LEADING THE WAY THROUGH THE 21ST CENTURY
SHOPPING CENTER BUSINESS

Feature Article, September 2009

Where's The Market?

Experts give their opinion on where the market is, and when it will be back.
Jill Bensley and Erica Barton

It's been a while since we've heard any good news from the retail sector in the United States. You don't have to be a genius to know that same-store sales have been declining at an increasing pace, and 2009 is a banner year for bad karma.

Figure 1 shows the percentage change of comparable store retail sales in current dollars from 1986 through 2008, according to ICSC. Throughout the late 1980s and early 1990s, annual change kept pace with inflation and in some years outpaced inflation by several percentage points, peaking in 1999, at 6.7 percent. Then came the 9/11 terrorist attacks and the rate of increase reverted to a slower pace for the next 6 years.

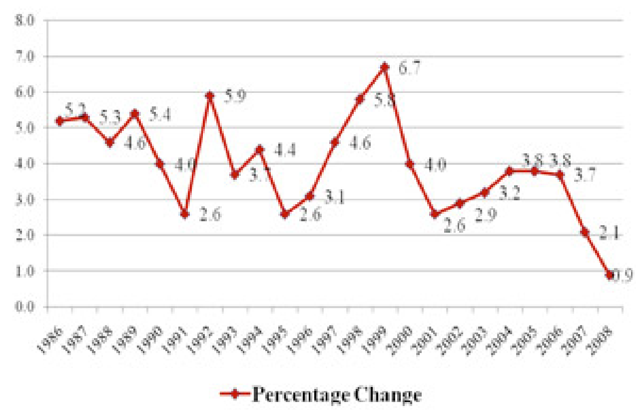

Figure 1 - Percentage Change of Comparable Store Retail Sales in Current Dollars from 1986 through 2008.

Then, the real recession hit, and for the first time anyone can remember, we have seen negative growth for 4 out the past 5 months in 2009.

In all this gloom and manure, where's the pony? After thinking about it and not coming up with much, we decided to interview some very smart industry friends who are on top of these trends. Wthout any nudging, we got some very positive answers on where retail is heading, and what the road ahead holds.

What The Experts Had To Say

We interviewed four individuals who are avid trend-watchers and who are also responsible for knowing where trends are headed, as well as making them happen in the retail world. They include:

• Michael Beyard, Retail Fellow Emertus, Urban Land Institute, Washington, D.C.

• Michael Rubin, President, MRA International, Baltimore, Maryland.

• Shaheen Sadeghi, President of Orange County, California-based LAB Holding, LLC.

• Cindy Chong, First Vice President, CIM Group and Manager of Hollywood &

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Highland Retail/Entertainment venue in Hollywood, California.

Some exciting changes are on the horizon. In this down-market, these individuals are on their toes and, as they say, "things are lookin' up."

As background, while the economic slowdown was an eventual necessity, it has become a self-fulfilling prophecy, feeding on itself.

In the 2000 to 2007 period , U.S. consumers were saving at an alarmingly low rate as shown in the bar graph in Figure 2:

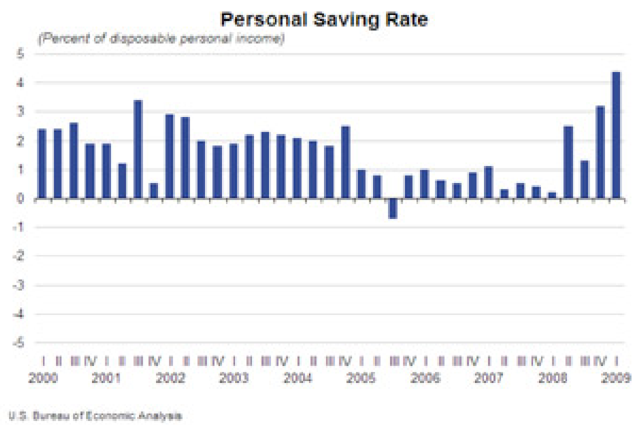

Figure 2 - U.S. Consumers Savings Rate from 2000 to 2009.

