

Urban Retail 101

Workshop #1



A Retail Real Estate Consulting Firm

San Francisco / Chinatown
Chinatown CDC
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Basic Concepts

- What is "retail"?
 - Anything that is open to walk-in consumers
 - Shops
 - Services
 - Coffeehouses
 - Restaurants
 - Entertainment uses



The Importance of Retail

- What's at stake...
 - Survival of the retailer
 - Bottom line of the landlord
 - Modernization of the building
 - Long-term vitality of the district
 - Sense of identity for the community
 - Tax base of the municipality
 - Social adhesion of the culture



Basic Concepts

- Where does retail come from?
 - It just drops from the sky, right?



Basic Concepts

- The havoc that Kevin Costner hath wrought...
 - The dangers of *Field of Dreams* thinking
 - The importance of market analysis



Basic Concepts

- The "science" behind retail
 - Can tell you all sorts of interesting things... if you know what to look for



Basic Concepts

Terminology

- "Trade area"
 - District's most frequent and loyal customers
 - Represent roughly 70% of its retail sales



Basic Concepts

Terminology

- Convenience goods and services
 - Interchangeable “commodities”
 - Price, style and quality roughly the same everywhere
 - Consumers will choose store solely on the basis of convenience
 - **Examples:** traditional grocers, drug stores, dry cleaners, fast food
 - Draws from the immediate neighborhood (i.e. local trade area)



Basic Concepts

Terminology



- **Comparison goods**
 - Price, style and/or quality vary from one store to the next...
 - ... consumers will “comparison-shop” and choose store on the basis of these factors
 - Favors districts with a large selection of such stores
 - **Examples:** apparel, footwear, jewelry, furniture, sit-down dining
 - Consumers will travel further for that selection

Market Analysis

- Two markets to consider...
 - Consumers demanding goods and services (from retailers)
 - Tenants seeking retail space (from property owners)



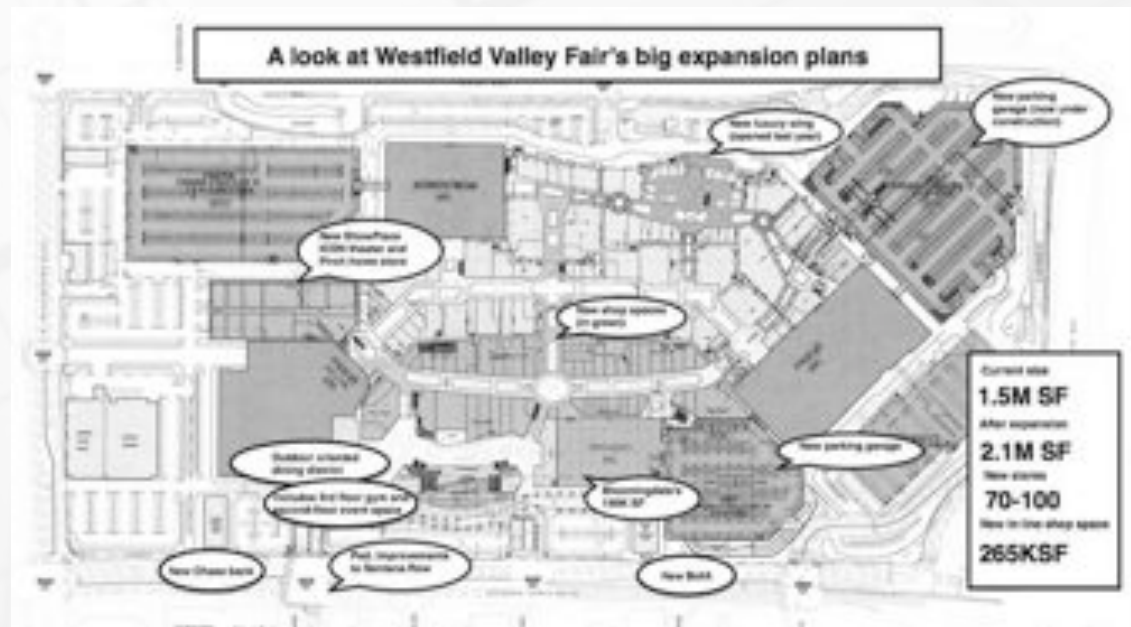
Market Analysis

- Two markets to consider...
 - Not evaluated in a vacuum but versus the competition (current and potential)
 - For the consumer
 - For the prospective tenant



