REMAKING THE GREAT AMERICAN MALL

As anchor stores withdraw, malls see an opportunity to update and refresh

by CRAIG GUILLOT

The growth of Internet retail, saturation of mobile devices, faster shipping and more selection is changing the mall environment faster than ever. As American malls continue to evolve, retailers and property owners are adjusting their strategies to cater to an increasingly complex retail environment.

There's a big shakeup going on in the mall industry — nearly one in three properties are not expected to survive. American malls have been on the decline for more than a decade, with dozens of large properties closing in recent years.

JCPenney said in February it would close up to 140 stores, following Macy's January announcement that it would close 68. But Sears, which announced the closing of 41 namesake units and 109 of its Kmart locations in January, dropped the biggest bombshell in March. That's when it said "substantial doubt exists related to the company's ability to continue as a going concern."

Other mall-based retailers including Aéropostale, PacSun, Abercrombie & Fitch and Wet Seal have together closed hundreds of stores in recent years. Experts say the pace of closures is rising, signaling a new time for the industry.

TOO MUCH SPACE

David Kessler, national director of CohnReznick's commercial real estate practice, says it can be "a nightmare or an opportunity" for developers and retailers.

It might be more a shaking out of winners and losers rather than that malls as a whole are suffering. Mark Cohen, director of retail studies at Columbia Business School and former chairman and CEO of Sears Canada, says mall space has been overbuilt and that changing shopping patterns have reduced the need for space.

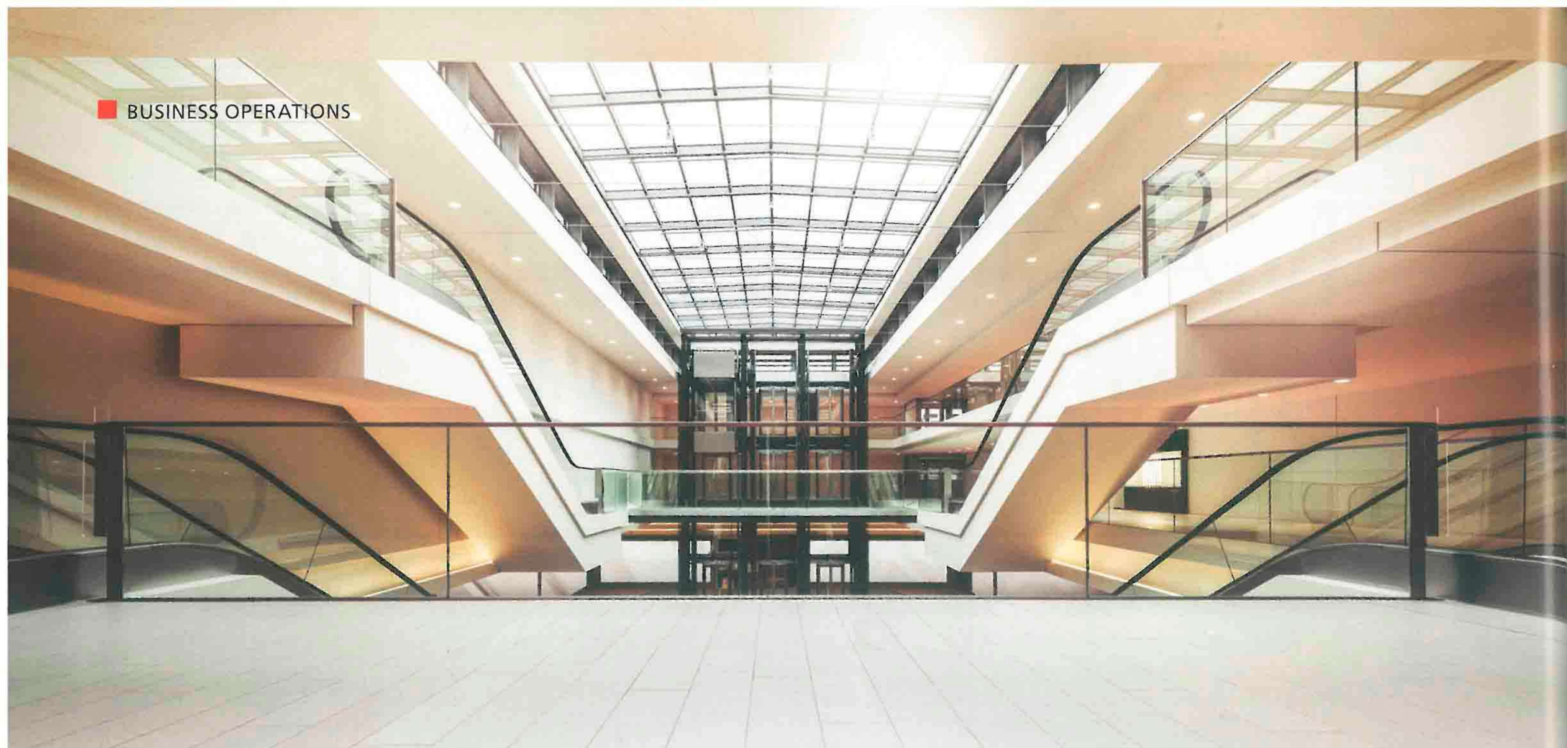
A 2016 report by Green Street Advisors said that department stores need to close as many as 800 more locations to return to the levels of productivity seen 10 years ago — equaling nearly one-fifth of all anchor space in U.S. malls.

