It is no surprise to retailers and shopping center developers in particular, and to U.S. consumers in general, that the department store industry is suffering. There are a myriad of reasons for this – the growth of large format specialty, off-price stores, and the impact of e-commerce prime among them – but the fact remains that the industry is suffering.

Department stores have been critical components of regional shopping centers for the past half century. Most regional shopping centers were laid out with department stores “anchoring” each wing or corridor of the center, with the goal of this positioning intended to generate walk-by traffic that would benefit the ancillary tenants along the way. The underlying theory was that smaller secondary tenants could not, on their own, generate enough customer traffic to be viable – they relied on department store-generated traffic to survive, much as a remora feeds off the food scraps from its host shark. Leasing economics reflected this premise and department store anchors were heavily subsidized while ancillary tenants paid significantly higher rent and CAM (common area maintenance) fees.
There are a number of factors that disrupted this traditional paradigm, including:

**Lifestyle Centers**

Emerged as a viable alternative to traditional department store-anchored regional malls. They generally seek to replicate the dynamism of a traditional downtown area and have fewer (or no) department store anchors than traditional regional malls.

Easton Town Center in northeast Columbus was an early example of this disruption, as it has been a very successful shopping environment despite having only two department store anchors (Nordstrom and Macy's) in a 1.6 million square foot development. Comparable regional malls of this size would generally feature 4-6 department store anchors.

**Department Store Vacancies**

Department store closures forced many mall operators to seek other retail anchor tenants. As such, many large-format tenants that traditionally located in power centers, such as Dick's Sporting Goods and Bed Bath & Beyond, have become more common as regional mall anchor tenants. The underlying logic was clear – if we can't have a department store anchor, let's get a large format retail tenant that will be capable of generating reasonable levels of customer traffic.

Regional mall owners also became more willing to add discount department stores, such as Walmart and Target, as anchor tenants; this was almost unheard of 30 years ago. With the exception of smaller market regional malls that needed to appeal to the full cross-section of potential consumers within their more sparsely populated trade areas, regional mall operators had generally shunned discount department stores in favor of traditional department store operators. This bias has faded as discount shopping has become more accepted, and as mall operators have had to explore all options to keep their centers viable.

The tenanting environment is much more complex in 2019. Even highly successful “A” malls are finding that they need to find alternative tenanting strategies to remain viable, as the pool of department store anchors continues to shrink. For operators of less successful “B” and “C” malls, ensuring future success will be significantly more challenging.
So what is the answer for mall operators? Is there a consistent, “one-size fits all” approach that they can take to replace disappearing anchor tenants in order to remain viable?

The answer to the above is a resounding “No.”

After decades of successfully exploiting a consistent anchor tenant/ancillary tenant paradigm, mall operators are now forced to step out of their comfort zone and carefully consider all viable options, and to identify a future tenant mix that will result in a viable property white fostering sales and profitable growth. There are several factors that mall owners need to consider when crafting their redevelopment plans, including how much rental income will a new tenant generate and how will it benefit the overall viability of the center. But, mall owners must go one step further before pursuing alternative re-tenanting options.

What is the underlying demand for alternative use?

Identifying the most appropriate alternate uses for a vacant portion of a regional shopping center is completely dependent on the localized supply and demand for that use. Some shopping center properties are blessed by the fact that demand exists for multiple new uses in their facility (such as residential, hotel, and office), and therefore have the luxury of selecting the use that maximizes profitability. Other properties are less fortunate and may only have one or two possible uses (or none) for vacant space.

What synergistic benefit will the new use provide to The existing tenant base?

Once you know the underlying demand for alternative usage in a market, mall owners also need to consider the impact the new use will have on the existing tenants. The impact can be positive or negative based on dependant the ancillary tenants are on foot traffic generated by an anchor.
Alternate Uses and their cross-shopping benefits

Below are some alternative uses and their cross-shopping benefits that can make each a viable option.