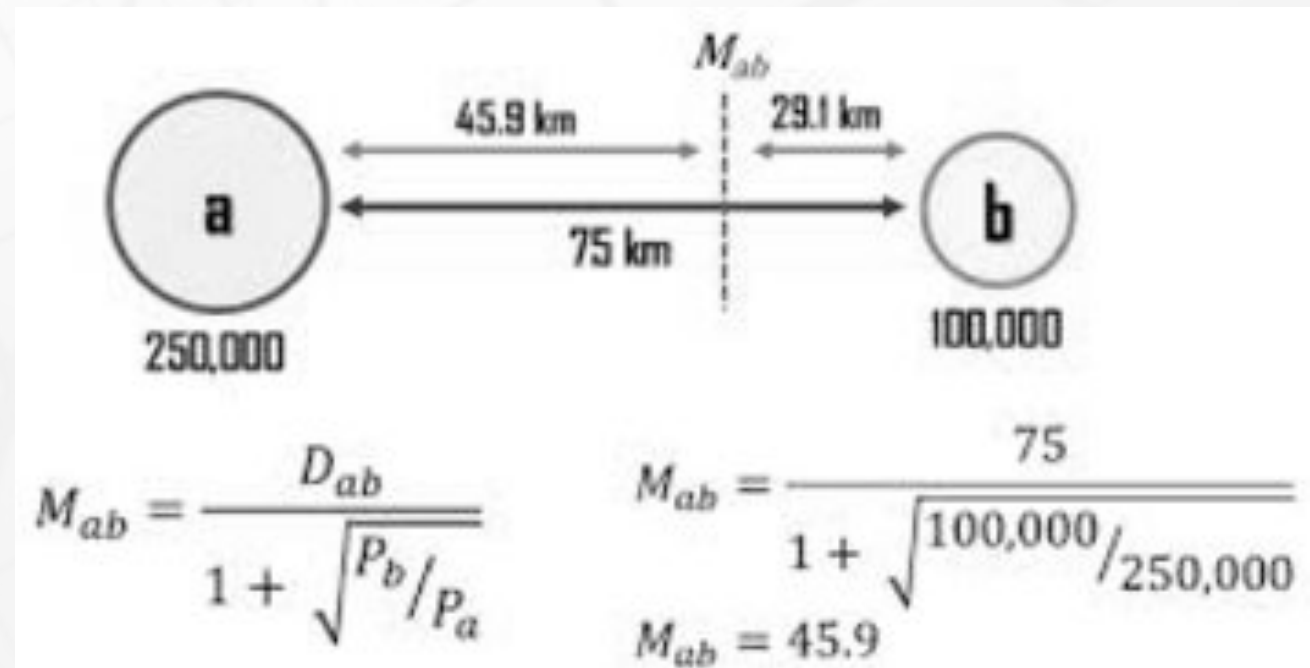
Consumer Demand

- The lure of clusters
 - The convenience of one-stop shopping
 - The comparison in comparison goods
 - So-called "fortress malls"



Consumer Demand

- Reilly's Law of Retail Gravitation
 - Larger shopping destination enjoys correspondingly more “gravitational pull”



Consumer Demand

■ Visibility

- How do consumers know / learn about it?
 - Becoming and staying "front-of-mind"
 - Captive sub-markets
 - Drive-by / walk-by traffic
 - Traditional and social media



Consumer Demand

- Access
 - How do consumers get to it?
 - Road network (and parking)
 - Transit service
 - Walkability



Consumer Demand

- Trip purpose
 - Why are consumers there?
 - What are they looking to buy (if anything)?



Consumer Demand

- Convenience goods and services
 - Quick "in-and-out" preferred
 - Auto orientation – free, in-front parking
 - Pedestrian orientation – sufficient densities within walking distance



Consumer Demand

- **Comparison goods** (including sit-down dining and entertainment)
 - Implies longer (leisured) stays
 - More willing to park further away, even in a parking deck



Consumer Demand

- The slow fade of commodities
 - Convenience retail as specialty
 - Grocery
 - Pharmacy
 - Pet supplies
 - Barbers



Consumer Demand

- Shopping experience
 - Based on current expectations
 - Paid parking
 - Cosmetics / up-keep
 - Homelessness



Consumer Demand

- Trade area demographics
 - Quantitative characteristics
 - The "density of demand"
 - SF Chinatown – low median income but large population per sq. mile