• Subprime loans were made to debt-ridden consumers.

• Banks who held the loans bundled them and sold them in tranches to everyone worldwide.

• Housing prices bottomed out in the United States due to overbuilding.

• Subprime mortgage holders couldn't pay their mortgages.

• Securitized debt instruments became worthless.

• Balance sheets of once prosperous companies tanked.

• Bankruptcies of major U.S. institutions caused upheaval in U.S. consumer confidence.

• Major institutions failed and massive layoffs resulted.

• Consumers cut spending and began saving more.

• The retail industry went into a tailspin.

I asked each expert very general questions about the retail situation in the United States: Where are we now? Are we at the end of the retail consumption high? What changes do you see coming? Are Americans changing their consumption patterns? What retail sectors will thrive and which will dive as a result of the recession? What will the retail world look like in 5 years?

All of the experts said that the retail downturn was inevitable. From overspending consumers to overbuilt markets, the industry was ready for a correction. Michael Beyard pointed out that the "numbers people" kept telling developers the growth of supply was outpacing demand, no matter what historical measure adopted. But credit was available and developers did what they love to do: develop. And per capita square footage of mall shopping center space in the United States rose from 5 in 1964, to 20 in 2000. While at the same time, sales for a large portion of shopping center type goods declined precipitously! The trend simply could not be sustained.

The Underlying Problems and Their Solutions

So what were the real issues and what caused the crash? Was the retail bust just a consequence of the bank failures? Not one of our experts believes that to be true. Shaheen Sadeghi put it very succinctly: "I don't see this as a recession cycle so much as a cultural shift. The crash of the financial system has forced us to look at our culture and make some fundamental changes that have needed revision for a long time."

He cited the United States' imbalance of consumer spending and wasting of resources. Americans consume like no other nation — using three times the amount of water per capita than the world average and nearly 25 percent of the world's energy, despite holding only 5 percent of the global population; and producing 5 times more daily waste than the average in poor countries.

According to Sadeghi, that trend is not sustainable. We have just seen the initial collapse of the culture of excess and waste and a transition toward a more European and thrifty way of life. To meet that fundamental change, Sadeghi is reworking conventional retail formulas, focusing on unique local products with quality and individuality. For example, in Costa Mesa, California, he is introducing an entirely flexible retail concept, named SEED People's Market, with the purpose of enabling local entrepreneurial business to take root despite the pressures of the current economy. In a very modern and almost gallery-type setting, SEED allows multiple and complimentary vendors and artisans to house "mini-shops" or "pop- up shops." Leases are short, quality sales staff supplied, utility costs covered; all the headaches of a small shop owner transferred to the SEED staff. "We intend to nurture the creatives who historically fuel new markets," he says, "and SEED provides that environment."

Also, as a "recycled" project on a grand scale, the LAB Holding team is renovating a 100-year old abandoned flour mill in Portland, Oregon. To celebrate the area's renowned culinary enterprises and wineries, the project's reuse will offer a cooking school, farmer's market stalls, on-site brewery, food presentation boutiques, community garden areas and more. Sustainability and healthy living connects all components of the project with numerous community events planned throughout the grounds. "It's not about buying more stuff," Sadeghi explains. "The future of retail is about an experience, a gathering place, becoming an integral part of the local community."

Transforming Retail

Michael Rubin, consultant, architect, teacher, thinker and developer in the retail, mixed-use, sports and themed entertainment industries has given the issue a great deal of thought. In his 2009 presentation to the Entertainment Development Council at the Spring Urban Land Institute Meeting, Rubin talked about 13 transformative forces affecting retail, leisure and entertainment trends, as shown in Figure 3.

