

HOW CAPITOLA CAN MAINTAIN ITS ECONOMIC EDGE IN A CHANGING RETAIL ENVIRONMENT: A RETAIL PRIMER



February 26, 2014



Types of Retail

- A 90-second History of Retail
- Active vs. Non-active
- Commodity vs. Specialty
- Omnichannel

A VERY BRIEF HISTORY OF RETAIL

- In the early 20th century, without cars, no need for shopping centers.
- By mid-Century, most towns had downtown shopping districts.
- A given town's homegrown department stores sold a wide variety of goods.
- Post-war suburbanization gave way to malls, which replaced downtowns in an increasingly decentralized urban landscape.
- Discounters like K-Mart began to erode dep't store market share; traditional department stores began to enter this world (Dayton Hudson → Target).
- More efficient "big box" and "category killer" retailers were the next step in retail evolution...more convenient, with everyday low prices.
- Regional Malls began to contract – commodity vs specialty was born. Lifestyle centers were born.
- Traditional department stores (Kohl's) began to abandon malls and join the category killers.
- Today's environment is about convenience/price vs experience.

COMMODITY RETAIL

A retailer selling goods and services which are consumed without emotional connection by the consumer and for which the consumer's primary motivation is price and convenience. Examples would include grocery and drug stores, mass merchants such as Costco, Target or Wal-Mart, office supply stores such as Staples or Office Depot, or electronics, books and music.



SPECIALTY RETAIL

Retailers selling goods and services which are consumed on a discretionary or emotionally driven basis using discretionary funds/income, and where experience is a primary motivator in choosing how and where to spend discretionary time. Examples include fine dining, clothing, luxury hard and soft goods, or electronic, books and music, and even specialty shopping districts.



ACTIVE RETAIL

Retail where the pedestrian interacts with the space even if they don't go in to buy something. Examples would include grocery/drug, specialty, mass merchants (CostCo or Target), and even a karate studio, art gallery, or real estate agency.



NON-ACTIVE RETAIL

Retail where the flow of the retail district is broken so that pedestrians don't interact with the built environment, or where there are limited hours so that spaces become dark during non-office hours. Examples include offices, medical facilities, auto repair, and can also be caused by poor design!



OMNICHANNEL RETAILING

- Omnichannel retailing is an evolution of multichannel retailing but is concentrated on a seamless approach to the consumer experience through all available shopping channels: mobile devices, internet, brick-and-mortar, television, catalog, and so on.
- Retailer / Landlord Opportunity: Combine the touch and feel of the brick-and-mortar experience with the excitement and impulse factor of web/mobile shopping (eg. tweet/food trucks, crowdsourcing...).
- Specialty vs commodity – Omnichannel works differently for each. For commodity it's research and purchase options, for specialty it's driving traffic to a store.



Impact of E-Commerce



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E-Commerce Impacting Retailer Growth

Planned Unit Growth by Retail Sector (Next 12 Months)



The retail marketplace will change more in the next **FIVE** years than it has in the past **20**.

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RETAILER ECONOMICS: SOURCES OF SALES

Big Picture:

- Residential Population (existing and growth)
- Daytime Population (existing and growth)
- Transient Population (existing and growth)
- Competitors (direct vs indirect)
- Sister Stores
- Recapture Leakage

Site Specific:

- Growth and infill areas are different.
- Does the area's demographic profile match the retailer's?
- Follow the housing. What are expectations of future growth? Need to project absorption.
- Follow the traffic (gravity side of the trade area)
- Quality of real estate (location)
- Quality of facility (visibility, access and parking).



“BUILD IT AND THEY WILL COME . . .”



LUCK IS NOT A STRATEGY



- In the real estate industry, competitive strategies tend to focus on ways to perfect imperfect markets, products and/or services.
- Words and phrases such as “build it and they will come” exemplify expectations whilst highlighting strategic insanity.
- Roman philosopher and statesman Seneca said: “Luck is what happens when preparation meets opportunity.”



Planning Issues

- Lots of stakeholders!
- Lots of points-of-view!
- Maintaining vs. evolving uses.



