



Retail

United States | 2017

Empty to Alive: The Next Use for Department Store Space

Retail Research Point of View



Empty anchors

point of view

We reviewed what happened to recently vacated department stores and found that many were leased out to new tenants, including restaurants, entertainment venues, grocers and even other department stores.

New tenants for empty anchors

Several major department store chains have announced sizable new closures this year. As many as 324 will soon empty, turning about 36 million square feet vacant. What might happen to all this space? We reviewed what happened to recently vacated department stores and found that many were leased out to new tenants, including restaurants, entertainment venues, grocers and even other department stores.



More department stores than we need

Traditional department stores are facing headwinds as some consumers choose to shop in discount department stores, at specialty stores and on the web. U.S. regional centers have more department store space than their counterparts around the world. In the U.S., 46 percent of gross leasable area throughout shopping centers is devoted to department stores, compare that to only 27 percent in the U.K., the region with the next largest percent¹. As recent closure announcements have shown, it appears that the U.S. has more than it needs.

Recent closure announcements will soon release between 314 and 324 department stores with an estimated 36 to 37 million square feet of space onto the market.

- Macy's closed 66 stores in fiscal year 2016 and plans to close another 34 over the next few years
- JCPenney announced in February that it would close between 130 and 140 stores over the next few months
- Sears Holdings announced in February that it would close an additional 108 Kmart and 42 Sears stores

What will the new highest and best use for these department stores be? In some cases, they will be leased by other tenants of similar size. In others, shopping center owners will reconfigure the space and lease it up to multiple tenants. In this first of two papers on this topic, we examine the tenant types that have made use of department store spaces. In the second, we'll examine how property owners redevelop empty department stores.



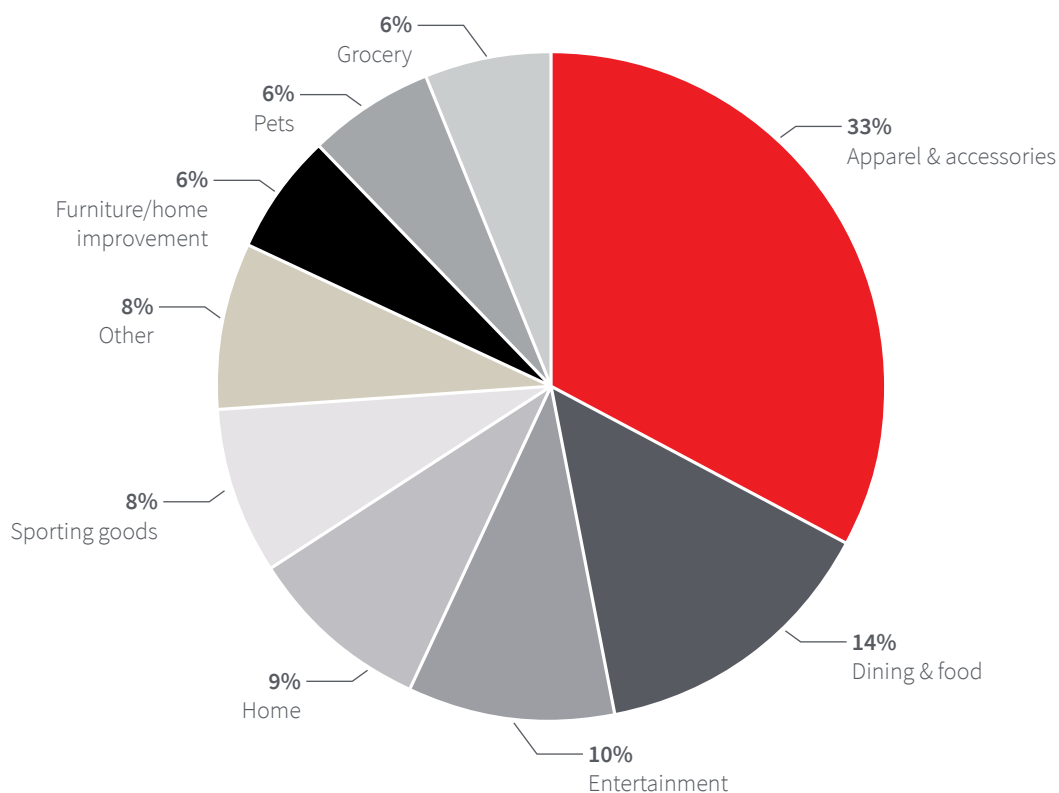
¹ Cistri/Urbis, Centers larger than 300,000 square feet

