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Why Now Could Be the Best Time for Digitally Native Brands to Take On Brick and Mortar

By Samantha McDonald



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As the COVID-19 health crisis took hold in the United States, many retailers sought to rightsize their brick-and-mortar fleets and permanently shutter underperforming stores — many of them now located in major metropolitan cities and other once-prime areas in the country. With an increasing number of empty storefronts up for grabs and retail rents skidding to historic lows, some insiders suggest now might be the time for digitally native and smaller brands to go into expansion mode.

According to Moody's Analytics, the pandemic has taken a significant toll on the U.S. brick-and-mortar landscape. The retail sector is projected to incur its largest drop in effective rents on record, declining by 7.5% this year — surpassing the last big drop of 3.7% in 2009, which was immediately after the Great Recession.

What's more, retail property vacancies were also forecasted to reach a historic level of 12.6% in 2021 and are not expected to return to pre-COVID-19 rates until 2027. However, more availability and lower rents could create favorable circumstances for new retailers and brands with ample resources to negotiate tenancies with landlords in some of the country's most highly trafficked (pre-COVID) shopping neighborhoods.

"Now, there are unprecedented opportunities for retailers," said Jon Spadafino, an associate and analyst at SRS Real Estate Partners. "Across the board, you're seeing rents down [as well as] different structures of leases. Landlords are taking so many different strategies because it's just such a tenant's market. So it's a long way of saying, yes, if you're a tenant that's in position to open stores or want to plant a flag in the big markets, then now is the time to do that."

Filling vacancies

In recent months, department stores like JCPenney, Nordstrom and Macy's, as well as Tapestry Inc.-owned Kate Spade, Columbia Sportswear Co. and Ascena Retail Group Inc.'s Justice, have altogether closed thousands of doors. Some of them — such as Asics Corp. and Gap Inc. — even shut down their flagship locations, as shopping corridors once flushed with tourists and locals are seeing record-low foot traffic levels.

Experts have predicted that the exodus from larger spaces will continue simply because of the higher costs of leasing locations that span tens or hundreds of thousands of square feet. However, even relatively smaller (albeit not necessarily less expensive) destinations have seen an uptick in vacancy signs, which have given way for smaller and more online-centric brands to take root.

Last week, for instance, [Taft Clothing](#), which launched as a direct-to-consumer men's shoe label back in 2013, opened up a boutique in Dallas' trendy West Village district. Then, over the weekend, made-to-order footwear brand Adelante made its foray into brick and mortar in its home city of Boston. Next week, Loeffler Randall will debut its inaugural brick-and-mortar outpost in New York City's posh SoHo neighborhood.

"If you think about how many people are walking through these locations, where there can be eyeballs on the product and engagement with the brand, that provides tremendous value in and of itself," said Ethan Chernofsky, VP of marketing at Placer.ai. "The value of offline retail is as important, if not more important, than it's ever been — but it's not going to be about having a thousand stores. We're going to see a much more diversified mix, with big companies and direct-to-consumer brands, and that's what's really exciting."

He added, "This [expansion] provides brands with really serious advantages. They provide consumers with really serious advantages. And they provide the [landlords] themselves with really serious advantages. This creates a very powerful potential win-win-win that could transform the face of retail."

Moving to the suburbs

Among the other changes brought about by the COVID-19 outbreak is a seemingly broader migration to the suburbs. With office employees working from home and coronavirus-related travel restrictions remaining in place, many Americans are either hunkering down inside their homes in the suburbs — or are flocking from major cities to such neighborhoods. And where the consumers go, the retailers — if they're smart — will follow.

In Simon Property Group Inc.'s fourth-quarter earnings call last week, CEO David Simon posited that the American suburbia is poised for a comeback. He explained that the mall giant's shopping complexes are already seeing signs of a rebound in states like Texas and Florida.

"I do feel very strongly that the high-quality suburbs are going to be where the action is in the future," Simon told analysts. "I'm telling you the suburbs are going to be hot. And our quality real estate is going to be where the action is for those well-located suburban centers of commerce, and that's going to be the big change coming out of the pandemic."

As they make their way to the suburbs, many big-name retailers and brands are inevitably leaving sizable holes in city centers. However, some experts suggest that, as coronavirus vaccines continue to roll out and people feel more comfortable congregating at public spaces, consumers could drift back to metropolitan areas, where smaller and digitally native retailers that are able to negotiate lengthier-than-usual leases with landlords could stand to benefit in the long run.

"It's important for retailers to closely monitor demographic trends and shifting economic patterns in response to the COVID-19 pandemic, but the value of individual locations and strategies may depend on each retailer's individual circumstances," said Stephanie Cegielski, VP of PR at the International Council of Shopping Centers. "Choosing the right site is a complicated process; what works for one may not work for another — and while suburban spaces may seem especially valuable right now, foot traffic and spending in cities could rebound quickly after the pandemic has eased."

She added, "What's especially important for retailers is to ensure that they have a physical and digital presence that meets the needs of the modern consumer."

Why retailers and brands still need brick and mortar

Even as COVID-19 continues to accelerate the adoption of e-commerce, experts remain adamant that brick and mortar is here to stay. Instead of simply merchandising products and transacting sales, however, the purpose of physical stores has evolved. And businesses — including smaller and online-first brands — have had to reimagine these spaces as they work to leverage both their physical and digital arms.

According to the ICSC, new store openings drive an average increase of 45% in web traffic for emerging brands, which are defined as those less than 10 years old. The opposite is also true: The organization found that web traffic drops off when retailers close stores — in one case declining up to 77%.

"Omnichannel is the buzzword for the next decade — and without the connection to the customer created via actual encounters, in addition to social and the realms of data accessible to brands now, an important touch point is lost," said Annette Healey, EVP with CBRE's New York Tri-State Region Retail Brokerage Services Group.

Although there has been a continued push for brands and retailers to expand their digital capabilities, the ICSC reported that 60% of companies believe foot traffic will return to pre-COVID levels over the next year or two. The winners, say experts, will not necessarily be the big players; instead, it's the brands and retailers that not only can maintain an engaging brick-and-mortar presence, but also are able to see their stores as multipurpose — whether for buy online, pickup in-store fulfillment; as package return centers; an experiential destination; or a combination of all.

"We anticipate the convergence of physical locations along with omnichannel offerings will continue to grow, especially when it comes to retailers being able to quickly fulfill online orders," Cegielski added. "Overall, our data shows when retailers are able to maintain both a physical and digital presence, they're more likely to succeed."

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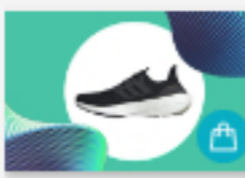
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