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Retail Continues to Shift as California Reopens

RETAIL CONTINUES TO SHIFT AS CALIFORNIA REOPENS

For some shopping center landlords, new concepts and renovations hold the key to future success. For others, bringing in more of what customers like is the answer. In either case, oftentimes lease negotiations are as creative as the retail transformations.

By Nellie Day

The past year has brought about challenges, closures and, most of all, change to the state's brick and mortar landscape. Now, as the world begins to move past the pandemic, shopping center owners must assess where the damage — and opportunities — lie.

First, the bad news. COVID-19 precautions accelerated the downfall of many retailers and stores that were struggling before the pandemic. It also sped up the adoption of online shopping as many California consumers were left with little choice in a restriction heavy state. The result is vacant storefronts, ranging from grotesquely large department store spaces to restaurants that just couldn't survive without diners.

In January, Coresight predicted 10,000 U.S. stores could close this year, a 14 percent increase from 2020 closures. Retailers that are able to hang on a bit longer should hopefully see brighter days as California loosens its restrictions. Gov. Newsom has said he plans to "fully reopen" California on June 15 if COVID trends hold steady.

"There is a subdued but growing optimism that most retail formats in good locations will come back nicely due to the pent up demand in the marketplace," says Jim Terrell, principal at B. Riley Real Estate, an affiliate of Los Angeles based B. Riley Financial. "That said, retail continues to endure margin compression and permanent shopping shifts to the internet. The U.S. is still overstored per capita, and we expect to continue to see retail space coming back to market, particularly in the department store segment."

Tawa Supermarket is opening its new hybrid concept for 99 Ranch Market at Westfield Oakridge Mall in San Jose in late summer. This will be 99 Ranch Market's first new concept store to open in California and its first site inside a mall.

Greeting A New Consumer

Though California's broad reopening is good news, shopping center owners and retailers undoubtedly have questions about what — and who — awaits the new retail environment. After all, they have vacancies to fill and, in many ways, a new consumer to welcome back — an oxymoron in and of itself.

The Allen Matkins/UCLA Anderson Forecast Commercial Real Estate Survey for winter 2021 notes that retailers are not only dealing with a shopper who has gotten used to the internet, but one who has re-evaluated their household income over the past 15 months.

"Increases in the savings rate on the part of households in response to the recession portends less individual consumption," the survey explains. "To be sure, some activities will be coming back, particularly personal services and experiential retail."

Taiwanese American grocer 99 Ranch Market is one retailer trying to cater to the new consumer by providing an experiential atmosphere. The Buena Park-based chain created a hybrid concept that is part grocery store and part dining destination, with enhanced in store and takeout options, new interior designs and convenient services like curbside pickup. This new concept will open at Westfield Oakridge Mall in San Jose in late summer.

"One of the challenges for grocers is to know how the store can offer an experience that enriches customers' shopping experiences," says Jill Lin, marketing and creative manager for Tawa Supermarket, which owns 99 Ranch Market. "If we can adopt an innovative concept to the business that makes shopping more of an experience, why not?"

The Oakridge location will be 99 Ranch Market's first new concept store to open in California and its first site inside a mall. The new concept will be situated in the mall's northwest corridor, which has undergone a reinvention as of late.

A former Sears space is now occupied by Living Spaces, while a Sears Auto Center has new life as a Sleep Number. 99 Ranch Market will occupy a space between Living Spaces and Macy's that previously served as in line retail for mall tenants that were relocated to accommodate the new store.

Though Lin notes the hybrid concept won't be integrated into existing stores due to limited space, the grocer is looking to expand, diversify and target prime locations, which may include shopping centers, if they offer the right mix of tenants.

The new 99 Ranch Market concept will be part grocery store and part dining destination, with enhanced in-store and takeout options, new interior designs and convenient services like curbside pickup.

"We will continue…to try to gain prime locations in cities and suburbs, ample space for parking that could boost ecommerce development and deliver a great experience to customers," she continues. "Being near synergistic retailers is always an advantage as you can join forces to drive traffic and sales. We believe the established foot traffic and synergies from surrounding stores, the movie theater (Century 20 Oakridge and XD) and restaurants in Westfield Oakridge will be beneficial for our business."


URW is bringing non-traditional tenants like fertility and family building clinic KindBody to Westfield Century City as the shopping center owner looks to cater to consumers' daily needs.

Colin Shaughnessy, executive vice president of U.S. leasing for URW, which owns Westfield Oakridge, expects to see this type of reinvention continue as shopping center owners look to lure customers back to the stores.

"We are seeing an abundance of innovative uses from ghost kitchens, dynamic food halls, street food concepts to fresh food marketplaces," he notes. "Our customers crave new and seamless experiences that cater to their daily needs."