Case Study: Seritage portfolio unlocks value through re-leasing Sears stores to apparel, food and entertainment

The rents paid by department store anchors have historically been low. In many cases, the opportunity to re-tenant space translates into higher rental income for the owner. Seritage Growth Properties is one REIT in the midst of unlocking this value. With a portfolio of 266 properties originally leased to Sears Holdings, Seritage is redeveloping these properties and re-leasing space to newer stronger tenants. The potential growth is significant. Sears Holdings pays an average of \$4.40 per square foot across the portfolio. In-place third-party tenants pay \$12.74. Tenants that have yet to occupy are paying an average of \$18.55². On average, Seritage has re-leased space at 4.4 times the previous rental rate. Seritage has a right to recapture at least 50 percent of every Sears Holdings lease, which equals over 22 million square feet.

The Seritage portfolio primarily consists of Sears, Kmart and Sears Automotive properties. Tenants that have executed new leases in these spaces are most likely to be apparel or accessories retailers. As of March 2017, apparel tenants, restaurant tenants and entertainment venues combined made up 57 percent of the new leases.

Tenants that re-leased Seritage property



² Seritage Growth Properties, Corporate Profile, March 2017

Popular dining concepts drive foot traffic

While traditional mall food courts were meant to merely fuel further shopping, restaurants in today's centers can be destinations in their own right. Center owners have taken the opportunity to reuse portions of former department stores to improve centers' restaurant offerings.

- At The Galleria in Houston, Fig & Olive and Nobu will each soon occupy a portion of what was once Saks Fifth Avenue
- Outback Steakhouse and Yard House have leased space in a portion of former Sears space in the King of Prussia Mall in suburban Philadelphia
- At GGP's Oakbrook Center in the Chicago area, the owner converted the lower level of a Neiman Marcus into two restaurants in 2013
- BJ's Brewhouse, Yard House and Shake Shack have all signed leases in the Seritage portfolio of Sears and Kmart properties

Of course, restaurants are often only a part of the re-leasing strategy. At Macerich's Danbury Fair, a former Filene's department store was divided in 2011 and leased to L.L. Bean and DICK'S Sporting Goods along with popular casual dining concepts BRIO and The Cheesecake Factory.

Both high-end and discount grocers find a new niche

Supermarkets have traditionally been a rare sight in enclosed malls. Yet expectations are changing. In a 2017 survey, 49 percent of mall shoppers said they would like to see a grocery store in their shopping center³.

- The grocer Wegmans will soon take over a 194,000-square-foot JCPenney footprint at GGP's Natick Mall in Massachusetts; 125,000 square feet will be occupied by Wegmans, who will sublet out the remaining space to other tenants; Expectations are high for the popular grocer, who some expect will produce ten times the sales as JCPenney did in the same space

Sears stores have also proven to be popular targets for grocer expansion. Whole Foods recently opened in the first level of a former Sears at Westfield Countryside Mall in Clearwater, FL. The Fresh Market took on a portion of downsized Sears space at Pembroke Mall in Virginia Beach, VA. 365 by Whole Foods will open in fall 2017 in a portion of the emptied Sears at the College Mall in Bloomington, IN.

Small format discount grocers like Aldi and Lidl are also in growth mode. Aldi will roll out as many as 130 new stores annually and Lidl has announced plans to open 150 in 2018. While discount grocers may not make sense in enclosed malls, Aldi did recently open a store on a pad site at a Kmart Center in North Miami, FL.



³ GGP Strategy & Analytics, 2017 survey of 14,000 shoppers

Entertainment tenants deliver fun

Along with dining, entertainment tenants have come to play a bigger role in shopping centers. In Macerich's portfolio, food and entertainment tenants as a percentage of inline space grew from 17.5 percent to 21.4 percent between 2007 and 2016⁴. There is a growing roster of theaters and amusement centers that have or will backfill former department store space.

AMC Theatres will take on former Saks Fifth Avenue space at The Shops at Riverside in Hackensack, NJ. Harkins Theaters opened in 2016 at the site of a relocated Nordstrom at Los Cerritos Center in Southern California. Premiere Cinemas took on the space of a former Mervyn's at South Plains Mall in Lubbock, TX in 2012.



And it's not just theaters, 57 percent of customers would like to see a bowling alley in their shopping center⁵. Concepts like Main Event Entertainment and Dave and Busters offer bowling, along with laser tag, arcade games, karaoke, dining and more. Dave and Busters has opened three locations in the Seritage portfolio and will open up to twelve stores total in the U.S. this year.