When malls reached their heyday in the '80s, they were often built near interstate highway exit ramps and catered to consumers within a seven-mile radius. Because the model worked for so long, Cohen says developers just kept building.

Yet in the past seven to 10 years, the "phenomenon of extraordinary space has turned on itself," Cohen says.

Too much space, combined with competing centers in close proximity, has increased competition in many markets. The retail industry has also been hit with two recessions and rapid changes in technology that have shifted the way consumers shop and engage in entertainment.

"Right now, there is more square footage per capita in the United States than in the sum total



Mall-based retailers who survive the evolution will be those that offer customers a "well-crafted omnichannel opportunity" to shop both online and in an engaging bricks-and-mortar environment.
— Mark Cohen, Columbia Business School

of Western Europe," says Cohen. "Business was generally pretty good and nobody wanted to consider the fact that we had built out onto a platform that would never be sustainable in the long term."

The closing of bricks-and-mortar stores and, in turn, shopping malls, has been driven, in part, by consumers' increased online shopping. But NRF President and CEO Matthew Shay said in an April television interview on Fox Business that the shift is not as large as many reports would suggest.

He also pointed out that most purchases are still being made from the same retailers, just on their websites rather than in their stores.

"What we're seeing here really is an enormous transformation in the industry," Shay said. "Remember that more than 90 percent of sales in this country still occur in bricks-and-mortar stores. Also, it's important to note that seven out of the top 10 and 21 of the top 25 largest e-commerce platforms are operated by bricks-and-mortar retailers. So this is not an 'us versus them' mentality. This is consumers changing their behavior.

"The retail industry is not going to go away," Shay said. "It's just going to continue to transform."

SIZE AND POSITIONING

Big department stores may always hold a place in American retail, but their relevance in malls is dwindling. Department store sales have steadily declined over the past 10 years, from $87.5 billion in 2005 to $60.7 billion in 2015, according to the Department of Commerce. As department store retailers adapt, they're focusing more on their online presence and culling less-productive physical spaces: Macy's recent plans to close more stores is part of its omnichannel strategy.

For malls already clinging to life, the loss of a major tenant could be a death blow. It's happening all over the country: The 821,000-square-foot Fort Steuben Mall in Steubenville, Ohio, went to a foreclosure sale in February after losing Sears in the past year and discovering Macy's would leave this spring.

In 2016, Simon Property Group sold the Esplanade, a 900,000-square-foot mall in New Orleans, as part of a three-property deal valued at $200 million.

Cohen says what happens to malls will be dependent on their size and positioning; while "super-regional" malls will continue to "bloom and thrive," B-grade malls will struggle and C- and D-grade locations "will simply disappear."

Many have already been caught in a domino effect, where store closures reduce foot traffic, spurring even more closures.

"That's deadly," Cohen says. "It creates a death spiral that just amplified the decline we are seeing. Customers don't want to go to dark, dirty, dingy and poorly stocked stores. Many stores have been looking like this for years."

RECONSIDERING SPACE

Chris Maguire is CEO of Cypress Equities, a developer, operator and manager of retail and mixed-use properties. He believes that the top 400 malls will be "just fine," as most are steadily raising rents and slowly increasing their sales per square foot.