With that in mind, URW is bringing a number of new and non traditional tenants to its centers. This includes Lucid, an electric car showroom, at Westfield Valley Fair in Santa Clara, as well as fertility and family building clinic KindBody and co-working facility BumoWork at Westfield Century City.

Adding More Of What Works

While diversification is always integral to retail, Ivan Gold, of counsel at Allen Matkins in San Francisco, adds that a few well known categories and brands are still on the hunt for vacant spaces.

"Big box discount retailers like TJ Maxx, HomeGoods, Ross and Burlington, and dollar stores like Dollar Tree, Dollar General and Family Dollar, will continue to open new stores," he says.

These expansions make sense, as they accommodate the treasure hunter and bargain consumers that have become cost conscious since the pandemic. John Shaefer, executive vice president of JLL in San Rafael, has seen these expansions as well, along with a few surprises.

"One category I didn't expect to see expand are fitness users based on current occupancy restrictions," he says. "Crunch, 24 Hour Fitness, LA Fitness and independent fitness operators have all been on the hunt over the past few months."

Crunch opened its newest location, a 37,000 square foot facility on the corner of Capitol Avenue and McKee Road in San Jose in March. Other franchises, including OrangeTheory Fitness and Club Pilates, have remained active, opening new U.S. locations throughout the pandemic.

"Retailers like grocers, fitness and big box are out there, and they want to be in these shopping centers," says Stephen Logan, vice president of development for Merlone Geier in San Diego. "What landlords have to do is put together a place that has a long future. Shopping centers need to be an area for the community."

Playing the long game often involves a little reimagination. For Merlone Geier's Northgate Mall in San Rafael, this meant converting an indoor mall into a mixed-use, open air shopping experience. Phase I of the transformation includes removing the 250,000 square foot mall's interior roof to give each retailer exterior access. The rest of the interior mall will be converted to outdoor facing retail with a couple of larger boxes.

"As we've watched everything open up throughout the pandemic, we've

Lucid has opened an electric car showroom at Westfield Valley Fair in Santa Clara as URW reinvents its shopping centers through a mix of traditional and non-traditional retailers that create new and seamless experiences for customers.

seen that exterior access is huge," Logan says. "Not only because it's what retailers want, but having a space where you have to enter from the interior of a mall is frowned upon."

Merlone Geier also plans to renovate and expand the current Century movie theater to include an Imax theater, add more retail, restaurant and outdoor spaces and create 896 apartment units where a Sears building currently stands. The vacant space had been partially occupied by an RH outlet — and was slated to become a Costco — until a community survey revealed residents favored larger changes to the shopping center, which included a housing aspect.

Merlone Geier is transforming Northgate Mall in San Rafael into a mixed-use, open-air shopping experience. Phase I includes removing the 250,000-square-foot mall's interior roof to give each retailer exterior access. Phase II may include up to 460 more apartments, additional revamped retail and open-air community spaces.

"When COVID hit, we realized we had to look at the mall, our capital situation and our revitalization plans differently," Logan explains. "We decided adding housing and updating the retail was a great way to move forward on a long term basis."

Stephen Logan
Vice President of Development
Merlone Geier

The first phase of redevelopment is scheduled to get underway in 2024. A second, longer term plan that extends to 2040 may include up to 460 more apartments, additional revamped retail and open air community spaces. This plan, however, is contingent on Macy's and Kohl's vacating the center — something Logan can't predict but wants to keep his eye on.

"We don't know what's going to happen with Kohl's and Macy's," he continues. "But history has shown us that though these two are great tenants and anchors, their stores just don't need to be that big. They're starting to realize they can be more efficient in smaller boxes. When you look at where the industry is moving, it's moving to smaller format stores."

Colin Shaughnessy
Executive Vice President of U.S. Leasing
URW

That may be true for department stores, but other categories are expanding in select markets, as Shaughnessy can attest. URW was trying to figure out how to backfill an old Sears location at Westfield Topanga in the Los Angeles submarket of Canoga Park, which is undergoing a transformation. The new iteration, set to debut in 2022, will contain an entirely new 18,000 square foot retail district, chef driven food hall, lounges and cocktail bars, and interior and exterior boutiques, among other features.

It will also receive a new anchor, Hermès.

"Originally, we planned to have Hermes located within the luxury precinct inside the center, but as we shared our vision for the redevelopment with their team, those plans shifted to give Hermès an anchor position in the Sears transformation project that would enable better connections with their customers and an opportunity to create their own identity within the expansion," Shaughnessy says. "We are about identifying the right space that meets the needs of the retailer within the respective market."

Anticipating The Future

With many transformation projects underway and certain retail categories expanding, California shopping center landlords seem to have a fairly healthy grasp on the COVID related vacancies so far. Unfortunately, one industry's fallout is just now getting underway.

"The theater business is the wild card," Terrell says. "Theater operators have generally had a very good grasp as to the demand in their markets, but the key question is whether the consumer will come back with all the various entertainment options available. Movie business challenges have been compounded by a lack of product and instability in the distribution network, which could mean a longer recovery is ahead for this sector."