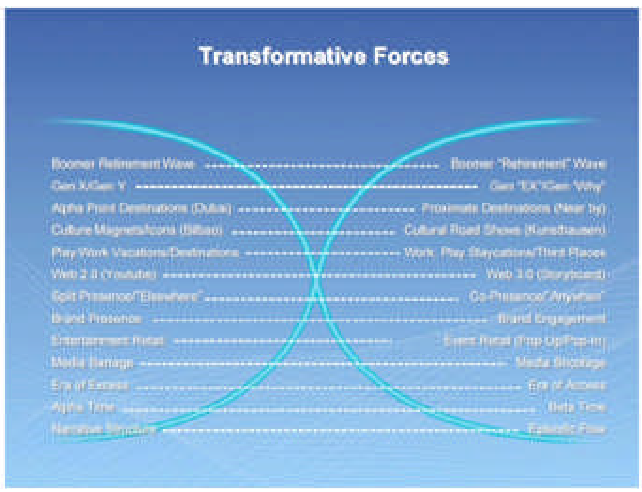

Figure 3 - 13 Transformative Forces Affecting Retail, Leisure and Entertainment Trends.

Some of the more interesting changes in the 3.0 Web format include The New Cinema. It remains a highly programmable social entertainment venue driven by a regular rotation of content. The new drivers reshaping the cinema include digital retrofitting, new sources of digital content (live casts), new screen formats (3-D; wide format) and new amenities. The new challenges include reduced "vault time," Web 3.0 and "Anywhen" media access. The new cinema will need to be socially engaging, offer unique-to-the-venue content and provide a new viewing experience — larger, immersive, brighter multiple settings.

Rubin also cited 21 new opportunities:

• Proximate Resorts & Destinations

• The New Third Places

• The New Cinema

- The 21st Century Plateau
- Co-Presence: "Anywhen" Environments and Portals
- Event Retail Environments (Pop-Up, Pop-In, Beta)
- Cows on Parade/Buring Man: Event Destinations
- Web 3.0 (Co-created Content)
- Brand Engagement
- Media Immersion/Integrated Environments
- Authentic Experiences
- Wellness Oriented Leisure
- Membership/Interest-based Leisure
- Heritage-oriented Leisure
- Work-Play Destinations
- Urban-oriented Leisure
- Discovery-based Leisure
- Eco-oriented Leisure
- The New Theme Park I: The App Park
- The New Theme Park II: The Overlay Park
- Rotations Venues

Rubin also highlighted other types of retail innovations, as shown in Figure 4.

Figure 4 - Retail Innovations.

Rubin postulates that in the future, brand engagement will take the consumer further than ever before. According to Rubin, brands will furiously reposition following the recession. A multi-channeling of brand presence will present a dilemma and brand engagement will be the new mantra. He says it will take three forms — co-branded venues, events and environments, Web 3.0 and immersive environments. There will also be pattern shifts and opportunities as shown in Figure 5.

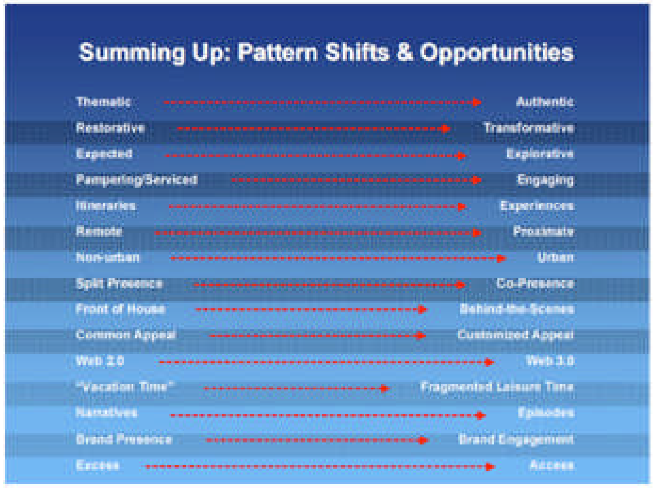

Figure 5 - Pattern Shifts & Opportunities.

What's New At Hollywood & Highland

Cindy Chong of CIM Group is on a high from all the changes at Hollywood & Highland. Seems that the "A" group of properties isn't suffering as much as other properties. Hard Rock Café closed at Beverly Center in 2006, and will reopen in 2011, at Hollywood & Highland in the 20,000-square-foot space vacated by Virgin Records.

