

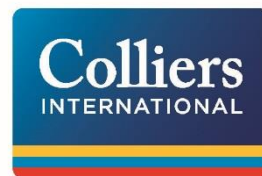
Urban Land Institute-MN

Changing Retail Market

John Johannson

Welsh Companies/Colliers International

WELSH



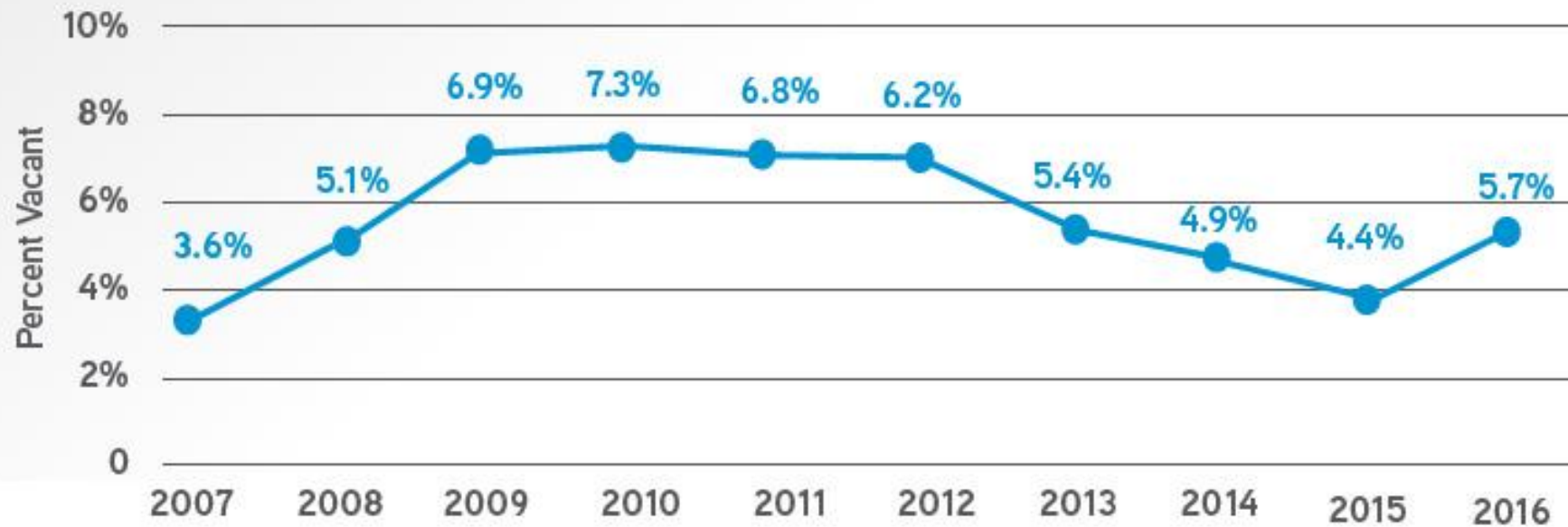
#1. What the Numbers Say:

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



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

1990 - Cost PSF		2016 - Cost PSF
\$32 (\$8 PSF)	Land	\$48 (\$12 PSF)
\$16	Sitework	\$26
\$32	Building Shell	\$60
\$18	Tenant TI's	\$38
\$5	Commissions	\$8
\$4	Fees	\$10
\$8	Miscellaneous	\$12
\$115 PSF	TOTAL PSF	\$202 PSF
\$14.00	Anchor Tenant Rent	\$15.00
12.1%	YIELD ON COST	7.4%

Addicted to Interest Rates

How borrowing costs close the gap:

1990's		2016
\$115 PSF	Project Cost	\$202 PSF
\$92 PSF	Loan @ 80%	\$162 PSF
9.0%	Interest Rate	3.5%
\$9.26 PSF	Debt on 25 yrs.	\$9.73 PSF
\$14.00 PSF	Rent	\$15.00 PSF
\$4.74	Cash Flow after Debt	\$5.27
\$23 PSF	Cash Equity	\$40 PSF
20.6%	Leveraged Yield on Equity	13.18%

