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Commercial property

Luxury Retailers Beat a Retreat From 'Vanity' Real Estate

By *Anna Nicolaou and Judith Evans in London*

High rents and consumer shift to online spurs upmarket brands to review store portfolios

Ralph Lauren is closing its flagship Polo store on Fifth Avenue / Reuters

Manhattan's Bleecker Street has seen better days. Boosted by a frothy investment market and booming tourism as New York recovered from the Lehman crisis, retail rents on the main drag of Greenwich Village had soared over the past five years. But in recent months upmarket retailers, facing steeper losses to online shopping and ever pricier rents, have shut their stores.

The departure of luxury brands including Marc Jacobs, Jimmy Choo and Ralph Lauren, which helped transform Bleecker Street from a bohemian centre to a high-end shopping paradise, has left two or three vacant shops on each block.

“The pioneers that made that street are pulling back . . . it really casts a shadow,” says Faith Consolo, chairwoman of the retail leasing and sales division at real estate firm Douglas Elliman. “I haven’t seen a cycle like this before.”

Similar trends are emerging along the priciest shopping corridors in the US, including Robertson Boulevard in Los Angeles and the design district in Miami, as retailers pull back from “vanity” real estate. They have been deterred partly by what had been runaway rental growth — as much as 50 per cent in five years, according to Cushman & Wakefield, the property consultancy.

But beyond the cyclical patterns of real estate, there is also a structural shift, analysts say, as online sales draw retailers’ focus away from prestigious store sites. While before a presence on a glitzy street was deemed a necessary marketing expense, some luxury retailers are now rethinking their footprint to adapt to a new kind of shopper that prefers browsing the internet from the sofa.

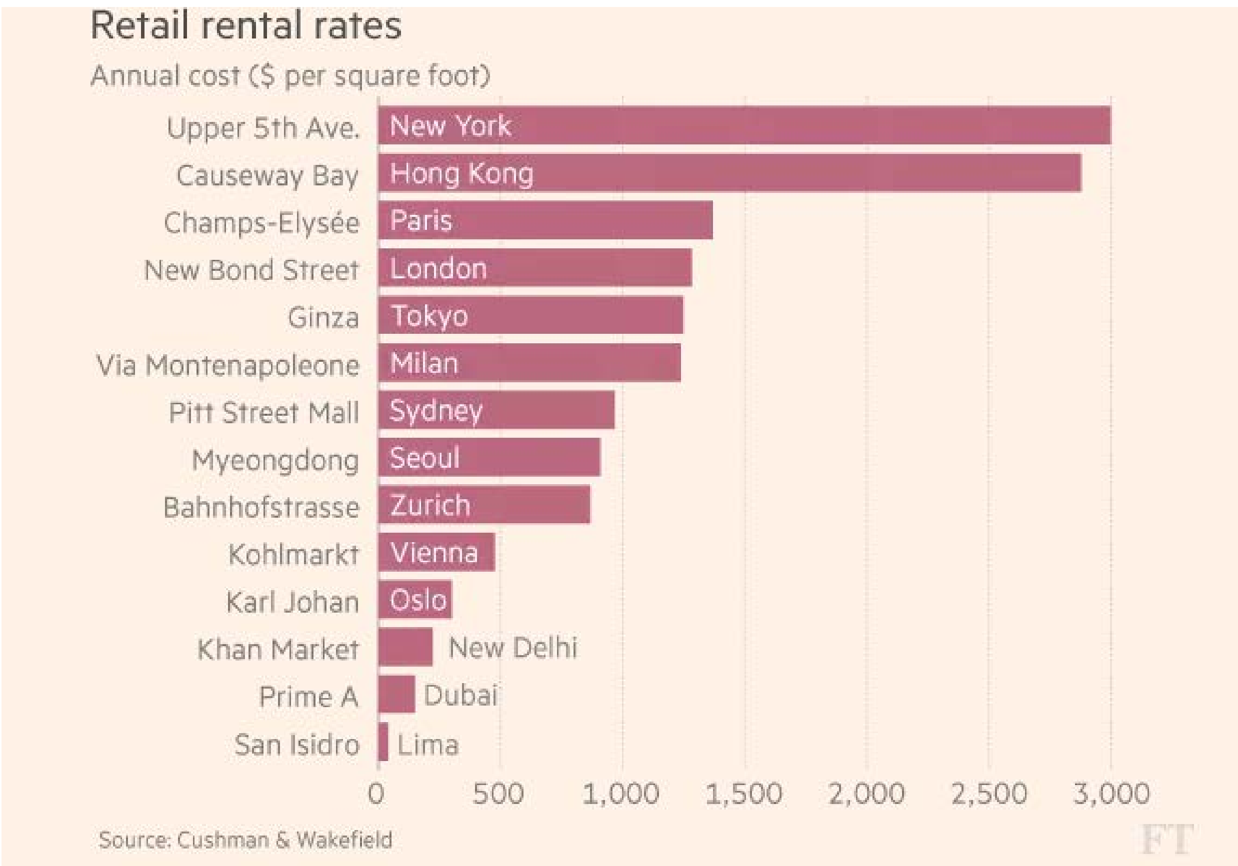
The Amazon factor is hurting retailers’ margins “so they are spending more on their own ecommerce platforms rather than bricks-and-mortar divisions”, says Ihor Dusaniwsky, head of research at S3 Partners, a financial analytics firm.

