ICSC WESTERN DIVISION RECAP

Developers see opportunity in mixed-use, secondary markets.

By Nellie Day

Now that most of the hot deals have dried up and competition is increasingly fierce, many ICSC Western Division Conference panelists saw great opportunities outside of dominant centers in urban cores. These opportunities best presented themselves, according to panelists, in mixed-use products in secondary markets. ICSC's Western Division Conference was held Oct. 1 and 2 at the San Diego Convention Center.

"We have learned that mixed-use is tremendous," said Kemper Freeman, a participant in the "Development is Revving Up" panel, chairman and CEO of Bellevue, Wash.-based Kemper Development Company and ICSC's past chairman. "It helps us speed up retail occupancy and rents, and the retail helps speed up occupancy and rents for multifamily."

Freeman cited the Bellevue Collection as an example of retail leading the way, ultimately fostering other development opportunities. The Bellevue Collection contains 250 stores and more than 45 dining and entertainment venues. Notable retail tenants include Nordstrom, Crate and Barrel, Macy's and Tiffany & Co.

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>
> *— Kemper Freeman, Kemper Development Company*

The Bellevue Collection is composed of three properties, including Bellevue Square shopping center, Lincoln Square, which contains a residential tower, office tower, luxury hotel, and retail, restaurant and move theatre space, and Bellevue Place, which contains two hotels, an office tower, and retail and restaurant space. All three components of the property are connected by sky bridges.

Kemper Development recently broke ground on a 2-million-square-foot expansion of the Bellevue Collection. The $1.2-billion investment will bring even more retail, office, hotel, residential, dining and entertainment options to the site.

"Great retail is the best catalyst for all other forms of real estate," Freeman said. "The best way to expand your center into other uses is to keep your retail in the best shape possible. Then work in the five other types of real estate, including hotel, condo, apartment, restaurants and entertainment."

Fellow panelist Brad Geier, managing partner of San Diego-based Merlone Geier Partners, agreed. Like Freeman, Geier also found success in the mixed-use space. His firm is redeveloping and expanding San Antonio Center, an outdoor shopping mall in Mountain View, Calif.

After freeing up space vacated by Sears in 2011, Merlone Geier went about repositioning the 50-year-old mall. Its current anchors include 24 Hour Fitness, Ross Dress For Less, Trader Joe's, Kohls and Walmart. The property will soon include the Village at San Antonio Center, which will contain residential, retail, office and restaurant space. Phase II of the Village will contain more specialty retail, office space, restaurants and a four-star hotel.

"This is a great example of a suburban infill site where original improvements are now obsolete," Geier said. "It needed to be repositioned or torn down. As the Sears leasehold burned off, it gave us an opportunity to redevelop the center and to develop a mixed-use project. Retail really is the catalyst, but it fuels other land uses as well, based on the desire of the community and city to see additional density in a location that's got great existing infrastructure."

Panelist Jeffrey Berkes, West Coast president of San Jose, Calif.-based Federal Realty Investment Trust, believed ground-floor retailers were pivotal to a mixed-use project's viability. They can also heavily influence rents and revenue, Berkes noted.

"Executing the ground-floor space correctly with retail, restaurant and services is the absolute driver to making a mixed-use project successful," he said. "Apartments above a solid retail space can generate a 15 percent to 25 percent premium over what the same use would garner down the street. Apartments, condos and offices will perform significantly better in a mixed-use environment than elsewhere. This is the same with hotels. Those in a mixed-use project can outdo a competitive set by 150 percent to 200 percent."

Berkes' success story came in the form of Santana Row, a mixed-use development in San Jose that contains 70 shops, 20 restaurants, nine spas and salons, a hotel, office space and three residential communities. He warned, however, that investors should do their due diligence before putting their faith in just any operator, as success in one product type doesn't guarantee success in another.

"There are hotel guys and multifamily guys and office guys," he said. "99.5 percent of them don't know how to execute a retail component. If you understand retail, you have a huge leg up in terms of creating value and other uses on your property. Take advantage. Don't let a lot of value go across the street."

What The Attendees Saw

Gary Glick and Scott Grossfeld, partners in the Los Angeles office of Cox Castle Nicholson, were two of the Western Division Conference's attendees. Below, the pair share their perspectives on the event.