SOME OF TODAY'S ISSUES

- Cities continue to struggle with vacancy rates in shopping areas.
- There is an increasing tide of non-traditional (and non-sales tax generating) concepts anxious to fill vacant retail spaces.
- When and where is it appropriate to allow non-traditional uses in retail areas?
- Should cities preserve retail areas and risk longer term vacancies, or should they compromise, follow the market, and allow the non-traditional uses?



FUNDAMENTAL SITE-PLANNING ISSUES FOR RETAILERS

- Acceptable retail footprint (mdse and service)
- Access in/out (turning movements)
- Parking – quantity & quality
- Visibility
- Pedestrian interface
- Exterior and way-finding signage
- Vertical transportation (escalators, elevators, ramps, cartveyors, stairs)
- Amenities (seating, bicycle racks, plaza areas)
- Loading and service areas (access/circulation)



MEANWHILE, IN THE DEVELOPER'S CORNER . . .

- What are the potential uses?
- What are the entitlement hurdles?
- What is the timing?
- What are the costs?
 - Construction costs.
 - Sitework costs (on and off site)
 - Soft costs (A&E, brokerage, fin., permits...)
- What is the financing environment?
- Is the pro-forma workable?



PLANNING AND ENTITLEMENT ISSUES FOR CITIES

- Existing zoning / Land-use
- Consistent with long term vision for the municipality (eg. GP, SP)
- Impact on Existing Infrastructure
 - Transportation
 - Utilities and Services
 - Environmental
- Impact on Surrounding Development



FUNDAMENTAL COMMUNITY ISSUES

- Provide an upgrade that is consistent with the neighborhood /community
- Provide incremental goods & services
- Improve quality of life/ livability of community
 - Safety issues
 - Traffic congestion
 - Environmental / Noise / Pollution / Appearance
- Improve neighborhood welfare
- Jobs
- Civic pride



POLITICAL AND ECONOMIC ISSUES

- Do politicians, planners, staff want it (some or all)?
- Does the community want it?
- Benefits the municipality
 - Revenue Stream
 - Property & Sales Taxes
 - Jobs
- Catalyst for future growth



EVERYONE HAS A JOB TO DO: (MITIGATING RISK AND CREATING CERTAINTY)

- Retailer / Developer Requirements to Address:
 - Parking, access, circulation, visibility
 - Exclusives and use restrictions
 - Economics (rent, delivery condition, TI allow)
- City/Community Requirements to Address:
 - Community benefit
 - Off-site contributions and dedications
 - Entitlement process and design requirements



ISSUES THAT SEPARATE CITIES AND PROPERTY OWNERS

- Cities needing sales tax revenues.
- Landlords in need of cash flow.
- Cities, wanting quality tenants in their prime retail area.
- Fewer tenants to fill existing retail spaces.
- Private property rights.
- Issues facing smaller vs. larger landlords.



... AND THE RESULTING PLANNING ISSUES

- Cities continue to struggle with vacancy rates in shopping areas.
- There is an increasing tide of non-traditional (and non-sales tax generating) concepts anxious to fill vacant spaces.
- When and where is it appropriate to allow non-traditional uses in retail areas?
- Should cities preserve retail areas and risk longer term vacancies, or should they compromise, follow the market, and allow the non-traditional uses?
- *Is a "managed balance" possible to engineer?*



Planning Issues

- **Mixed-use and urban retail**
- **Design issues**



ATTRIBUTES FOR RETAIL IN A MIXED-USE PROJECT

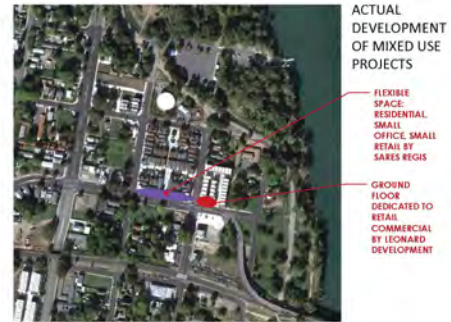
- Well articulated retail presence visually differentiated from other uses
- Signage (retailer identity)
- Parking – Access – Visibility
- Adequate clear-height
- Ventilation, HVAC, refrigeration, and remote equipment
- Service Areas – loading, trash, and storage



MIXED-USE CAN WORK



...BUT SOMETIMES IT DOESN'T!