Round 1 Bowling and Amusement opened its first location in Japan inside a former skating rink; Today, the entertainment center has 105 locations across Japan and has opened an additional 13 locations in the U.S. with plans to open 50 by 2020.

- Round 1 leased 56,000 square feet of the former Macy's at Northwoods Mall in Peoria, IL
- At Exton Square Mall in Exton, PA, Round 1 opened inside a former JCPenney
- Punch Bowl Social, an adult-oriented gaming center, bar and "gastro diner" opened in 23,000 square feet of former Nordstrom space in Circle Square Mall in Indianapolis, IN in 2016

Other unique types of entertainment have also found homes in enclosed malls. At The Florida Mall in Orlando, a Crayola Experience opened in a portion of a former Nordstrom. Kidzania will open its first U.S. location in Dallas in 2017, with as many as 20 more in the coming years. It's a unique indoor theme park where kids are set loose in a mini city where they can try out jobs like chef, firefighter, baker or doctor.

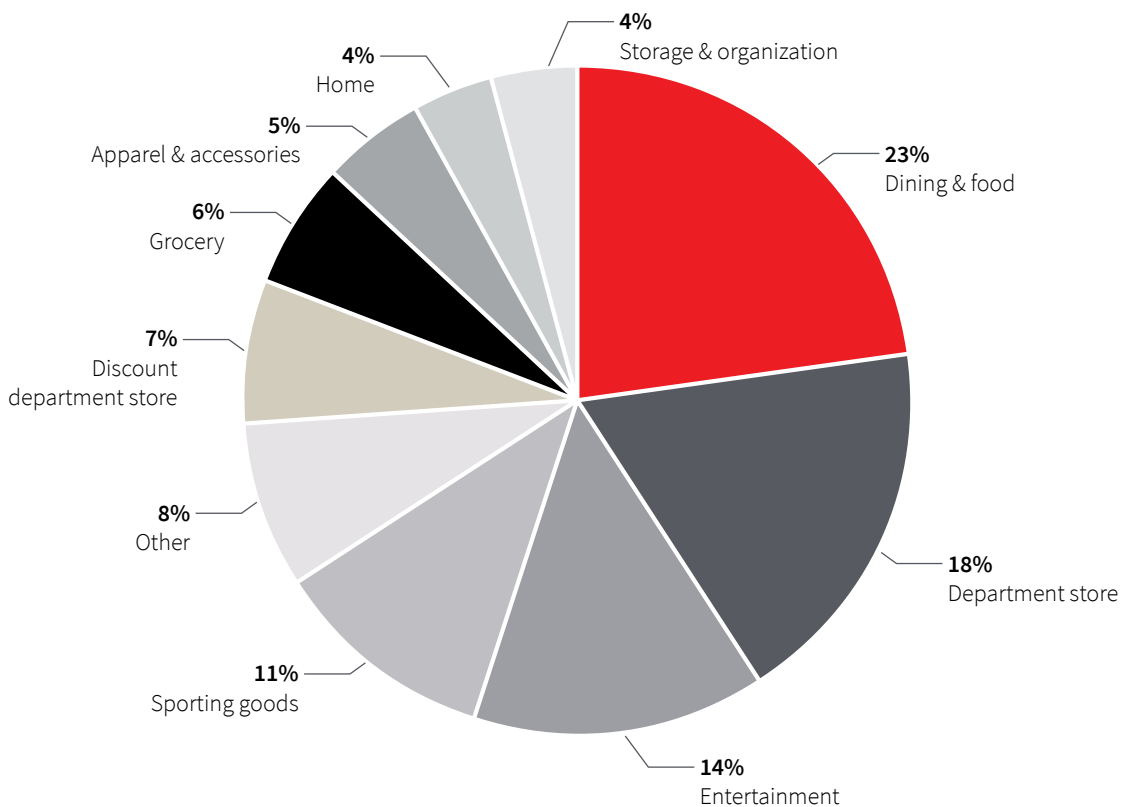
⁴ Macerich Company Overview, December 31, 2016

⁵ GGP Strategy & Analytics, 2017 survey of 14,000 shoppers

Case Study: GGP replaces department stores with food, entertainment and other department stores

We analyzed the redeveloped and re-tenanted department stores within the GGP portfolio, a real estate investment trust which owns 127 retail centers across the U.S. There were 46 examples in which all or part of a department store anchor was replaced by a new tenant. In more than half of the instances, multiple tenants were needed to fill the space. Replacement tenants were most frequently food and beverage, other department stores or entertainment offerings.

