soft goods and to food uses, entertainment, and services. Similarly, medical and health-related uses are also on the rise, which is tied not only to the aging and retirement of the Baby Boomers, but also to the still evolving effects of The Affordable Care Act. Two leases (totaling around 12,000 sq. ft.) recently brokered by our company were with large medical users with strong credit. These types of tenants have the added benefit of bringing significant pedestrian traffic and consumer dollars to neighboring retailers.

### **Bridging Market Gaps**

Adjusted Rents. Over the last year, the gap between landlords' and prospective tenants' rent expectations has diminished, facilitating the leasing process. Although Westchester County's vacancy rate has been quite stable, quoted rents have shown a more significant change, ranging from a high of \$30.76 per sq. ft. NNN in 2006 to a low of \$25.86 per sq. ft. NNN in 2010, according to CoStar - a spread of just under 20% (although that percentage would be lower if comparing total rent costs including NNN reimbursements). In 2011, quoted NNN rents averaged \$26.42 per sq. ft., and have remained relatively flat through 2Q14.

Tougher Deals. Paradoxically, while more leasing deals get past the Letter of Intent stage, they have been more difficult to close. A greater number of negotiations seem to be getting mired in legal nuances and obscure what-if scenarios. Moreover, e-mail and texting from small screens has made business (and personal) communications copious, rushed and at times less courteous, which can quickly undermine the trust upon which the negotiation process is predicated. Neither e-mail nor texting has the benefit of face-to-face discussion, which is more likely to help foster mutual understanding. Also, as the Westchester retail market continues its transition from a tenant's market to a more balanced market, a potential stumbling block in negotiations is tenants' and landlords' misaligned expectations about what terms are truly representative of the current market standard.

Strong Investor Demand. On a positive note, an indication of confidence in the long-term prospects of the Westchester retail market is the pent-up investor demand for Westchester retail real estate. Our firm, primarily a seller's agent, has assembled a continually updated database of current owners and active buyers with significant capital ready to invest in retail properties within our market. As the specter of an increased interest rate environment looms, these buyers are hoping to capitalize on the window of opportunity afforded by today's artificially low interest rates.

### **New Shopping Centers Planned**

Tenant mixes in new centers reflect consumer demand in the market, often showcasing large, upmarket grocery-anchored centers with service, food-use, medical and recreation tenants to complement soft goods retail.

The largest recent retail development in Westchester County, 1.3 million sq. ft. Ridge Hill in Yonkers, was completed in 2011 and is finishing its absorption in the market. 53,000 sq. ft. Armonk Square just opened its doors last quarter; DeCicco's is the anchor tenant.

Upcoming approved and proposed developments in the County include:

Name	Town	Size	Retail Anchors
Chappaqua Crossing <i>(proposed)</i>	Chappaqua	120,000 SF	Whole Foods
Rivertown Square	Dobbs Ferry	113,500 SF	Mrs. Greens, Sundance Movie Theater
Boulevard <i>(proposed)</i>	White Plains	230,000 SF	In entitlement period
Keystone Square	White Plains	45,000 SF	N/A
Metropolitan Plaza	White Plains	30,000 SF	Chipotle, Planet Fitness
Target (Stand Alone)	Yonkers	135,000	Target

Big box retailers such as Target strive to find ways to expand in the Westchester market, but limited land availability, high construction costs and community opposition have constrained their growth. These category-killers draw huge numbers of people to an area, but by definition drain retail demand from neighboring markets.

### Location, Location, Location

The Westchester County retail market is very local. Shopping centers have a very different set of dynamics from Main Street retail, and the relative health of any retail has to do with the forces affecting its specific location and the municipality in which it is located, particularly for the downtown areas.

Zoning Codes. Most zoning codes favor soft goods retail because it is perceived as having the least impact on parking. However, increased consumer spending on services and food uses have changed the ideal retail mix necessary to maintain vibrant shopping areas. Going forward, retailers and consumers will favor those municipalities which are willing to expand their zoning codes to adapt to the changing retail environment.

Parking. Parking remains a key issue for many downtown areas. Increasing parking inventory near shopping areas is the most obvious, and most difficult, solution. More manageable ways to minimize real and perceived parking friction is by making retail streets one-way, or using less onerous parking rules and enforcement (e.g. free weekends).

Pulling from Manhattan. Manhattan retail rents have quadrupled in some areas in the last five years. Westchester County can be a less expensive way for New York City retailers to reach their customers, reinforcing their brand in areas where their patrons live, as well as gaining access to the larger population which does not work in Manhattan but has similar spending habits.

### Stability + Opportunity

In summary, technology-driven changes have created more uncertainty in the retail environment. While increased consumer confidence and spending power has improved overall sales, internet retail and demographic trends have directed bricks and mortar retail growth toward food, service, medical and entertainment uses.

Tenant and landlord rent expectations are not as far apart as they were two or three years ago, but deals are taking longer to get done. Municipalities that are best able to formulate zoning codes and approval processes that address the changing retail environment will offer the best opportunities for both tenants and landlords.

It is the nature of retail real estate that each space needs to be assessed on an individual basis. However, at its core, the Westchester County retail market provides a remarkably stable foundation on which creative tenants and investors can take advantage of the depth of buying power in the market.