Urban Land Institute-MN

Changing Retail Market

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#1. What the Numbers Say:

Retail Market Statistics Suggest a Healthy Market

- 67 million s.f. total shopping centers - Twin Cities
  - Does not include corporate owned single building facilities (i.e. Wal-Mart, Costco)
- 3.8 million s.f. available today
- 94.2% occupancy
- Rental Rates:
  - Average $16 p.s.f. (not including regional malls)
Occupancy History - Twin Cities

Vacancy

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent Vacant</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>3.6%</td>
</tr>
<tr>
<td>2008</td>
<td>5.1%</td>
</tr>
<tr>
<td>2009</td>
<td>6.9%</td>
</tr>
<tr>
<td>2010</td>
<td>7.3%</td>
</tr>
<tr>
<td>2011</td>
<td>6.8%</td>
</tr>
<tr>
<td>2012</td>
<td>6.2%</td>
</tr>
<tr>
<td>2013</td>
<td>5.4%</td>
</tr>
<tr>
<td>2014</td>
<td>4.9%</td>
</tr>
<tr>
<td>2015</td>
<td>4.4%</td>
</tr>
<tr>
<td>2016</td>
<td>5.7%</td>
</tr>
</tbody>
</table>
Positive Trends

- Careful development - controlled expansion
- Grocery competition - new activity
- Strong, consistent demographic base
- Average tenant performance is above average in Twin Cities
Concerns/Challenges

- New construction costs
- New development dependent upon low interest rates (see chart)
- Lack of new big-box concepts amid consolidation in each sector
- Lack of small shop “retail” - turning to service and quick-serve dining
Retail Development Proforma -

Anchor Tenants

<table>
<thead>
<tr>
<th>1990 - Cost PSF</th>
<th>2016 - Cost PSF</th>
</tr>
</thead>
<tbody>
<tr>
<td>$32 ($8 PSF)</td>
<td>$48 ($12 PSF)</td>
</tr>
<tr>
<td>$16</td>
<td>$26</td>
</tr>
<tr>
<td>$32</td>
<td>$60</td>
</tr>
<tr>
<td>$18</td>
<td>$38</td>
</tr>
<tr>
<td>$5</td>
<td>$8</td>
</tr>
<tr>
<td>$4</td>
<td>$10</td>
</tr>
<tr>
<td>$8</td>
<td>$12</td>
</tr>
<tr>
<td><strong>$115 PSF</strong></td>
<td><strong>TOTAL PSF</strong></td>
</tr>
<tr>
<td><strong>$115 PSF</strong></td>
<td><strong>$202 PSF</strong></td>
</tr>
<tr>
<td><strong>$14.00</strong></td>
<td>Anchor Tenant Rent</td>
</tr>
<tr>
<td><strong>12.1%</strong></td>
<td>YIELD ON COST</td>
</tr>
</tbody>
</table>
Addicted to Interest Rates

How borrowing costs close the gap:

<table>
<thead>
<tr>
<th></th>
<th>1990’s</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Cost</td>
<td>$115 PSF</td>
<td>$202 PSF</td>
</tr>
<tr>
<td>Loan @ 80%</td>
<td>$92 PSF</td>
<td>$162 PSF</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>9.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Debt on 25 yrs.</td>
<td>$9.26 PSF</td>
<td>$9.73 PSF</td>
</tr>
<tr>
<td>Rent</td>
<td>$14.00 PSF</td>
<td>$15.00 PSF</td>
</tr>
<tr>
<td>Cash Flow after Debt</td>
<td>$4.74</td>
<td>$5.27</td>
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<tr>
<td>Cash Equity</td>
<td>$23 PSF</td>
<td>$40 PSF</td>
</tr>
<tr>
<td>Leveraged Yield on Equity</td>
<td>20.6%</td>
<td>13.18%</td>
</tr>
</tbody>
</table>
Online Shopping Pressure

Market Share:

2005 - 2.6%
2010 - 4.6%
2015 - 7.6%
2016 - 8.3%
E-Commerce

- Not as scary as before
- Certain fungible products irreparably punished
  - Books, Music, Office Supplies, Electronics (?)
- Dual Focus - Brick & Mortar and an on-line presence
- Successful retailers embrace technology
  - Research before shopping
  - Return Policy; Same Day Pick-up
- Amazon may add retail stores?
- Sierra Trading Post (TJX Companies)
- Again, consumer wins
#2. What the Newspaper Says