Spending Power			
Within a Three-Mile Radius (2013)	Downtown Berkeley	Downtown Walnut Creek	Downtown Palo Alto
Population (2013)	204,151	96,352	146,138
Population Density (per sq. mile)	7,411	3,408	5,169
Population Growth (2000-13)	+11.1%	+5.8%	+6.2%
# Residents Aged 35 or Above	106,935	60,321	73,466
# Residents With B.A. or More	89,473	42,698	55,151
# of Households Earning \$75K+	36,481	23,142	30,442
Total Spending Power	\$4.04 billion	\$2.07 billion	\$1.97 billion

Source: Nielsen-Claritas, MJB Consulting

Consumer Demand

- Trade area demographics
 - Increasing appeal of crossover concepts (assuming authenticity and accessibility)



Consumer Demand

- Trade area psychographics
 - Lifestyles, sensibilities and aspirations (qualitative)



Tenant Demand

- Two markets to consider...
 - Tenants seeking retail space from property owners
 - Comparing to possible alternatives



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STORE HOURS
MONDAY – WEDNESDAY 10AM – 8PM
THURSDAY – SATURDAY 10AM – 9PM
SUN & HOLIDAYS 11AM – 6PM

High quality,
stylish basics
for men,
women & kids

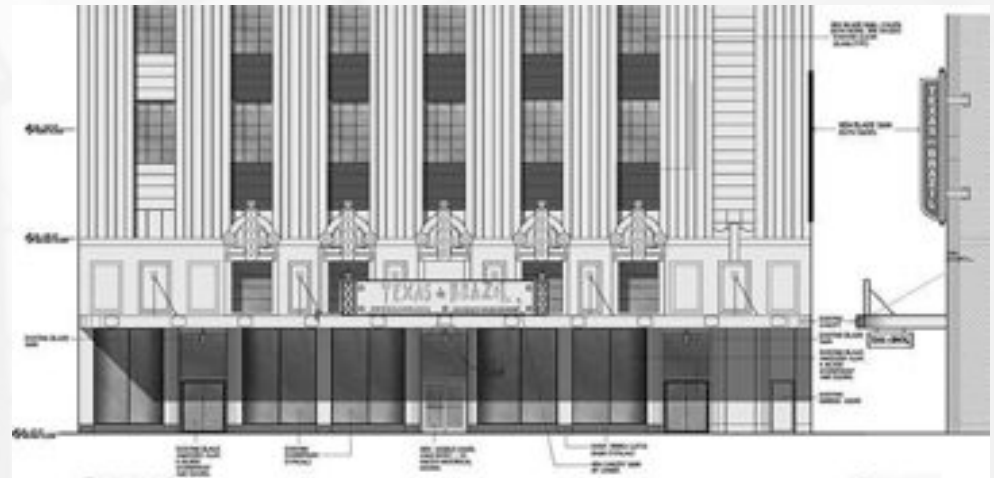
Tenant Demand

- Leasing today dominated by F & B, services
 - We live in a fast-casual world...
 - The informalities of fine dining
 - Approaching saturation in certain categories
 - Coffee and coffeehouse culture
 - Indulge, then exercise (or vice versa)

The logo for tendergreens, featuring the word "tender" in a lowercase sans-serif font, followed by a stylized green leaf icon, and then the word "greens" in the same font.

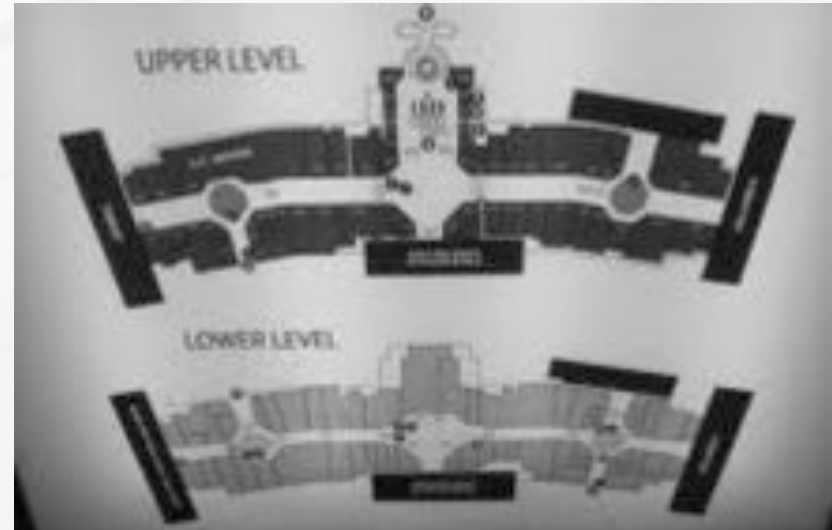
Tenant Demand

- Available and suitable spaces
 - Square footage
 - Linear frontage
 - Configuration