Meanwhile, although consumer confidence surveys appear positive, sales growth overall has dropped. The signs of weakness are leading some landlords to offload properties. On New York’s Fifth Avenue, the world's most expensive shopping street, vacancy rates have jumped from 10 per cent a year ago to 16 per cent, according to Cushman & Wakefield. Rents there have fallen for the first time since the recession "and the trend is not over", the consultancy warns. Vacancy rates across SoHo have climbed to 18 per cent, from 12 per cent a year ago, according to Jones Lang LaSalle.

The newfound caution among retailers has had a "very significant and fast" negative impact on retail property, says Chris Conlon, chief executive of Acadia Realty, a real estate investment trust.

It is not just prestigious streets that have been hit. Malls are also hurting, as chains from Sears to Macy's shut hundreds of stores. Analysts at Green Street Advisors argue that "low growth is the new normal", while market rents are becoming decoupled from tenants' revenue growth as more sales move online.

"[Rents] are at a price point now that exceeds what retail sales can perform," says Spencer Levy, global head of research for CBRE. He notes that a stronger US dollar also hurts sales in New York, where deep-pocketed foreigners historically flock for deals.



Investors have caught the gloomy mood: shares in US retail Reits have tumbled by almost 25 per cent since their peak last August, according to Dow Jones, compared with an 11 per cent decline across all Reits. Capital values in the private markets have yet to mirror that shift, but listed shares often act as a bellwether.

Meanwhile, hedge funds are building up significant short positions against retail players. Short interest against international retail Reits has more than doubled to $12.5bn since November, according to data from S3 Partners. Of this, $1.5bn of short positions are held against Simon Properties, the US's largest retail Reit. "Looking back over several years, this is the first time I have seen [short interest] at over $10bn in aggregate," says Mr Dusaniwsky of S3 Partners.

The nervousness is also affecting non-listed groups. Thor Equities, the private equity real estate firm, is seeking to sell three Fifth Avenue properties bought between 2007 and 2011 after failing to find tenants for much of the space, risking an inability to generate income to pay off loans attached to the properties. "If you want big tenants . . . there aren't that many that want that size footprint any more," says Jedd Nero, principal at real estate broker Avison Young.

Thor "did not get the numbers they wanted" and is now looking to lease out the spaces, says someone familiar with the company's thinking. "Landlords take a little while to face reality," the person adds.

