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WILL RETAIL IN 2017 BE "TRUMPED"?

By Gary Glick

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While there has been some concern about the Trump Administration's onslaught of executive orders in the first months after taking office, the retail market believes the Administration's policies will mean good things for the retail industry, and benefit developers, investors and retailers. By Gary Glick

Since the Great Recession, the U.S. economy has slowly but steadily improved. This continued to be the case in 2016. For most of the year, the yield on the 10-year Treasury remained at historic lows, the economy continued to add jobs, unemployment dropped below 5 percent, real gross domestic product growth settled in at about 2 percent, energy prices remained exceptionally low and the stock market reached historic highs.

Despite all of these positive factors, commercial real estate continues to face some hurdles.

The Changing Retail Landscape

The wild card for the economy-at-large and for commercial real estate is the "Trump Factor." On the one hand, the Trump Factor could be very positive for the economy: President Donald Trump has plans for significant infrastructure spending, tax reform (including significant tax cuts for corporations, which could result in off-shore jobs returning to the U.S.), and the rolling back of regulations that impede lending and business growth.

However, the Trump Factor could "spook" business as a result of the president's unpredictability and increasing evidence of a tendency to "flip-flop" on policy. It appears that business generally views the Trump Factor positively, as evidenced by the way the stock market has reacted since the election and the unexpected run-up in the 10-year Treasury rate of about 1 percent.

Despite dire predictions for retail sales and shopping centers in 2016 due to the prolific rise of internet shopping, retailers and retail developers continue to evolve quickly to attract customers; most are attempting to add Amazon-proof uses to their shopping centers. For example, restaurants and fast casual dining have replaced many of the tenants traditionally found at shopping centers.

Movie theaters have made a major comeback, offering enhanced amenities such as fully reclining seats and high-end food and alcohol. “Experiential” is the buzzword for retail developers: Create an enhanced experience at shopping centers to attract consumers away from their homes because, even with high-speed internet and large-screen high definition TV in their homes, people still crave interaction with others in communal environments that provide entertainment and unique shopping experiences.

Since the recession, high-end retail and off-price retail have done extremely well. It is everything in the middle that has suffered, particularly big box category killers (whose offerings can be found as easily or more easily on Amazon) and non-high-end department stores such as Macy’s, Kohl’s and Sears. Many of these retailers have made strides to attract consumers to their stores or internet portals. They have down-sized, matched Amazon prices, offered better in-store experiences and service, and provided omni-channel options between their own internet sites and stores, with in-store or fast home deliveries.

Retail Predictions for 2017

Taking into account all of the above factors, Cox Castle Nicholson, in this year’s annual retail forecast, predicts 2017 will be another good year for most sectors of the retail real estate market, and we expect capital will continue to be available for retail investment sales and borrowing, albeit at a slightly higher cost above the historic lows of the last few years.

However, new shopping center construction likely will continue to be largely stagnant in 2017 due to anemic new home building in undeveloped and suburban markets. Retail development likely will continue to be driven mostly by the repositioning of poorly performing regional malls, the renovation of existing retail centers, new in-fill development (often paired with a multi-family component), and some new ground-up construction in robust economic pockets such as Silicon Valley.

We also expect that foreign investment will rank as the highest source of available capital for real estate in 2017. The demand for U.S. real estate among foreign capital providers stems largely from geopolitical uncertainties, including the economic downturns in Greece and China and the Brexit vote.

Many foreign investors still view U.S. investment as the best opportunity for safe growth, as do many domestic investors struggling to obtain returns in other investments comparable to the rates of return on commercial real estate. Because of cap rate compression and demand, much of this capital is now flowing into secondary and tertiary markets with the expectation of higher returns.

Despite the uncertainty of the Trump Factor, the U.S. continues to remain the “gold standard” for real estate investment. Considering the expectation of a continuation of a low interest rate environment (even with the prospect of gradual increases), low unemployment, low energy prices and a robust U.S. stock market, over the short term we continue to believe that the U.S. economy will outperform other developed markets, thereby continuing to provide an environment for significant capital to find its way to retail real estate investors and borrowers in 2017.

Gary Glick, a partner at Cox Castle Nicholson, specializes in shopping center development and retail leasing, representing both developers and retailers.