The pain is already being felt as companies like Los Angeles-based Decurion Corp. announce they won't reopen Pacific Theatres and ArcLight Cinemas locations. ArcLight has seven California locations, including famous destinations like the Pacific Cinerama Dome on Sunset Boulevard and ArcLight Hollywood.

Pacific and ArcLight also served as anchors at some of Southern California's most noteworthy shopping centers. They led tenant rosters at the Grove in Los Angeles, Americana at Brand in Glendale, Santa Monica Place in Santa Monica and Paseo Colorado in Pasadena, among others.

The famous Pacific Cinerama Dome on Sunset Boulevard in Hollywood will not reopen according to its owner, Decurion Corp. The theater business has been hit particularly hard by COVID-19 and state restrictions.

For top centers with creative landlords, Terrell doesn't necessarily see these impending vacancies as a huge deal.

"Real estate developers are creative by nature and good real estate is still a product in demand," he notes. "We have seen theaters converted into churches, music venues, restaurants, bookstores and even hardware stores. With the growth of distilleries, operations associated with cannabis, ghost kitchens, e-gaming locations, and other new and exciting concepts, good real estate will not have an issue getting redeveloped."

Decurion Corp. owns Pacific Theatres and ArcLight Cinemas, neither of which are set to reopen following the pandemic. This includes the Pacific Theatres at the Grove in Los Angeles.

Still, if a new tenant or use doesn't materialize, creativity may come at a price for landlords with less than stellar demand.

"The conversion of theaters to other types of retail is expensive and typically counts for a considerable portion of GLA [gross leasable area] in malls and regional centers," Shaefer says. "Landlords will be forced to make significant financial decisions related to this subject."

Landlords may also be forced to make significant financial decisions if they want to attract tenants to lingering spaces of any size, notes Scott Y. Stuart, CEO of Turnaround Management Association, an organization that focuses on corporate restructuring, renewal and corporate health.

Scott Y. Stuart
CEO
Turnaround Management Association

"It's a buyer's market for retailers, and landlords are going to have to be both creative and gracious if they are going to succeed in filling commercial space," he says. "The balance of bargaining power has shifted in retail, creating optionality for retailers given how commercial property owners are struggling and will continue to do so. There will be bargains for retailers in current or new spaces who possess an optimistic market outlook for retail."

Of course, creativity also extends to deal making. Knowing many retail landlords are cash strapped, tenants can leverage longer free rent periods in lieu of tenant improvement allowances or push for lower rents up front, Shaefer suggests.

Landlords can also offer tenants greater flexibility when it comes to operating hours, Gold adds, particularly during seasonal or operational adjustment periods. Then there's percentage rent deals, which have become a hot topic since the pandemic. Though this

AMC Entertainment is currently "in talks" with several landlords that will soon have vacant theater space as Pacific Theatres and ArcLight Cinemas remain shuttered. The movie theater company is interested in purchasing these leases, which may include the ArcLight Hollywood that sits adjacent to the Cinerama Dome.

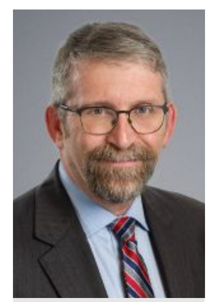
strategy has provided some relief and compromise during COVID, Terrell notes it's not always an easy answer, especially when financing is involved.

Jim Terrell
Principal
B. Riley Real Estate

"It is difficult for a landlord to find lenders willing to finance on percent rent only deals," he says. "More likely, you will find floors set on the leases with a percent rent component as tenants take a more aggressive approach on other provisions in the leases."

These may include co-tenancy clauses, use of common areas and lease term. Gold notes that some of these provisions can be mutually beneficial for the landlord, as an uncertain brick and mortar landscape may call for more flexibility and less commitment all around.

"I would expect many leases to initially be for shorter terms to lower the level of commitment by either party in the face of an uncertain period of economic recovery," he says. "We are also encountering a greater number of early termination provisions as an alternative to shorter terms, allowing either party to elect to exit a lease early, in some cases without customary criteria, such as failure to achieve certain gross sales levels."



Ivan Gold
Of Counsel
Allen Matkins

All of these are good strategies to get tenants into vacancies and retail landlords back in the green. Yet, for all the astute suggestions listed above, Terrell believes the wisest thing anyone can do in this market is keep their head screwed on straight.

"The best advice is to not become emotional over a piece of real estate," he says. "Too often, tenants fall in love with a particular location and reduce the objectivity by which they evaluate it. Landlords, too, need to be objective about their holdings. Real estate doesn't move but people do. What might have been Main and Main at one point in time may suffer from an exodus of population or be outflanked by something new. The key is to be realistic and objective while embracing your vision." **CC**