Special Otten Johnson Alert: Coping with Crisis and Thinking About the Future (From Our Home Offices)

As our communities, nation, and world reel from the impact of the COVID-19 public health crisis, Otten Johnson extends our sincere gratitude to all of the health care providers, first responders, public health leaders, and others who are serving those who are sick and at risk. Since we are business lawyers without the skills or expertise to provide medical care, our contributions to resolving this crisis are largely relegated to working from home to avoid spreading disease and offering financial contributions to worthy organizations supporting our community. But because we cannot help but think of this crisis through the lens of our land use, real estate, and business practices, we are bringing our clients and friends this series of alerts, exploring how the current pandemic affects our work, what we're learning from it, and what the future holds.

Part 7 – What Does the Pandemic Mean for the Retail Apocalypse?

April 9, 2020 • Jim Johnson

For the seventh alert in our series, we explore what the COVID-19 outbreak means for the already-struggling retail sector and those that rely on retail sales as an economic lifeblood.

Entering 2020, uncertainty characterized the retail sector due in part to the impact of tariffs on costs and supply chain reliability. Consumer spending in December 2019 had unexpectedly plunged 1.2 percent, when economists expected a much more mild dip in the range of 0.2 percent. Economists were lowering their expectations for GDP growth, and the country was bracing for a slowdown and potentially a recession.

In fact, brick-and-mortar retailers had been struggling for some time, with 81 major retail bankruptcies occurring since 2015. Nationally, retail consultants characterized 2019 as a "time of transition," with some stability in the very top tier retailers. Lower tier players were trying to remain relevant by attempting to understand what consumers want. To successfully compete in 2020, consultants were advising retailers to invest in technology and focus on customer convenience. Such advice would turn out to be particularly prescient.

At the beginning of 2020 in Colorado, things were a bit more upbeat. Retail spending was increasing based largely on the strength of the local economy and sustained white-collar job growth. Retailers like Amazon and others were announcing and preparing for an increased presence along the Front Range. Vacancy rates in Denver hovered around five percent – good by national standards. By all appearances, the retail sector in Denver was well positioned to grow through 2020 and perhaps beyond.

Such was the retail climate before the virus hit.

Retail sales are critical to the US economy. Core retail sales (excluding auto and gasoline sales) make up one-half of personal consumption, which in turn, comprises 70% of GDP. When already-struggling, brick-and-mortar retailers close in response to the coronavirus (between 50 and 100 retailers are closed), it places additional pressure on those businesses due to lack of sales, on GDP growth directly due to a lack of spending, and on future spending due to job losses and to the uncertain duration of store closures. It's a triple whammy.

Just as significantly, lack of sales tax revenue profoundly affects the ability of local governments in Colorado to provide services. Sales tax revenue is the engine driving municipal budgets in Colorado. In Denver, the finance department budgeted almost $800 million in sales tax revenue for 2020, almost half of the city's overall budget. Many other Front Range municipalities rely on sales tax revenues for much more than half of their overall revenues. Any significant decrease in retail taxes goes straight to the bottom line.

Denver's Chief Financial Officer is currently estimating a decrease of only about 5.3 percent or $40 million in sales tax revue as a result of coronavirus-related closures, compared to the 9.2 percent drop Denver experienced during the 2008 recession. One reason for this distinction, perhaps, is, unlike then, Denver now levies sales taxes not only on transactions occurring within the physical stores located within its municipal boundaries, but also on those sales made online to customers located in Denver. This change may help reduce the impact the coronavirus has on Denver's budget this year and perhaps usher in a new pattern of development.

Because of the outsize impact of retail sales on municipal budgets, many Colorado municipalities have historically favored retail over residential development. Many elected officials view residential development, despite paying for all of the public infrastructure required to construct it, as not paying its own way and a net drain on municipal coffers. But, if municipalities could comfortably rely on retail sales to generate dependable sales tax revenue, they might be inclined to approve more and higher density residential developments that alleviate the current affordability crisis. The current increased move to online retail, and local governments' ability to tax that activity, may provide such reliability, as risk is spread geographically. And although the current crisis is unlikely to spawn a wholesale change in municipal revenue structure, municipalities may need to consider whether changes in retail necessitate a reconsideration of the primacy of sales tax revenue in their budgets.

The transition to online retailers has been well underway for some time. As Deloitte suggested in its 2020 retail forecast—before the impact of the coronavirus was beginning to be understood—retailers must invest in technology, embrace online sales, and make the experience more convenient for the consumer. With the social distancing measures currently in place across the country, many families have fully embraced online retail. Those who have not previously used online shopping, even for groceries, are flocking to them now. The transition to more online shopping was underway, and the coronavirus has greatly accelerated and expanded it, and it seems unlikely that online shopping habits formed during this pandemic will quickly revert to pre-existing routines.

The present crisis presents an opportunity to consider and plan for the impacts a majority-online shopping climate will have on retail, and all commercial and residential development patterns, as well as infrastructure use and design. As local government planning departments slow down, the current crisis presents an opportunity to consider and implement changes to zoning codes and budget strategies that will encourage thoughtful and forward-thinking retail development.

Jim's Tip

I am getting into a new, home routine so the days don't run together. I am embracing the positives to be gained from isolation with my family. Family time = Stress relief.

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