Tenant Demand

- Within the flow of potential shoppers
 - Between two "anchors"
 - As in the typical enclosed mall
 - On the "right" side of the road
 - "Drive-home" and/or sunny side



Tenant Demand

- Corners versus in-line spaces
 - Offer better visibility and access
 - Patio seating and drive-thru (for food and beverage)
- Notion of "the 100% corner"



Tenant Demand



- Retail site planning and modal split
 - Must be in alignment
 - Store signage
 - Building setback

Tenant Demand



- Retail site planning and modal split
 - Must be in alignment (continued)
 - In-front or in-back parking
 - Perceived (female) safety

Tenant Demand

- **Occupancy costs**

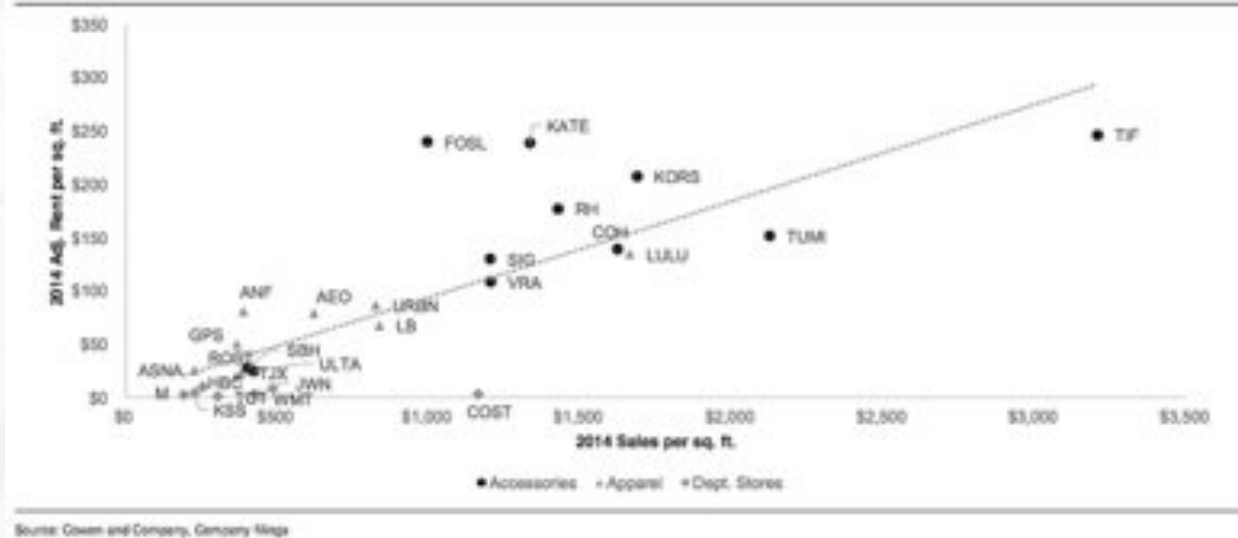
- Base rent
- Pass-through expenses
 - "Triple-net" or "NNN" – taxes, insurance, maintenance (or "CAM")
- Build-out costs
 - Tenant improvement allowances or "TI"
- Percentage rent

- **Retail condominiums rare**



Tenant Demand

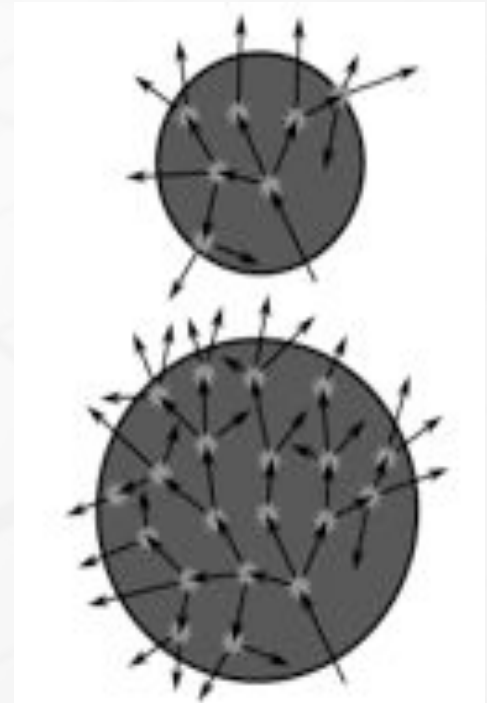
Figure 7 . Better Sales Productivity is Directly Related to Higher Rent per Square Foot