Maguire says these malls can "quickly backfill" and often benefit from losing long-term anchor tenants as it gives them a fresh opportunity to update with more lucrative and relevant retailers.

"You have some of these stores almost acting independently at [some] malls," he says. "They might pay little rent. The consumer parks in front, goes in to do their shopping but doesn't go into the mall because there is no experience."

Both mall owners and retailers are reconsidering their use of space. Kessler says retailers don't need as much space at the mall anymore because they are leveraging logistics systems to optimize warehouse space, inventory systems and last-mile warehouses from which goods can be shipped relatively quickly.

Real estate investment trust Seritage Growth Properties is carving many former Sears locations into smaller parcels for retailers like Dick's Sporting Goods, PetSmart and Nordstrom Rack that produce more sales per square foot.

Apple Store produces the highest sales per square foot among mall retailers, according to eMarketer. Others in the top rankings include Michael Kors, Kate Spade & Co., lululemon Athletica, Tiffany & Co. and Coach.

At the Tyrone Square Mall in St. Petersburg, Fla., developers are already talking about replacing a 189,000-square-foot Sears with a 152,000-square-foot shopping center that would include Dick's Sporting Goods, Lucky's Market and PetSmart.

At the Landmark Mall in Alexandria, Va., the announced closure of Macy's has cleared the path to a major redevelopment that will transform the mall into a mixed-use property with apartments, retail and restaurants.

MALLS TO MIXED-USE

Many shopping centers simply won't survive as "malls" in the traditional sense. While they may retain a mall-like appearance and retail stores, more of their footprints will be used for mixed-use tenants including everything from office and medical space to trampoline parks and entertainment venues.

Some developers are even building multi-family housing units in declining malls. Two years ago, Westminster Arcade in Providence, R.I., one of America's first malls, was converted into an apartment complex. Highland Mall in Austin, Texas, was recently transformed into a campus for Austin Community College.

In Fort Lauderdale, Fla., the 32-acre site of the former Fashion Mall is being developed into an open-air complex with 700 apartments, 225,000 square feet of commercial space and 250,000 square feet of renovated office space. Developers are positioning it as a "lifestyle center" with a mix of small retailers, restaurants and entertainment.

Since the recent announced closure of the JCPenney at Hilltop Mall in Richmond, Calif., area leaders have been calling to convert the mall into a mixed-use development of housing, offices and retail.

"There's development and active infill in suburban areas to create the live-work-plan environment," Kessler says. "Many [residents] see it as more convenient than being downtown."

'CREATE AN EXPERIENCE'

Maguire says many of these lower grade malls have had no capital investments for 10 or more years, nor have they addressed updating merchandise mixes to how consumers want to shop today.

"You have to create an experience," he says. "You have to put capital in these things. There are hundreds of malls that are not going to be malls [anymore]."

The B-grade and lower malls that will survive are those that quickly and readily adapt with an influx of capital and strategy. Maguire points to Bassett Place, a mall Cypress Equities purchased 14 years ago in El Paso, Texas.

When the property, one of three malls in the city, was acquired, Maguire says it was "partly run down" — while Target, Kohl's and Costco were adjacent, the mall also had a lot of empty space.

Over the past 14 years, Cypress Equities has upgraded and redeveloped the property three times: Bassett Place now has the only Dave & Busters arcade and IMAX movie theater in El Paso.

Maguire says by upgrading the merchandise mix and adding the entertainment, the mall has steadily grown its cash flows. Since the big Simon mall is only four miles down the road, Maguire says the company had to take a different approach rather than try to compete head-on.

"Our rents have grown," Maguire says. "Our retailers' sales are doing very well."

Mall-based retailers who survive the evolution will be those that offer customers a "well-crafted omnichannel opportunity" to shop both online and in an engaging bricks-and-mortar environment, says Cohen. He says the retailers will need to leverage flexibility to reposition themselves and take advantage of changing trends.

Cohen says successful retailers have been refurbishing, rehabbing and renewing merchandise presentation. "Legacy retailers who are not well placed in those 235 AAA malls and who don't have exciting, powerful, fully-integrated websites are doing [this] to face what we're seeing now, almost on a daily basis," Cohen says.

Craig Guillot is based in New Orleans and writes about retail, real estate, business and personal finance. Read more of his work at www.craigguillot.com. STORES