Another out-of-the-box tenant at Hollywood & Highland includes Cirque du Soleil at the 3,400-seat Kodak Theater. The theatrical group has entered into a 10-year, $100 million agreement to create a permanent show for the venue. The new production features a movie industry theme and will open in 2011, playing 368 times annually.

Zara, the hot Spanish retailer, will make an appearance at the nearby Hollywood project owned by CIM. Pop-up stores also come and go, and pay good rents, according to Chong. The experience at Hollywood & Highland shows the creative ways retail is leasing these days: from theater shows, to pop-up stores, to leasing space to countries (in this case, the United Arab Emirates).

Does Chong think Americans are through with conspicuous consumption? "Yes," she says. In her opinion, the phenomenon is generational, with younger consumers shying away from logos and pushing away from showiness, and Boomers reevaluating all lifestyle options. She talked about the European model of buying less and acquiring more quality. Of course, this bodes well for luxury brands. She believes sectors that will thrive in the near term include health and beauty, cosmetics, less expensive brands such as H&M and Target that offer designer fashion and home accessory items. She also spoke about the emergence of more retail cooperatives such as Fred Segal and Garden Farm co-ops in urban areas. (This is very similar to Sadeghi's new SEED concepts in Costa Mesa and Portland.) She also believes that big, big stores are out, and retailers with too many outlets will have to pull back. She believes the integrity of brand as paramount. And integrity means the end of arrogant companies (in any industry) who do not follow their consumers' mind-sets and wishes.

What Goes Down, Must Come Up

Michael Beyard of the Urban Land Institute believes that we are still on the downward slope of the retail curve since we have multiple real estate bubbles bursting at the same time, namely housing, office and retail. This condition assures that the recession will require more time to correct. Further, many exurban projects (those located far from city centers) are completely unviable now because of the cost of gas and the changes in the American consumer to a mindset of "less is more."

But Beyard is optimistic about the luxury goods segment. While more savings is the order of the day, the personal savings rate is only slightly greater than four percent. And the middle market will have pent-up demand, once the economy recovers and consumers see the light at the end of the tunnel.

Beyard foresees innovators scooping up retail spaces vacated by bankrupt and outdated tenants. These empty spaces won't be taken over by housing, junior department stores or restaurant clusters. Rather, they may be occupied by smaller format urban style Wal-Marts or Wegmans-type gourmet grocery stores. Retail developers will become more innovative out of necessity. They will change their business model from rent-based profit to creative business and more mixed-use models. They will become more expansive and enter into business with their retail tenants.

Beyard also sees more convenience retail mixed with regional and lifestyle uses, as in Europe and the Middle East. He predicts we will see more lifestyle/aspirational tenants mixed in with grocers, in a complicated and convenient mix of uses. He believes that value retailers such as Wal-Mart have been eating up market share and will continue to do so because they have turned around their image and become very nimble by changing size, location and merchandise quickly. He also sees a resurgence of entertainment tenants in retail locations, middle-income magnets such as the mixed-entertainment multiplex offering bowling, bars and gaming. More entertainment retail tenants will likely emerge, those that make the merchandise the star in an entertaining format, such as Sephora and Ulta. And entrepreneurial retailers will become the wave of the future, those that are selling to the younger generations that want their shopping, leisure and entertainment in the same place in a non-chain format.

The Consensus

All of our experts predict that by 2015, retail will be thriving once again, albeit in new formats and new locations. There will be painful restructuring, changes brought about by the cultural revolution, and a move to smaller, more sustainable, sensitive, greener sellers. We will see retail projects in places and configurations we haven't seen before and a plethora of new high-density urban projects. Finally, cities, regional government, transportation agencies, citizens, developers, and retailers will cooperate to engage the public and create new projects with an eye to the future. SCB

Jill Bensley is president of Ojai, California-based JB Research Co. She can be reached via email at jill@jbresearchco.com. Erica Barton is an independent research consultant based in California.

FRANCE PUBLICATIONS, INC.
3500 Piedmont Road
Suite 415
Atlanta, Georgia 30305
TEL: 404-832-8262
FAX: 404-832-8260