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

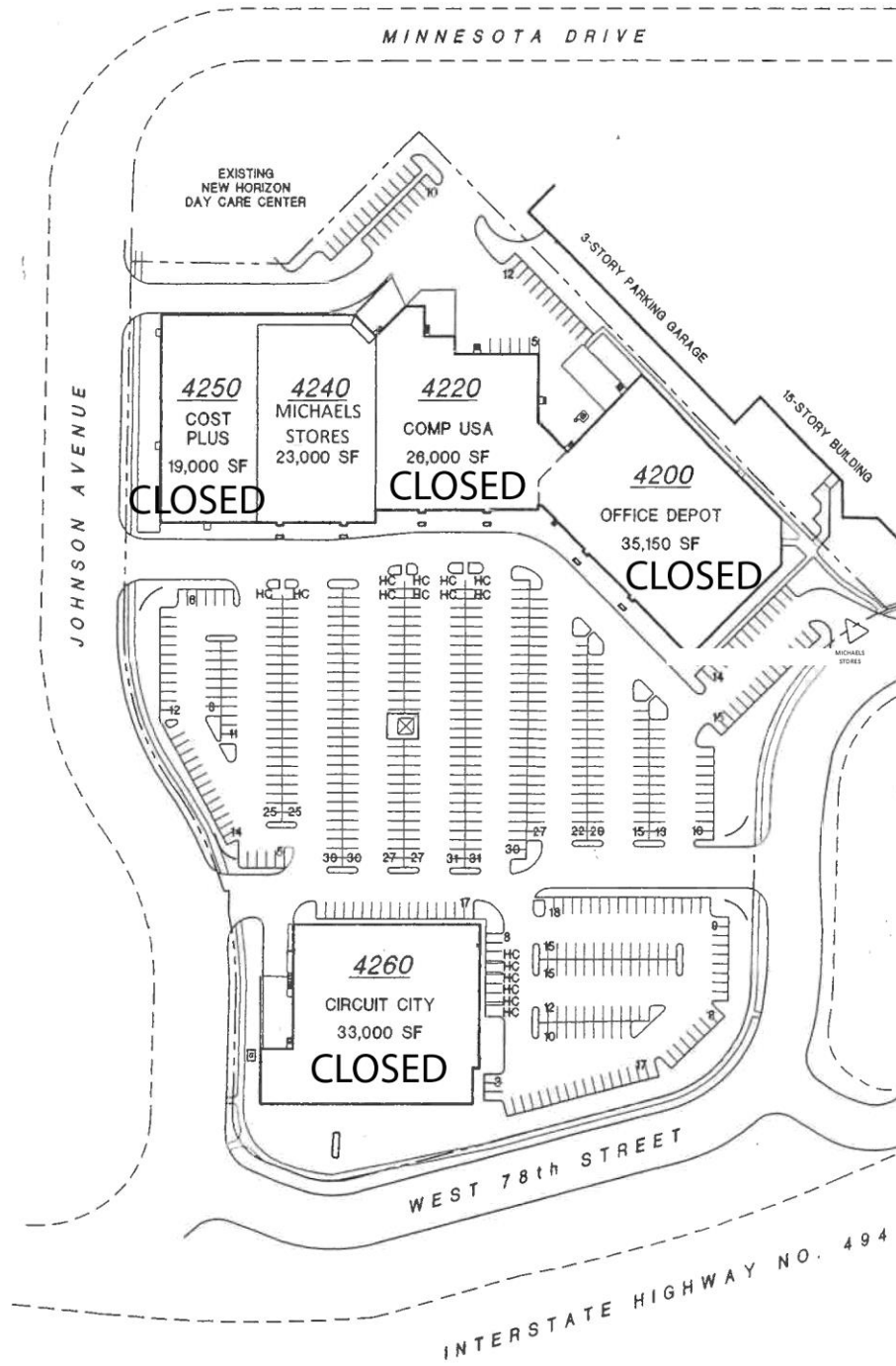
- Rainbow Foods
- Sports Authority
- Golfsmith
- Montgomery Ward
- Circuit City
- CompUSA
- Radio Shack
- Service Merchandise
- Mervyn's
- Linens-N-Things
- HomePlace
- Frank's Nursery & Crafts
- Children's Palace
- Office Depot/Max
- Ultimate Electronics
- The Good Guys
- Border's Books
- Steve & Barry's
- 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

John Johannson

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WELSH