ACTUAL DEVELOPMENT OF MIXED USE PROJECTS

- FLEXIBLE SPACE: RESIDENTIAL, SMALL OFFICE, SMALL RETAIL BY SARES REGIS
- GROUND FLOOR DEDICATED TO RETAIL COMMERCIAL BY LEONARD DEVELOPMENT



(RED)

DEDICATED RETAIL
• VACANT FOR 3 YRS.



(PURPLE)

FLEX SPACE
• FULLY OCCUPIED WITH RESIDENTIAL & SMALL OFFICE USERS
• CITY HOPES FOR RETAIL IN FUTURE



ATTRIBUTES FOR A NON-TRADITIONAL ANCHOR (EXAMPLE: GROCERY STORE)

- Well defined entries
- Appropriate parking
- Adequate/safe-feeling garage ceiling clear height and lighting
- Clear building and way-finding signage
- Safe and comfortable environment



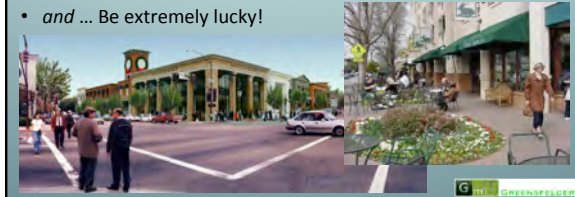
STRATEGIES FOR A THRIVING DOWNTOWN

- Create a Vision - Public/private partnerships, specific plans.
- Think Big - Corridors, city blocks, aggregate parcels.
- Create connections.
- Create pedestrian friendly environments.



STRATEGIES FOR A THRIVING DOWNTOWN

- Encourage active building facades & outdoor uses.
- Manage for change.
- Be an Advocate – Every revitalization effort needs a champion.
- Stand Firm – Know when to say no.
- *and ... Be extremely lucky!*



STREET SCAPE AND PEDESTRIAN CONNECTIONS



CREATING A LINKED RETAIL DISTRICT



UPDATING A SUBURBAN PLANNING MODEL



HOW DO YOU PLAN FOR CHANGING RETAIL?



Total Taxable Sales Recovering

- Still not quite back to 2007 peak (\$4B lower)
- Does not account for inflation
- Likely reflects growing internet sales



Number of Stores Also Recovering

- Number of CA permits increasing
- Still 5% lower than at 2007 peak

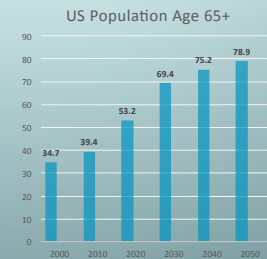


Internet Sales Gaining



Retail Trends: Aging Boomers

- By 2030, almost 70M will be age 65+, most will be healthy
- What will they want to buy?
 - Food, gifts, housewares, clothes, travel, medical items
- How will they buy it?
 - Accessible stores
 - Internet
 - Delivery services are key



Retail Trends: Millennials

Millennials were born from 1980 to 2000

- Estimated at 80+ M
- Largest generation in US history
- Greater use of technology & internet shopping
- More global, urban
- More emphasis on “green” and social media engagement
- Analysts say Millennials are more brand-loyal than their parents
- 52% more likely to buy on impulse
- Retailers “making me smile” was 33% more important to Millennials than to Boomers



How Much Retail is Supportable in my City?

- Unless your city is growing substantially, probably not as much as you used to have....
- ...and the retail you do have will change over the next 20+ years...during the period of your General Plan.
- Likely trends:
 - More “churning” as internet sales disrupt traditional “bricks and mortar”
 - More big boxes will go dark
 - Large commodity retailers will differentiate their store types to fit urban landscape
 - More retailers will offer stores and products targeting growing ethnic groups
 - Some cities will see more local entrepreneurs – rebirth of small “mom and pops”?
 - Pop-ups, food trucks, other temporary retail

Tips to Plan for Future Retail

- **Conduct Leakage Analysis**
 - Demand Estimate - Existing Supply = Supportable S.F. in your city
- **Focus on Place-Making to attract quality retailers**
 - For active spaces and specialty retailers, this is #1 public thing to do
- **Concentrate retailers together**
 - Make sure people can get there without using a car
 - Work with property owners and retailers to overcome non-compete issues, shared parking strategies, etc.
- **Avoid simplistic rules like 100% retail on ground floor**
- **Review plans from perspective of seniors, millennials, children**
 - Is this retail accessible (transit, pedestrians, wide sidewalks, signage)?