Large format retailers

Filling an open anchor in a shopping mall with a large format retailer seems like a no brainer, but it isn’t that easy. The benefit a new retailer will have on the shopping mall is greatly dependent on the type. The benefit of supermarket anchors in a regional mall is mixed – while supermarkets generate a high number of weekly customer visits, little cross shopping will occur between a grocery customer who has a cartful of groceries or has just purchased frozen foods and more traditional ancillary tenant customers. Similarly, home improvement centers such as Home Depot or Lowe’s may not make the best co-tenants – many of their shoppers are contractors (not likely to cross-shop), while many others have a single-minded focus on remodeling or repair projects when shopping.

Office and Co-working Spaces

Office workers represent a potential source of consumers, and their proximity to other mall tenants will likely result in frequent shopping trips. However, there are two limitations to the cross-shopping benefits accruing from office building workers: the number of workers within the office space, and the shopping propensity of these workers. A typical office building has about 200 square feet of space per employee – as such, a 200,000 gross square foot department store might reasonably accommodate ~1,000 employees, which is a fraction of the ~300,000+ trade area residents typically served by a regional mall. Further, office workers have above-average demands for food service (especially during the lunch hour) and convenience purchases, but may not be in a mindset to undertake major shopping excursions at the end of the workday. Office buildings also have much more limited traffic on weekends, which are an important time for regional malls.

Hotels

Hotels provide a steady stream of new visitors to an adjoining regional mall. As an example, a 200-room hotel with an average 70% occupancy rate and an average stay of 2 nights per guest and ~1.25 guests per room will generate ~32,000 unique visitors to the hotel, all of whom represent potential regional mall patrons. Guests at a hotel located in a resort area will likely be more conducive to make expenditures than typical business guests.
More Alternative Uses

Apartments and Condominiums

The construction of apartments or condominiums as part of a regional shopping center can provide a source of adjacent shoppers, but their numbers are limited. The average new apartment in the U.S. is ~900 gross square feet – as such, a 200,000 gross square foot space would only yield ~200 – 225 units. An average of two persons per apartment would yield 400 – 450 residents – certainly helpful, but hardly likely to generate the same traffic as a strong retail anchor.

Fitness Centers

Fitness centers typically bring a limited population base to a center, as many of their customers patronize a fitness center on a regular basis (such as weekly). Further, the times selected by many patrons to work out (such as before work) may inhibit their cross-shopping opportunities.

Health Care Facilities

Health care facilities (such as ambulatory offices for a hospital system) generally attract a fairly limited number of patients, diminishing their benefit as a significant customer source. Further, many health care facilities are not open and/or have reduced hours on weekends.

Theaters

Theaters represent a logical tenant replacement – theatergoers often seek out food and beverage options prior to or after going to the movies and may have free time before or after to do some shopping.

Churches

Churches have the opposite challenge as health care facilities – if services are only held on Sunday, their cross-shopping benefits during the balance of the week would be comparable to leasing space to a warehouse.

Capital Funding Requirements

Once you have identified what alternate use to pursue based on the demand in the market and the synergistic benefits of the current tenant mix, a shopping mall owner will need the capital to fund the re-tenanting of one or more vacated anchor locations. The capital necessary to make the needed improvements and modifications to attract new tenants can be substantial. While mall operators who are well-capitalized will have the financial ability to execute on their new strategy, owners of suffering malls have to overcome this large hurdle in order to finance the amount of capital needed to act on even the best of redevelopment plans.
The decline in the number of viable department store anchors will continue to provide challenges to regional shopping center owners in the U.S. Those owners who have access to capital, who take the time and effort to develop a viable redevelopment plan, and who have the good fortune to have demand for other uses on their property will continue to thrive in the coming years.

IN SUMMARY

HAVE QUESTIONS ABOUT RETAIL SITE SELECTION?

Talk to the experts!

CLICK HERE TO CONTACT US

We look forward to helping you any way possible!