- Ratio of occupancy costs to projected gross sales
 - 10% rule-of-thumb
 - 1,000 sq ft space at annual rent of \$20/sq.ft. = rent of \$20,000/year
 - Requires gross sales of \$200,000/year
 - Tenant likely to fail if ratio higher than 15%

Tenant Demand

- Concept of “critical mass”
 - Point at which a given market undergoes a fundamental change with regard to its scale and potential
 - Where one “goes for X, Y or Z”
 - A whole greater than the sum of its parts



Tenant Demand

- Lure of "co-tenancy"
 - Typically achieve far greater volumes amidst *critical mass* than in standalone locations
 - Increases visibility and cross-traffic
 - Mitigates perceived risk
 - “Safety in numbers” strategy
 - Anchors as the most coveted co-tenants
 - Non-retail anchors and trip purpose



Tenant Demand



- Momentum and trajectory

- Evolutionary stages and pioneering "bellweathers"

- "I chose **Hayward** as our next opportunity because it's a jewel on the rise. The diverse population, the development and value for your investment is strong, and I feel like we fit perfectly into the new renaissance culture that's emerging here. We hope to play a significant role in the vanguard of the Hayward culinary scene resurgence."

- **Michael LeBlanc**, owner of Pican in Uptown Oakland and now, Bijou in Downtown Hayward

Tenant Demand

- Criteria (or weight given thereto) varies based on kind of tenant
 - Large national brands versus small local "chain-lets"



Tenant Demand



- Store "prototypes" (chains)
 - Allow for economies-of-scale in design and development
- Willingness to deviate (and absorb added costs)
 - How badly does it want to be in that (type of) sub-market?
 - What has the trade area been conditioned to expect?

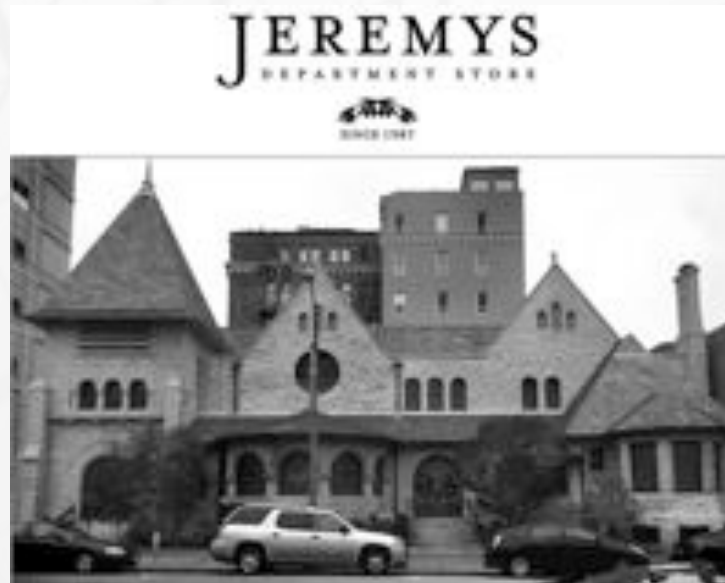
Tenant Demand

- Property owners
 - Level of engagement (if any)
 - Personalities and sensibilities
 - Willingness to partner (e.g. TI)
 - Track record



Tenant Demand

- Public sector
 - Providing certainty and predictability
 - *"Time is money"*
 - Room for discretion = risk



Tenant Demand



- Public sector

- What messages is it sending to the private sector?

- "If [Lincoln Landing] is not approved, that would be the **'kiss of death'** for Downtown Hayward as far as the development and leasing communities were concerned."

- Prominent East Bay retail leasing professional

Property Owner Perspective

- Incentivized to focus exclusively on the bottom line...
 - ... but too often demonized as greedy and unscrupulous



Property Owner Perspective

- Need to recoup up-front costs and earn a profit
 - Higher development costs = higher occupancy costs
 - Have to "buy" anchors



Property Owner Perspective

- Need to recoup up-front costs and earn a profit
 - Higher development costs = higher occupancy costs
 - Higher-quality buildings
 - Larger public realm
 - More "community benefits"



Property Owner Perspective



- Obsessed with (perceived) risk
 - Replicate what has worked before
 - Prefer large "credit" tenants
- Constrained by funding sources
 - Debt payments to lenders
 - Returns to investors (private or public, i.e. "us")

Property Owner Perspective

- Realities of development economics
 - Occupancy costs based on development costs + return
 - Are **interested** tenants able and willing to pay those rents?
 - If not, how might the math be changed?
 - Public/private partnership
 - Flexibility with land uses and densities



Property Owner Perspective

- "The rents are *too high*" fallacy
 - Rents = what the market (for retail space) can bear
 - Only *too high* if there is...
 - Extended period of vacancy
 - Constant turnover of tenants
 - Maybe just *too high* for certain kinds of tenants (*that you want*)?