What to expect in 2014

- **Rents will plateau for the top tier**
 - Retailers settle into the new occupancy costs
- **Residential still highest and best use**
 - horizontal and vertical mixed use
- **Downsizing to mitigate occupancy cost**
- **Further consolidation through M&A**
- **Continued evolution of omni-channeling**
- **Less pure large-scale retail development**



Village Oaks
San Jose, CA

Retail Vision 2014: Northern California Outlook ZEPHYRUS



ADVANCING BUSINESS IN SILICON VALLEY

You have aspirations. We can help. It starts with the simplest of actions, a conversation. Together, let's figure out how to make Fremont work for you.

CITY OF FREMONT'S RETAIL STRATEGY



Figure out your Environment and Prioritize

- Not all retail is created equal
 - Identity is key
 - A/B/C centers
- Focus efforts on “A” centers and on retail voids
- Identify best places for service retail






Develop Team and Tools

- Dedicate staff to implement retail plan
- Designate multi-department cabinet on development
- Develop research and marketing materials





Form Strong Partnerships

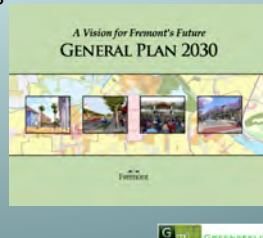
- Form partnerships with brokers, retailers, and beyond
- Participate in International Council of Shopping Centers (ICSC)
 - Attend, volunteer, and utilize Alliance
- Regional approach through Economic Development Associations (EDA's)
- Partner with other agencies
 - PG&E, Health, Sewer, Water, etc.






“Bake” Retail Goals into General Plan

- Economic Development Element
- Retail guidelines for mixed use
- Zoning, zoning, zoning



Grow your Own Tenants

- Recruit, Retain, and Grow!
- Marketing support
- Pioneers are local

Concluding Thoughts

RETAILER AND DEVELOPER ANALYSIS

- Retailers won't build new stores when there is not market share or enough demand available to support them.
- New stores must be equal to or better than competition with respect to location and site attributes.
- Developers must weigh potential for success against uncertainty.
- Bottom Line: The more a site can be validated for retailer interest and for developer certainty, the greater the chance for success.
- *Note to the City:* HELP CREATE CERTAINTY!

TRY THIS ON FOR SIZE...

- Are our expectations about vibrant areas realistic? Should we be spending so much time regulating to try to achieve vibrant areas which are, in fact, the outliers?
- The most vibrant areas are the most organic. Examples: Santa Cruz Ave (Los Gatos), SF retail streets, College Ave (Berkeley/Oakland), D/T Santa Cruz, State St (Santa Barbara), D/T Petaluma, Healdsburg or Sonoma Square.
- Encourage natural retail evolution and do not force retail where it does not meet the basic retail criteria.
- What areas merit strict standards ("A" space) as opposed to those with more relaxed standards ("B" or "C" centers)?
- New/emerging [good] uses that don't fit into zoning definitions (eg. food trucks, "temporary" or "pop-up" uses).

CITY APPROACH

- What's important in a developer?
 - Can the developer deliver from a financial perspective?
 - Is the developer (or the "market") telling the City what it wants to hear, or reality?
 - Should the City look for a tenant first and then a developer or the other way around?
- Look from the retailer's point of view!
 - How is any particular retailer looking at this City as an opportunity?
 - How can this City make the retailer's analysis more compelling?

POSSIBLE SOLUTIONS?

- Allow poorly-functioning retail to evolve into non-retail uses.
- Encourage clustering of non-active uses – where?
- Restricting uses can have unintended consequences. If uses are to be restricted, how can this be done constructively?
- Work with property owners directly rather than through restrictions.
- Shorter lease terms for non-active uses.
- Cities to identify their strongest retail nodes, defend those as retail, and allow other areas to evolve through market forces.
- Create and fund programs to help property owners analyze available opportunities and execute the strongest alternatives.



Whew!
(The End)



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