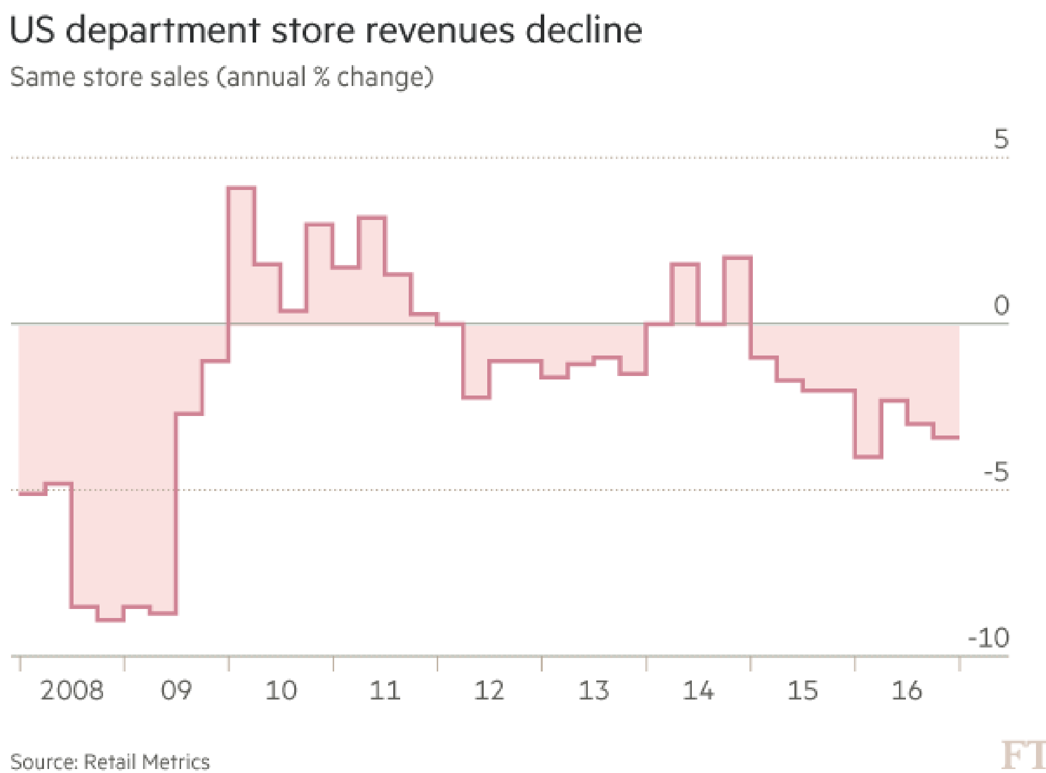
Bleecker Street in Greenwich Village, c1965 / Getty

One of the properties, a 19-storey office and retail building at 590 Fifth Avenue, has had its asking price cut from $170m last year to $150m, according to Bill Shanahan, a broker at CBRE who is selling the property. Plans to convert it into a flagship retail space failed to tempt a tenant.

Analysts and brokers say that landlords have been slow to adapt their leasing strategies despite an overhang of supply, leading to "very lengthy" deal negotiations, according to Cushman & Wakefield.

Mr. Conlon of Acadia Realty says: "If you bought in SoHo or Fifth Avenue in 2015 and you underwrote that real estate to capture that kind of growth, then it's kind of like musical chairs: the music stops and you're probably disappointed today."

As rents continue to slip, some landlords and tenants are beginning to meet in the middle, says Patrick Smith, vice-chairman of JLL's retail brokerage, who predicts that "by the end of this year you're going to see more transactions". However, most retailers are staying on the sidelines for now, says Mr Nero: "No one wants to catch a falling knife."



While there are some pockets of excessive lending in the market — Green Street says, for example, that Reits owning less desirable "B" and "C" grade malls are "carrying too much debt and are ill-equipped for a sizeable decline in asset values" — more prudent lending since the 2008 crisis should help to limit potential distress.