Property Owner Perspective

- Landlord / developer exceptions
 - Ones incentivized to think more broadly, consider "loss leaders"
 - Filling large amounts of retail space
 - Driving higher premiums on other uses
 - Motivated by larger mission
 - Bringing "patient" capital



Broker Perspective

- Paid by commission (from landlord)
 - Gravitate to the easiest deal, for the highest rent
 - Focused on matching tenant to space
 - (Also) not incentivized to think more broadly



Public Sector Perspective



- Responding to (most vocal) constituents
 - .. and/or moneyed interests
- Generating jobs and sales-tax revenue
- Leveraging other investments
- Creating or strengthening the brand
 - Attracting new residents, workers, visitors, investors, etc.

Community Perspective

- Retail as a public good or utility
 - ... but browsing does not pay the bills



Community Perspective

- Retail as a public good or utility
 - Progressive politics and cost burdens
 - Every \$1 increase in min wage results in...
 - 4-10% increase in restaurant closures
 - 4-6% decrease in new restaurants
 - Impact felt on the margins (which can make all the difference)



Community Perspective

- Retail as the *face* of the community
 - The first (and only) land use that visitors can see and understand
 - A reflection of our aspirations and sensibilities
 - How we see ourselves and want to be seen by others



Community Perspective



- Retail as a pawn in identity struggles
 - Rampant use of code language
 - "... engaging the *community*" (i.e. *people like us*)
 - "... offering *authenticity*" (i.e. *people like us can relate to it*)

Community Perspective

- Longing for the personal and small-scale
 - "Artisanal", "handcrafted", "curated", "bespoke", etc.
 - But when happens with small starts to become big?
 - Or big tries to go small?



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Community Perspective



- **Formula retail ordinance**
 - Establishments with multiple locations as well as standardized features or a recognizable appearance
 - Considered detrimental to "community character"
 - Must be controlled to "maintain neighborhood individuality"
 - Prohibited in Chinatown Visitor Retail district (Grant Avenue)

Community Perspective

- What is (and is not) a "formula retailer"
 - 11 locations in the U.S. or internationally? (either, now)
 - 11 locations with the same banner or owner? (yes)
 - 11 locations to attain economies-of-scale? (yes but...)
 - 11 locations owned or franchised? (either)
 - 11 locations but started locally? (yes but...)
 - 11 locations but "we like them"? (yes)



Community Perspective



- "Legacy Business Registry and Preservation Fund"
 - Recognizes small businesses and non-profits as *historic* assets
 - Benefits include...
 - Annual grant based on number of employees (for businesses)
 - Per-sq-ft rent subsidy on long-term leases (for landlords)
 - Requirements include...
 - 30 years in business or more
 - Has contributed to its "neighborhood history"
 - Agree to maintain "identity, name and craft"

Community Perspective



■ Retail as a pawn in identity struggles

"I just read a story about how brunch is over," a friend says. "One of the commenters said: 'Brunch isn't over. It's over for you.' " Just because you stopped staying out late and sleeping in and then stumbling over to Cafe Orlin for a Bloody Mary and eggs at 2 p.m. doesn't mean no one else is doing that now, or doing something that feels just as exciting.

If you're complaining about the East Village, or New York in general, being dead, I think it's worth considering the possibility that, yes, it is over — for you. But for plenty of others, the city is as full of potential and magic as it was in 1977. Or 1964. Or 1992. Or whenever you last walked down the street and felt like it belonged only to you."

