

November 15, 2016

Small Retailers Face Threats at Every Turn

Sky high rents and Amazon top a long list of hurdles in the battle for survival



NEW YORK—Small retail stores across the country are facing unprecedented pressures that go beyond the normal ebb and flow.

High rents have finally cracked a crop of retailers that had adapted and weathered the intrusion of the internet and chain stores thus far—think shoe stores, fabric stores, electronics stores.

“Most of them made many adjustments and continued to thrive in their neighborhood,” said Ruth Messinger, former New York City council member and small business advocate.

“Then they got hit by a rent increase that they just couldn’t afford.”

The impact is not only devastating to the character of communities, but it weakens the economic fabric and guts the middle class, experts say.

The losses are being felt in cities nationally and globally.

“In cities as diverse as Oakland and Nashville, Milwaukee and Portland, Maine, retail rents have shot up by double-digit percentages over the last year alone,” according to an April report by the nonprofit Institute for Local Self-Reliance (ILSR).

And if those pressures weren’t enough, consider the behemoth that is taking a bite from every pie—Amazon.

“Amazon is also different in that throughout human history, commerce has been connected to place. Business activity and trade have always been near where people live,” said Stacy Mitchell, co-director of ILSR. “Amazon represents a disconnection of commerce from place that’s unlike anything that’s come before.”

While consumers might be hailing Amazon as a super-convenient retail option, the online giant is the number one concern for 70 percent of independent retail business owners, according to a national survey conducted by the ILSR earlier this year. Amazon’s net sales revenue grew from \$8.49 billion in 2005 to \$107 billion in 2015.

Why Losing Independent Retailers Matters

Mitchell said the nation has lost more than 100,000 independent retailers in the last 15 years, and the trend is concerning.

“Independent retailers contribute much more to the health of our local economy and communities than chain stores or Amazon do,” she said. “Studies have shown that for every dollar that you spend in a locally owned business, that dollar creates two to three times as much economic impact than if you spend it at a national chain.”

The hollowing out of the middle class in America can be partially attributed to the decline in small businesses.

“Places with a lot of local businesses have a big, robust middle class, they have more opportunities for people to move into the middle class, so you don’t see quite as much of that growing inequality,” Mitchell said.

In a 2015 study, “Wage Inequality and Firm Growth,” researchers crunched data from 1981 to 2010 on wages and the size of firms in 15 countries. The authors found a strong relationship between growth in the average firm size and rising levels of income inequality, particularly in the United States and the U.K.



Jeremiah Moss, who writes the blog Vanishing New York under that pseudonym, is part of a grassroots group called #SaveNYC. The group’s website and Facebook page bring attention to the plight of mom-

and-pop businesses, and encourage state and city governments to protect small businesses and cultural institutions.

“When we lose small businesses, we lose the local character of our neighborhoods and New York becomes a generic city,” Moss said in an email. “We lose the social connections that small business people provide. And we lose money. Chain stores take money out of the neighborhood, funneling it back to the corporate headquarters in Texas or Florida or Wisconsin or wherever. None of this is good for the city.”

High Rents in New York City

Alex Cohen, a broker with commercial real estate firm Core, said the 2008 economic downturn had a dramatic impact on retail, but that was cyclical. Because of a drop off in consumer demand, many retailers had to slash their prices and many went out of business. Now, it is different.

“This is a new phenomena,” Cohen said. “We’re not in a down part of the cycle right now, the economy is very strong. New York continues to be a strong tourism market.”



Cohen said the vacancy rate in SoHo has gone from 10 to 20 percent over the last 18 months. “That is driven by the strength of e-commerce, the preferences of people to purchase online ... and the challenges that retailers have faced maintaining profitable stores with very high rents.”

Cohen said he is starting to work with more retail brands that want to lease space short-term for a pop-up store, to test the market before being locked in geographically and timewise.

Moss is calling the death of the city’s small businesses a “mass extinction event” and holds chain stores responsible.

“The city has never in its history been decimated by national chain stores,” he said. “We see the same global corporate-tourist monoculture destroying regional character in London, Paris, Venice. We see it in San Francisco, Seattle, Boston.”

And the displacement of local businesses isn’t confined to trendy or affluent neighborhoods, the April ILSR report found.

In New York City, the Bronx has seen the biggest jump in court-ordered evictions of small businesses, and over the last year it also experienced the largest percentage increase (3.3 percent) in the number of chains, the report stated.

A Boston Market is replacing local business Zaro's Bakery, which was given just a few weeks' notice that its lease would not be renewed, ILSR said.

In Washington Heights, several long-standing businesses have been evicted or handed hefty rent increases. The Dominican grocery store Liberato Foods reportedly faced a tripling of its rent, according to a February Village Voice article.

Several factors are to blame for the rent increases, said ILSR, including soaring commercial real estate prices; the increasing popularity of cities; the growth-imperative of national chains; a limited and declining supply of small spaces; and a preference for national companies over independent businesses in commercial real estate financing.

Not a Level Playing Field

Small business advocates are fighting an uphill battle against the powerful real estate industry and local politicians, who are reluctant to introduce anything with teeth.

One bill designed to help small businesses with lease renewal, the Small Business Jobs Survival Act (SBJSA), was introduced to the New York City Council by Messinger in 1983. It has been re-introduced continuously since, in slightly varied iterations, but has never made it as far as a hearing or vote. The bill would give store owners the right to renew their lease, the right to negotiate fair lease renewal terms, and the right to legal protections against unfair renewal terms.