General Retail Market - 2017

- Don’t read the news! Endless Agony!
- Annual occurrence - in February
- Some years more challenging
  - 2009/2010 - Many Tenant Failures
  - 2017
    - Gander Mountain / HH Gregg / Macy’s / Sears / JC Penney / Payless Shoes / Kmart / Rue 21 / Game Stop
    - More to come
Declining Tenant Pool

- Rainbow Foods
- Sports Authority
- Golfsmith
- Montgomery Ward
- Circuit City
- CompUSA
- Radio Shack
- Service Merchandise
- Mervyn's
- Linens-N-Things
- HomePlace
- Frank's Nursery & Crafts
- Children's Palace
- Office Depot/Max
- Ultimate Electronics
- The Good Guys
- Border's Books
- Steve & Barry's
- Sound Advice
- On Cue
- Musicland
- KB Toys
- Zany Brainy
- Gemco
- Media Play
- Kmart
- Sears
- Sportsman’s Warehouse
- Storables
- Ritz Camera
- Blockbuster Video
- Non-Stadium Theaters
- Just For Feet
- Champion Auto
- Herman’s World of Sporting Goods
- Oshman’s
- Best Products
- County Seat
- Delia’s
- Fashion Bug
- Kids ‘R’ Us
- Gottschalk’s
- Warner Bros. Store
- Drug Emporium
- F&M Drugs
- Phar-Mar
- Computer City
- Hancock Fabrics
- Schaak Electronics
- Fedco
- Highland Superstores
- Incredible Universe
- F.A.O. Schwartz
- Levitz Furniture
- Bombay Company
- Heilig-Meyers
- Wickes Furniture
- Builder’s Square
- Builder’s Emporium
- Coast-to-Coast Hardware
- Eagle Hardware
- EXPO Design Center
- Handy Andy
- Home Base
- Home Quarters
- Knox Lumber
- Payless Cashways
- Hechinger
- B. Dalton Books
- Coconuts
- Crown Books
- Price Rite Warehouse
- Hollywood Video
- Movie Gallery
- Mr. Movie
- Tower Records
- Sound Warehouse
- Waldenbooks
- Virgin Megastores
- Child World
Declining Tenant Pool

- Are we really surprised?
- National Selection - “Dollars Vote”
- It’s not always bad. Actually, it’s healthy.
- Eden Prairie Center example
- Southdale 494 example
Southdale 494

- 2009 Plan
- Only Michaels Stores!
  - The Center was just 15% occupied
Southdale 494

- 2014 Plan
- 100% Occupied!
- Trader Joe’s (15,000 s.f.) was the principal driver
  - Grocery
- Sometimes we need complete failure to create something functional.

- In the end, the consumer wins
Is 2017 Different than 2008-2010?

- Maybe
- Lack of new concepts?
- Yet, some good stories
  - Five Below
  - Total Wine
  - Sierra Trading Company
  - Hy-Vee
  - Café Zupas
  - Piada
  - Portillo’s
  - Amazon (???)
  - Hobby Lobby
Is 2017 Different than 2008-2010?

- Retail will keep changing
- The Consumer Wins - Dollars vote
Ongoing Retail Trends

▶ GROCERY - Still #1
  - THE MOST IMPORTANT COMPONENT OF RETAIL
  - The format/stores will constantly change, but the demand for grocery retail will remain largely stable.

▶ Principal driver of Retail
  - Always will be repeat customer
    - Internet is challenging for grocery
  - Daily/Weekly needs
Grocery

Rapid Change

- Don’t fight it
- Embrace it
- The weak fail for a reason
- Today, only about 40% of all food consumed is bought in a grocery store
- Can’t have a healthy retail market if there is no activity in the grocery sector
Grocery

Revenue Generators

- Grocery averages about $520 psf annually
- Market leading grocery averages as much as $900 to $1,000 psf annually
  - Trader Joe’s - $1,734 psf
  - Whole Foods - $930 psf
- General retail averages about $300 psf annually
Grocery

Net Margins

- Average grocery margin - 1%
- Great operators get to 2% to 3%
- Departments like Bakery and Deli have higher profit margins
- The fine details matter - no room for error
Grocery

- When the grocery shopper moves, a community’s retail base also moves
  - Be receptive to new concepts
  - Keep your residents shopping in your community
What lies ahead

- Measured growth, if any, in Retail sector
- Focus on filling upcoming vacancies
- Some antiquated centers will, and should, fail
- Grocery battle
  - Survivors will remodel; new concepts will expand
- Interest rates will determine pace of new development, if any
- Self-development by tenants will continue
  - Not as sensitive to interest rates
Central Park Commons
Eagan, MN
Questions/Comments

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