- Ada Calhoun, Author

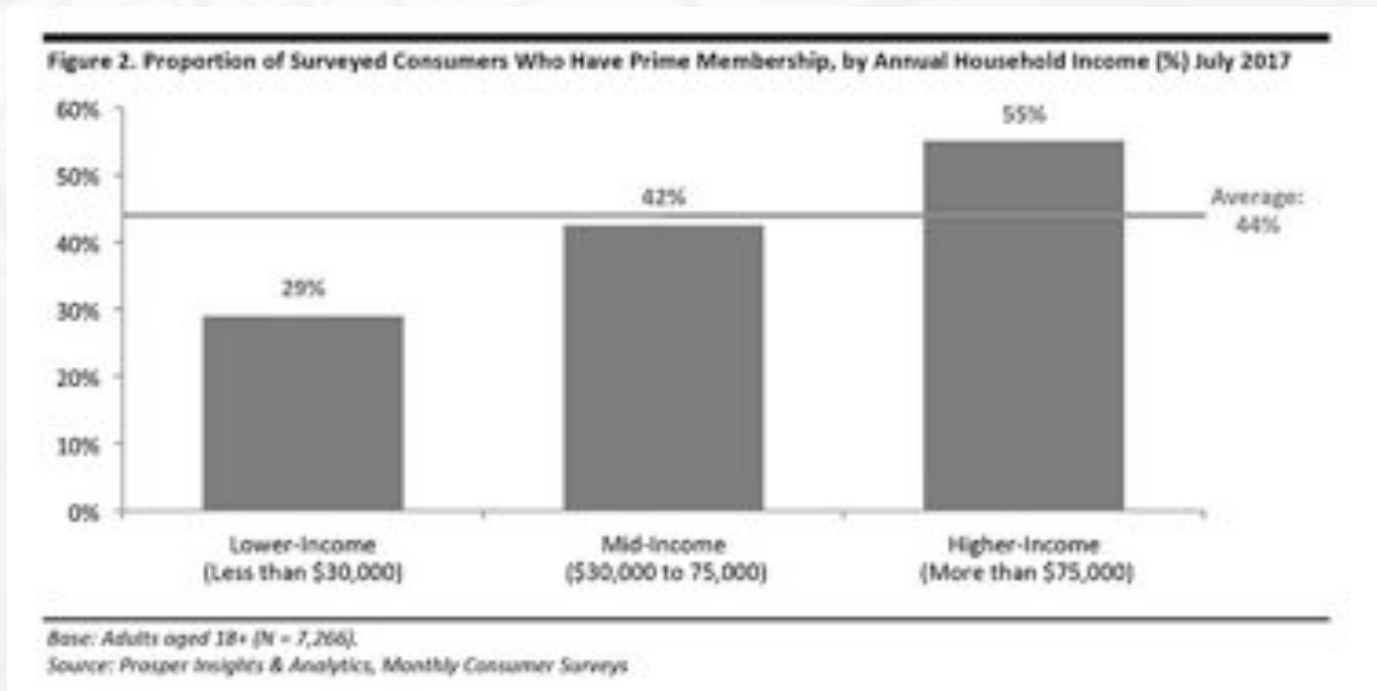
Impact of E-Commerce



- "E-commerce hysteria" (consumer demand)
 - Accounts for 8.3% market share (4Q '16)
 - % includes omni-channel sales, shipping costs, etc.
 - Growth rate appears to be slowing

Impact of E-Commerce

- "E-commerce hysteria" (consumer demand)
 - Penetration correlated with income levels



Impact of E-Commerce

- "E-commerce hysteria" (tenant demand)
 - Continuation of brick-and-mortar expansion in certain categories
 - Off-price fashion
 - Cosmetics and skincare
 - Home furnishings / improvement
 - Rise of "clicks-to-bricks" phenomenon
 - Longtime struggles of disappearing chains
 - Attributable to other factors



Impact of E-Commerce

- "E-commerce hysteria" (tenant demand)
 - Pure-play ultimately unsustainable
 - High costs of shipping and returns
 - Physical presence needed for "front-of-mind"
 - Higher online sales in submarkets with stores
 - "Right-sizing" portfolios and finding the right "omni-channel" balance



Diverse Retail: A Typology

- "Immigrant gateway" district
 - First-generation immigrants
 - Arrive with little to no income
 - Within high-density cities (historically)
 - Local examples include...
 - Stockton Street
 - Oakland / Chinatown



Diverse Retail: A Typology

- "Immigrant gateway" district
 - Food from the homeland
 - Eateries, specialty food markets
 - Media in the native tongue
 - Books, music and videos
 - Professionals who speak the language
 - Doctors, dentists and insurance agents
 - Financial institutions from the mother country



Diverse Retail: A Typology



- "Immigrant gateway" district
 - Can be very strong performers on a per-sq-ft basis...
 - ... but demand must be replenished across generations
 - Initial settlers typically move up and out
 - 2nd generation often does *not* want to run the family business
 - ... or else, growing # of retiring merchants, vacant spaces

Diverse Retail: A Typology

- "Later-generation touchstone" district
 - Where initial settlers (who left for the suburbs) return to reconnect
 - Emphasis on cultural, religious and/or culinary traditions
 - Eateries, specialty food markets
 - Pull weakens with each subsequent generation