Tenants that re-leased empty GGP department stores



Fast fashion and discount apparel sellers see an opportunity

Inexpensive apparel continues to be a bright spot in the retail sector. Primark, the new-to-America fast fashioner with shockingly low prices, has taken on multiple former department stores here in the U.S. These include portions of former Sears space in both the Simon-owned Burlington Mall and South Shore Plaza in Massachusetts. In 2016, Primark opened in portions of Sears at Macerich's Danbury Fair in Danbury, CT and Freehold Raceway Mall in Freehold, NJ.

Primark and Zara together will open in 2018 at the site of a former Sears at Macerich's Kings Plaza Shopping Center in Brooklyn, NY. Along with several other smaller tenants, the redevelopment will offer the owner a stabilized yield of 4 percent stabilized yield which represents an incremental return over Sears former annual rent. The yield would increase to 8 percent excluding the Sears rent from the computation.



Macy's has replaced some of its current space with the discount Macy's Backstage concept. These stores operate within a portion of existing Macy's in centers like Rockaway Townsquare in New Jersey and the Shops at Nanuet in New York. Nordstrom Rack, Saks Off Fifth, ROSS Dress for Less and Burlington have each rolled out locations in former department store space across the Seritage portfolio. At Magnolia Mall in Florence, SC, Burlington leased a portion of space formerly held by Sears and will open by the end of 2017.



Cosmetics, sporting goods and home furnishings

Other retail sectors are taking advantage of available department store space as well. Ulta will take a portion of a former Sears at College Mall in Bloomington, Indiana. The cosmetics retailer plans to expand even further by opening 100 net new stores in 2017.



DICK'S Sporting Goods has also capitalized with three planned or opened locations within the Seritage portfolio. At the Viewmont Mall in Scranton, PA, DICK'S along with its Field & Stream concept, and a Home Goods, leased up a former Sears. DICK's will also move into Sears space at Capital City Mall near Harrisburg, Pennsylvania.

Home Goods, at home, Floor & Décor, Raymour & Flanigan and Orchard Supply have all opened locations in Sears or Kmart space across the U.S.



Even a few new department stores

There are a few recent cases of new department store operators taking over space too. At Woodland Mall in Grand Rapids, Von Maur will open in a space formerly occupied by Sears in 2019. VonMaur also took the place of Nordstrom in the Mall of Georgia in 2016. JCPenney opened at the site of a former Gottschalks at Inland Center in San Bernardino, CA in 2016.

Each shopping center is unique

The highest and best use for an empty anchor will differ from one shopping center to another. The demographics and lifestyles of the community that surround the center will play a large role in dictating re-leasing or redevelopment. Of course, sufficient capital for redevelopment or improvements required to attract new tenants may be a roadblock for some. 63 percent of the closing mall anchors are found in privately-owned shopping centers⁶. These owners may not have the same will or capital to make upfront investments as would a public REIT.

⁶ Green Street Advisors, Store Closing Analysis, March 24, 2017

Contact



James D. Cook
Director of Retail Research
JLL
jamesd.cook@am.jll.com

About JLL Research

Jones Lang LaSalle's research team delivers intelligence, analysis and insight through market-leading reports and services that illuminate today's commercial Real estate dynamics and identify tomorrow's challenges and opportunities. Our more than 400 global research professionals track and analyze economic and property trends and forecast future conditions in over 60 countries, producing unrivalled local and global perspectives. Our research and expertise, fueled by real-time information and innovative thinking around the world, creates a competitive advantage for our clients and drives successful strategies and optimal real estate decisions.

About JLL Retail

JLL's retail experts partners with retailers, investors and owner/operators with an extensive team of dedicated experts around the world. They understand the inherent complexities and variability associated with both the retail industry and increasingly complex capital markets. Its specialists are recognized for their independent and expert advice to clients, backed by industry-leading research that delivers maximum value. With leading in-depth knowledge of the local, regional and global market dynamics, JLL aims to truly partner with its clients for the entire lifecycle of an asset or lease. Its experts deliver clients maximum value that support and shape their investment, site selection and brand strategies.

JLL is the largest third party retail property manager in the United States with more than 1,000 centers, totaling 125 million square feet under management. The firm has more than 140 retail brokerage experts spanning more than 30 major markets, representing more than 900 retail clients. In 2015, JLL's Retail Group completed transaction management and portfolio optimization on 1,500+ leases, negotiated 500+ leases for retailers and 1,000+ leases for landlords and completed more than \$2.7 billion of investment sales, dispositions and financing for investors. For more news, videos and research from JLL's Retail Group please visit: www.jllretail.com.