Takeaways from the ICSC New York Breakfast Program

The Fung Global Retail & Technology team attended the International Council of Shopping Centers (ICSC) New York Breakfast event this week, where a panel of three real estate business leaders spoke about the retail real estate industry. Key takeaways included:

1) Excess retail vacancies are leading to more conservative and location-based deal making.
2) The supermarket of the future will be smaller, have fewer SKUs and offer a narrower product assortment.
3) Retail lenders are cautious right now, which could impact new businesses and small companies.

The Fung Global Retail & Technology team attended the ICSC New York Breakfast event this week, where a panel of three real estate business leaders spoke about the retail real estate industry. The speakers discussed the retail real estate situation in various geographies as well as the retail climate and its impact on their business models. The panel also discussed Amazon's recent announcement that it would acquire Whole Foods Market and theorized about what the acquisition could mean for the grocery space and real estate in general.

The discussion was moderated by Mitch Salmon, Managing Director of Garrison Investment Group, and the panel participants were:

- Andrew Mainardi, III, President, Mainardi Management
- Bob Carson, EVP, Levin Management
- Daniel Taub, President, DLC Management

Deborah Weinswig, Managing Director, Fung Global Retail & Technology
deborahweinswig@fung1937.com US: 917.655.6790 HK: 852.6119.1779 CN: 86.186.1420.3016

Key takeaways from the event include:

1) Excess retail vacancies are leading to more conservative and location-based deal making.

Moderator Mitch Salmon asked the panelists how they are managing one of the industry's biggest challenges, excess inventory. DLC Management's Daniel Taub responded, "We are sorely underdemolished." Total direct per-capita construction is a fraction of what it has been over the past 20 years, and most of the new development is concentrated in the Southeast, according to Taub. He added that the failing malls should never have been built.

Source: Fung Global Retail & Technology

Location is a crucial component of any deal, particularly with regard to excess inventory. A lot of the "underdemolished" properties Taub referred to are in more remote locations, and they are generally C and D properties. Bob Carson's firm, Levin Management, manages properties in outlying areas such as Erie, Pennsylvania, and Hickory, North Carolina. Carson highlighted that these locations were suffering even before the recession hit. He emphasized that the deals that his firm structures with tenants in these areas would be difficult to achieve in major metropolitan areas because they may be below the market value due to location. He said that, sometimes, you have to look for alternative uses for space if you cannot make a deal that works.

Andrew Mainardi said that the excess inventory issue has caused his firm to become more conservative in how it finances deals, so that when the company loses a tenant, it may hurt, but it will not kill the firm.

Although repurposing malls for alternate uses is a popular idea, Salmon emphasized that firms must take into account the total cost of the project, including the asset's idle time, taxes on the property and all of the considerations regarding renovation of the total square footage of the space.

Deborah Weinswig, Managing Director, Fung Global Retail & Technology
deborahweinswig@fung1937.com US: 917.655.6790 HK: 852.6119.1779 CN: 86.186.1420.3016

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2) **The supermarket of the future will be smaller, have fewer SKUs and offer a narrower product assortment.**
   Last week's announcement by Amazon that it was acquiring Whole Foods was a big topic of discussion at the breakfast event, as was the potential implications of the acquisition for the grocery sector. Taub highlighted that the food sector has been disrupted over the past three to five years. Consumers are shopping for groceries differently, he noted, and subscription companies such as Blue Apron have entered the market, along with many more quick-service restaurants, food halls and smaller-format grocery stores. The Amazon-Whole Foods deal is another disruption and one that Taub noted is a validation of brick-and-mortar's importance and a positive for retail.

   The three panelists theorized about the future implications of the deal with regard to grocery store size and format and the grocery tiers that will feel the impact. Mainardi estimated that supermarket footprints will shrink from 60,000 square feet to 50,000 square feet in five years, and then to 40,000 square feet in 10 years. Carson agreed, and projected that grocery retail will have a smaller footprint overall, similar to those of Aldi and Lidl, with fewer SKUs and narrower product ranges. The panel briefly touched on large-format grocery stores, such as the new, 124,000-square-foot Kroger in Texas. One panelist opined that stores that big will replace part of their shelf space with center-store space devoted to experiences.

   The panelists highlighted that the grocery sector is continuing to evolve as consumers' shopping habits shift, and noted that, in five years, the sector will be dramatically different. The panelists predict that the five-year time frame will vary somewhat based on geography, as consumers in middle America may change their habits a bit more slowly than consumers in major metropolitan areas.

3) **Retail lenders are cautious right now, which could impact new businesses and small companies.**
   The panelists shared their observations on the local, regional and national markets, and discussed the state of retail lending and the available liquidity in the market. Mainardi said that banks have been more resistant to lending to retailers and that they are reducing the length of their terms. He added that insurance companies are also cutting back on their exposure to retail. Taub seconded the point, saying that lenders are more cautious, but he noted that plenty of lenders are still investing in multiple deals right now.

   The panel noted that the environment is more challenging for new retailers trying to establish a foothold in the industry than it was prior to the recession, and that they must explain their retail story in much more detail now. However, Taub highlighted that there is no roadblock to getting a deal done. The other panelists concurred, saying that building relationships with lenders is critical for securing deals and that understanding the submarket in which an asset is located is very important. Carson said that it is essential to talk to local tenants and townspeople in order to gain insight into what the next development project may be. The other panelists agreed that talking to local tenants and residents had helped them learn a great deal about potential tenants. Salmon jokingly said, "You haven't done your homework until you've been kicked out of a mall for asking too many questions."

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Deborah Weinswig, CPA
Managing Director
Fung Global Retail & Technology
New York: 917.655.6790
Hong Kong: 852.6119.1779
China: 86.186.1420.3016
deborahweinswig@fung1937.com

Erin Schmidt
Research Associate

Hong Kong:
8th Floor, LiFung Tower
888 Cheung Sha Wan Road, Kowloon
Hong Kong
Tel: 852 2300 4406

London:
242–246 Marylebone Road
London, NW1 6JQ
United Kingdom
Tel: 44 (0)20 7616 8988

New York:
1359 Broadway, 18th Floor
New York, NY 10018
Tel: 646 839 7017

FungGlobalRetailTech.com