It currently has 27 sponsors—a majority—with some notable exceptions. Robert Cornegy, chair of the city council small business committee, has not sponsored the SBJSA and says red tape is the real issue for small retailers. As a council member, Melissa Mark-Viverito endorsed the 2008 version of the bill, but as speaker she has blocked it from a hearing and vote. And John Banks, head of the Real Estate Board of New York, called the SBJSA unconstitutional, according to a Village Voice report in February.

There are many ways in which government policy tilts the playing field against small retailers, said Mitchell.

Amazon, for example, opened three data centers in Ohio last month, which created 125 jobs. The project received state incentives to the tune of an estimated \$81 million over 15 years, including \$77 million for the sales-tax exemption and \$4 million for payroll tax credits—which works out to \$648,000 per job—according to a 2015 Bloomberg report.

"Independent retailers never get anything like that. They go to city hall and say, 'I want to open a second location, will you give me a big tax break?' and they'll be laughed out the door and told, 'This is a free market, you've got to learn to compete,'" Mitchell said.

The current lease negotiation process allows landlords free rein to set the price, terms, and time frame of a lease. Some store owners have even been given until the end of the month to vacate the space they're leasing. Increasingly, shop owners operate under leases that run for five years or less, down from a once-standard 10 years, leaving them vulnerable to rent hikes and eviction, according to a 2009 report by the Pratt Center, a nonprofit focused on equitable neighborhoods in New York.

Landlords sometimes keep storefronts empty in hopes of landing a higher-paying tenant such as a chain store, which are often considered more creditworthy. And for landlords with multiple properties, an empty store may be helpful for accounting purposes, by allowing them to write off losses.

“When a building-owner wanted to land a rich tenant like a bank, they would warehouse their smaller ground floor commercial units until they could make a huge combined space for one large tenant,” Manhattan Borough President Gale Brewer said at a city council hearing on small businesses, on Sept. 30.

“Big banks and drug stores were pushing to establish themselves in my district to the detriment of the mom-and-pop stores. The bank didn’t need the space to do business; they wanted the commercial frontage for advertising,” Brewer said.



Zoning Changes, Commercial Tax

In her role as city council member on the Upper West Side, Brewer helped create a special zoning district that restricted the amount of frontage a bank could have on the street to 25 feet. Along parts of Columbus and Amsterdam avenues, any building with 50 feet of frontage or more needs to have at least two commercial units within that frontage (supermarkets are exempt).

“This is the closest the city has come to enshrining the classic New York commercial street environment into zoning text,” Brewer said.

Brewer is now pushing to introduce a penalty for landlords who hold their storefronts vacant, as well as a registry of vacant storefronts similar to other cities. A 2014 proposal in Berkeley, California, looks to charge landlords \$180 to register a vacant storefront and \$300 for every six months it remains vacant. The District of Columbia implemented a similar fee in 2011.

Brewer, along with council member Corey Johnson, is also drafting a bill that would exempt small owner-operator street-level businesses and supermarkets from Manhattan’s commercial rent tax. The rent tax is a city charge of 3.9 percent of annual gross revenue applied to businesses below 96th Street with annualized rents above \$250,000.

Formula Retail

San Francisco introduced a formula retail (chain store) strategy to some areas in 2005 to help retain unique community character—and the policy is being watched closely by other cities.

The strategy limits formula retail stores with multiple locations and a recognizable “look” or appearance—such as restaurants and chain stores—in certain areas.

The policy has significantly limited the entry of chain stores into the controlled areas. In a 2013 study, the San Francisco Planning Department found that formula retail businesses occupied 24 percent of the commercial space in controlled areas, while uncontrolled areas had 53 percent occupancy—almost double.

The number of formula retail establishments within control zones is 10 percent, whereas it’s 25 percent without the zoning.

As of 2009, there were 15 cities nationwide that had formula retail restrictions in place.

New Development Requirements

Many cities can require new mixed-use developments to include affordable housing—but policies that require developers or landlords to provide space at below-market prices obviously impact the overall financials of the development.

To offset the cost of including affordable housing, developers sometimes rely on the revenues from ground-floor retail spaces, which means they generally favor larger spaces and chain stores.

But now, cities might also require developers to set aside smaller retail spaces in new developments.

Consumers

Public education is an important aspect for small-business advocates—consumers can effect change with their wallets.

“We’ve certainly seen positive impacts from the buy local movement,” Mitchell said.

Small Business Saturday, the day after Black Friday, was launched in 2010 to encourage support for small, local businesses—and an estimated \$14.3 billion was spent on that day in 2014. Cyber Monday sales paled in comparison at \$3.07 billion in 2015, according to data by Adobe Digital Index.

A good sign for small retailers, but it’s not enough, Mitchell said.

“The challenge right now is for independent businesses and for community advocates to gently remind people that that choice has huge implications for the place they live in.”

Retail Lease Hikes Around the Country*

(*percent change from 2015 to 2016)

Small retailers are facing higher rents across the country. For comparison, over the last year, median per capita income rose 1 percent and retail sales grew just 1 percent, while inflation was 0 percent.

Upper West Side, New York

\$390 per square foot
Up 37 percent

Portland, Maine

\$18 per square foot
Up 22 percent

Oakland, California

\$27 per square foot
Up 16 percent

Cleveland, Ohio

\$14 per square foot
Up 12 percent

Austin, Texas

\$20 per square foot
Up 10 percent