Diverse Retail: A Typology

- "Ethnic / non-ethnic hybrid" district
 - Where lost demand has been "back-filled" by tourists and suburban day-trippers
 - Emphasis on culinary tradition
 - Eateries
 - Raises questions of authenticity



Diverse Retail: A Typology

- "Ethnic / non-ethnic hybrid" district
 - Where lost demand has been "back-filled" by foodies/neo-hipsters and wealthier co-ethnics
 - Emphasis on culinary traditions
 - Eateries
 - Raises questions of authenticity and accessibility

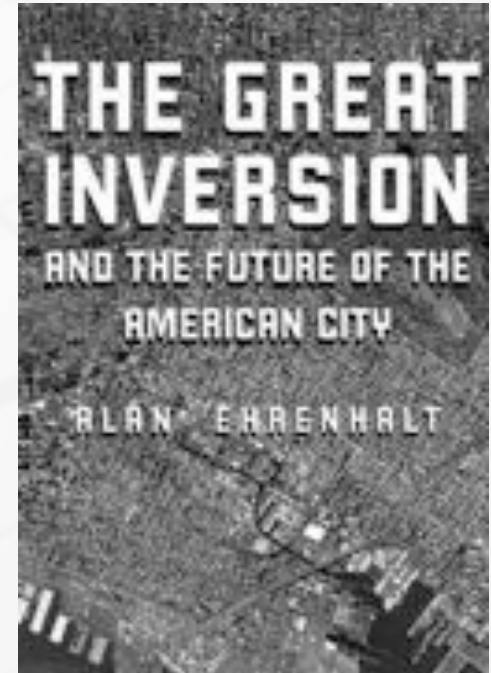


Diverse Cities: At Risk

- Misalignment with neo-hipster sensibility
 - Proximity to Financial District
 - Established tech leaves little room for start-ups
 - Resulting pressure on adjacent districts



Diverse Cities: At Risk



- Impact of "demographic inversion"
 - Inner city no longer "where poor people live" while affluent flee to the exurbs
 - *Now* where the affluent choose to settle, pushing immigrants / poor to the suburbs

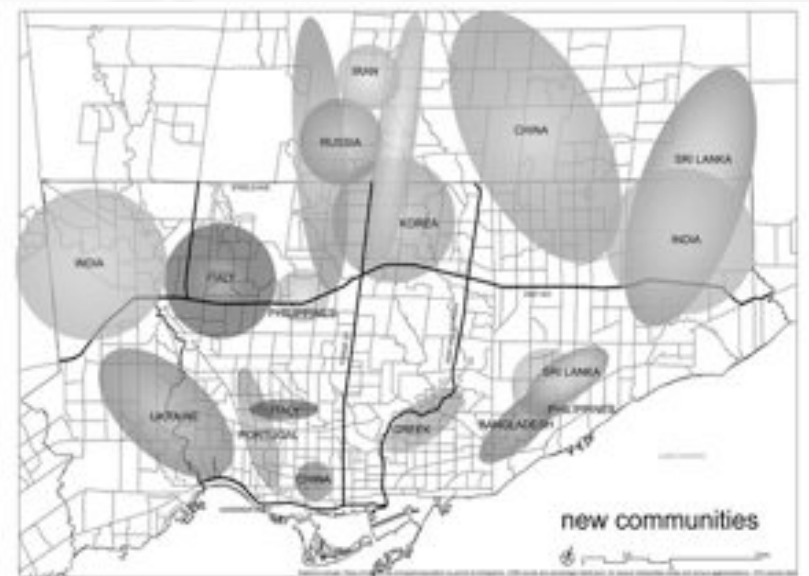
Diverse Cities: At Risk

- Impact of demographic inversion
 - Resurgence in urban living resulting in loss of ethnic and/or socioeconomic diversity



Diverse Cities: At Risk

- Impact of "demographic inversion"
 - Suburbanization of ethnic diversity (across the socioeconomic spectrum)
 - Traditional first-generation immigrants
 - Ethnic Vietnamese - San Jose's Little Saigon



Diverse Cities: At Risk

- Impact of "demographic inversion"
 - Suburbanization of ethnic diversity (across the socioeconomic spectrum)
 - Educated first-generation immigrants, with resources
 - Taiwanese - Cupertino, Milpitas, Fremont
 - Drawn to good schools, new homes, sense of space
 - » "The 99 Ranch Effect"



Diverse Cities: At Risk

- Impact of "demographic inversion"
 - Danger of falling below threshold needed to sustain niche in the urban setting
 - Disproportionate effects of little incursions





Contact Info

With any comments or questions...

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