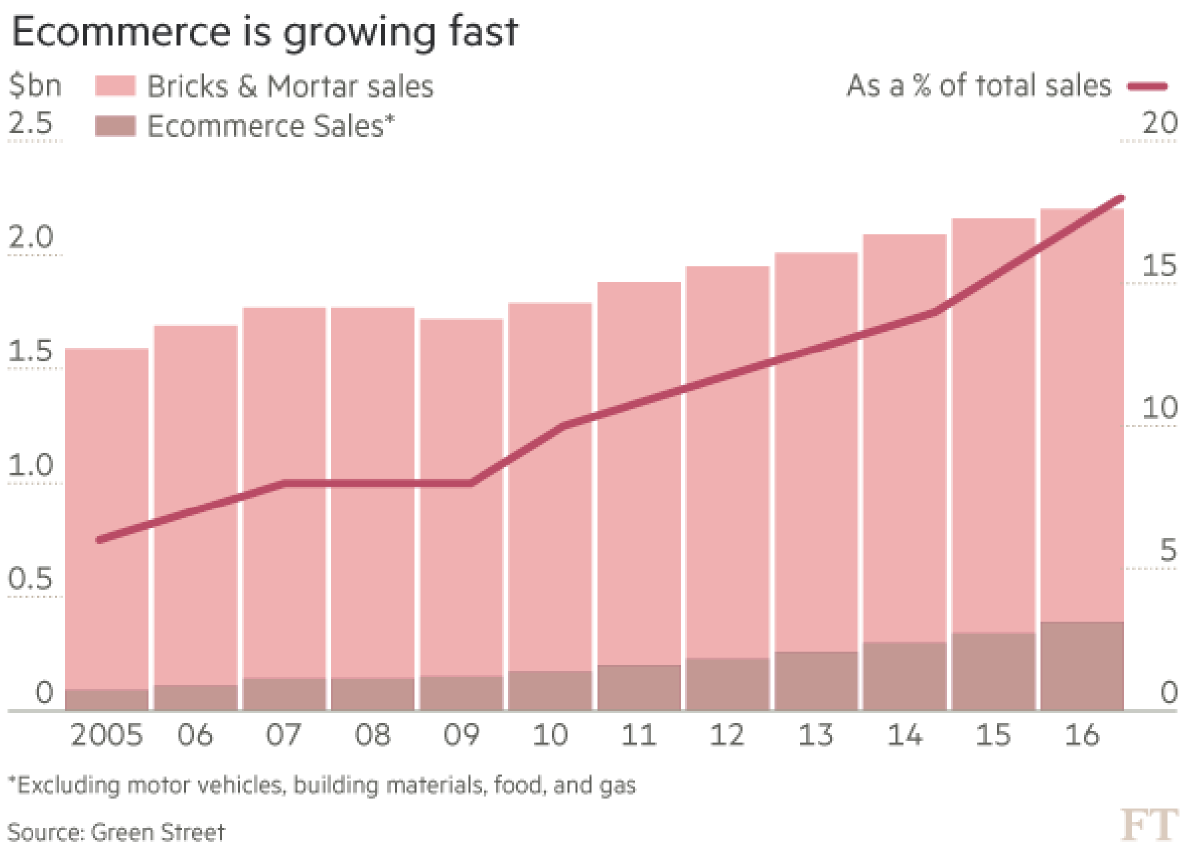
However, the structural shift towards ecommerce looks likely to have some way to run. Green Street estimates that about 20 per cent of sales for "mall-like products" such as clothing have shifted online; that is forecast to rise above 30 per cent in the next five years.

Other prime retail sites may also have to confront this shift.

Rents in Hong Kong's Causeway Bay are weakening and on Paris's Champs-Élysées they were flat over the past year, according to Cushman & Wakefield, though downturns in tourism were bigger factors than online sales.

In New York, it is difficult to gauge how long the current correction will last because there have been few deals to draw upon, says Mr Conlon. For spaces in SoHo that were renting for $1,000 per square foot at the peak, rents have dropped by as much as 20 per cent. "We're in the middle [of the correction]. Retailers are saying: I'm not sure what I should pay, so I'm going to wait." He says Acadia is preparing to buy in these markets because he predicts they will be distressed.

"You're seeing a seismic shift in retail, and you'll continue to see consolidation as tenants that can't figure it out go out of business," says Mr Nero of Avison Young. "It's not the way it was in the past 100 years, where you put a product on the shelf and everyone comes in."



Food eats up bigger share of US shopping centres While upmarket names are cutting back, one bright spot for landlords has been a different type of shopping experience: food.

Food halls featuring trendy restaurants and fast casual outlets have become a staple of New York's new retail property developments. "Le District", a 30,000 sq ft food market, is the centrepiece of Brookfield Place, a luxury shopping centre that opened two years ago in Manhattan's financial district. Eataly, an Italian food emporium, has leased 48,000 sq ft at the World Trade Center's new Oculus shopping mall.

Landlords have been keen to lure food tenants, which usually take on longer leases than other retailers, to meet demand from on-the-go urban shoppers, says Faith Consolo, chairwoman of Douglas Elliman's retail leasing and sales division. "It's like we spit them out," she says. "The food experience is what made these new developments . . . it is a creative time in retailing."

Food now takes up about 9 per cent of space in US shopping centers, nearly double that of a decade ago, and is projected to rise to 20 per cent in some markets by 2025, according to a report by JLL. The brokerage expects the number of food halls in the US to increase from 140 this year to 200 by 2019. Food "can now act as an anchor", according to the International Council of Shopping Centers.

"As demand for traditional merchandise space abates, demand for food service space appears insatiable." A well-stocked food hall can draw shoppers, particularly millennials, who look to spend money on experiences; food has the added benefit of being "internet resistant", according to analysts at Green Street Advisors.

"Convenience used to be a bad word. Today it's a much better word, and a big part of that is food," says Robert Burke, founder of luxury brand consultancy Robert Burke Associates. "The right food and the right entertainment are now the key components of a shopping center."