Developers Focus Inward at Redevelopment

There was an undeniable vibe at this year's ICSC Western Division Conference that retail expansion and redevelopment are way up, largely driven by economic growth.

In speaking with developers at the conference, they're focused on maximizing the value and performance of their current retail assets, versus ground-up developments. They are looking inward and asking how they can improve the position of their current products.

Gary Glick

Scott Grossfeld

There is a ton of money in the market right now. With an eye toward strong ROI, and cap rates in the 4.5 to 5.5 percent range on well-developed, strong-tenanted retail centers, investors are targeting existing products to redevelop.

Regional mall developers across the country are investing in their own assets to enhance the brand and increase the value of their products. For example, a large developer in West Los Angeles plans to add more than 100,000 square feet to one of its malls, elevating its first-class feel by optimizing its tenant base, bringing in hot, new restaurants, relocating the movie theater (and making it state of the art), updating the food court and adding more parking.

To be clear, this focus on improving assets certainly isn't limited to malls.

Developers are taking advantage of low interest rates to refinance and improve all types of existing retail centers.

Developers are also financing new opportunities, perhaps none larger than mixed multifamily and retail developments.With the steep growth in apartment developments and redevelopments in California over the past seven years, developers want a significant retail component to make their projects more attractive to renters, hitting on the well-known live-work-play phenomenon.

Investment money is currently headed toward retail redevelopment and very select development in areas where new residential rooftops are being built, such as Silicon Valley. Developers are getting very strategic about how they deploy those dollars to increase the value of their assets.

Food Is The New Anchor

Lots of chatter on the show floor revolved around the concept that food is filling many of the spaces in retail centers left behind by shop tenants and pad users.

This idea circles back to a prevailing theme at this year's ICSC RECon Las Vegas show whereby operators of retail centers now prefer to lease to experiential tenants such as restaurants, quick-service food providers and theaters that provide an experience that cannot be offered over the internet.

At the right price point, consumers will leave their homes and spend time at shopping centers, either shopping for groceries, seeing a movie, having dinner or a quick fast-food experience, or going to their fitness clubs (24 Hour Fitness, LA Fitness, etc.). As a side note, fitness facilities have been mainstay tenants and godsends for retail developers since the recession.

On the food front, look at the dramatic growth in the West with burger and made-on-demand pizza shops over the past 12 to 18 months.

Several new fast-casual burger tenants have entered the California market, challenging the existing stalwart incumbentslike Burger King, Carl's Jr., Fatburger, In-N-Out Burger, Jack in the Box, McDonald's, Tommy's and Wendy's. Some of these new players include Five Guys, Habit Burger Grill, Sonic Drive-In, Steak 'n Shake and Umami Burger.

Made-on-demand pizza is following the same high-growth trajectory, with new players such as 800 Degree Pizza, Blaze Pizza, MOD Pizza, Pieology, Project Pie and Red Brick Pizza, which are taking direct aim at Domino's, Little Caesars, Papa John's, Pizza Hut and Round Table. These new players are attempting to bring the Chipotle service concept to pizza, and they are filling the void left by shop tenants that went out of business, mostly due to the Great Recession or internet shopping.

Another food-related segment where big players will vie for prime retail space in the West is the growing coffee café category. The battle lines are being drawn between incumbents like Coffee Bean & Tea Leaf, Peet's, Starbucks and the new entrant to California, Dunkin' Donuts. It will be interesting to see if Dunkin' Donuts can grab a large market share of this business in California, as it has done so in many other parts of the country. Given the huge growth potential in the morning grab-and-go foods category, these 400-pound gorillas are filling retail space as quickly as it can be found, especially those precious high-visibility pads that can accommodate drive-thrus.

The "greening" of America has had an impact on Western retail as well. Several health-conscience grocers and fast-casual dining users have popped up as of late Whole Foods has been around for years, but now we are seeing othersenter the market, such as Fresh Market and Sprouts, along with a host of new eateries, including LYFE Kitchen, Urbanspoon and Veggie Grill.

It's an exciting time to see all of these new retail concepts. Some will survive, many will not. However, for the retail developer, these food providers offer a very welcome relief in the post-Great Recession world of leasing. ■