The American mall: A survival guide

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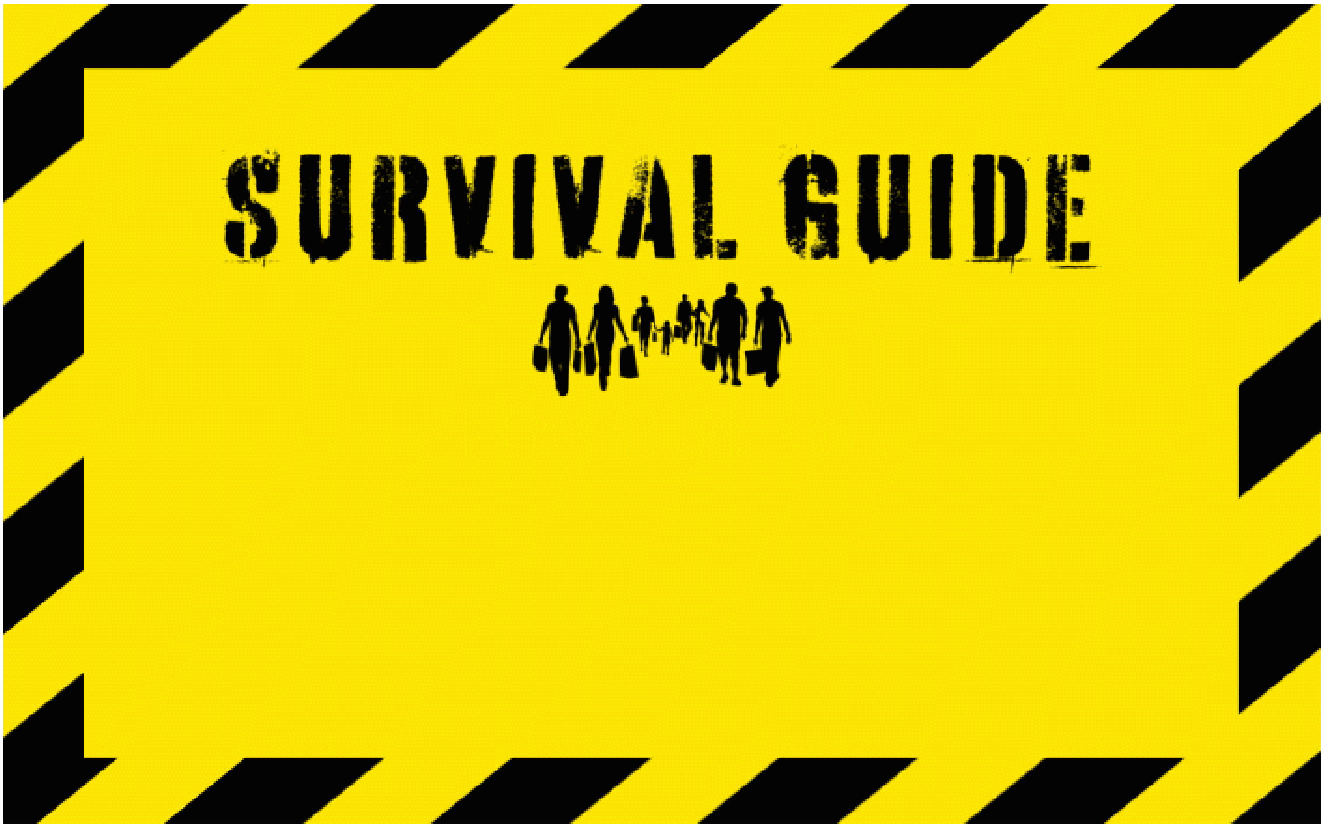


The death of the mall is an idea as ingrained today as the waft of baked pretzels and department store perfume less than a generation ago.

Even David Simon — who took the country's leading mall owner public in 1993 and continues to reign over the firm — has his doubts.

"Do we have too many malls?" Simon Property Group's CEO rhetorically asked investors during the company's second quarter earnings call. "Sure."

Traffic at the country's largest malls dropped 51 percent in the first eight months of 2020 compared to the same period last year, according to data Placer.ai provided to *The Real Deal.*

The Covid-induced emptiness comes as real estate investment trusts squabble with retailers over lease payments and struggle with their own mortgage bills. "The biggest issue for malls is their debt and lack of access to capital," said Alexander Goldfarb, a senior analyst at Piper Sandler.

Such problems were underscored last month when Brookfield Property Partners and

Nandar Realty each punted on mortgage payments at individual malls, catapulting the shopping centers into special servicing. Meanwhile, two of the biggest malls in the country — the Mall of America in Minneapolis and American Dream Mall in East Rutherford, New Jersey — have missed millions of dollars in mortgage payments.

David Simon, Simon Property Group

A recent Credit Suisse report noted that 25 percent of U.S. malls are set to close by 2022 and the no-frills website deadmalls.com lists centers that have already shuttered.

"There will be a lot of shopping malls that simply won't survive," said Michael Soto, research director at Savills.

There is, however, a mall-half-full version of this story in which the REITs that cut their losses and reposition can endure, a view held by Soto and a number of brokers, analysts and even some owners.

Weathering the storm, experts say, depends on following a few strategies: partnering with e-commerce companies including 800-pound gorilla Amazon, swapping out department and clothing stores for grocery and health retail, and even leveraging nostalgia for the mall as a community gathering space.

Malls may not return to their former glory — or ever again symbolize U.S. consumerism — but they can survive. Here's how:

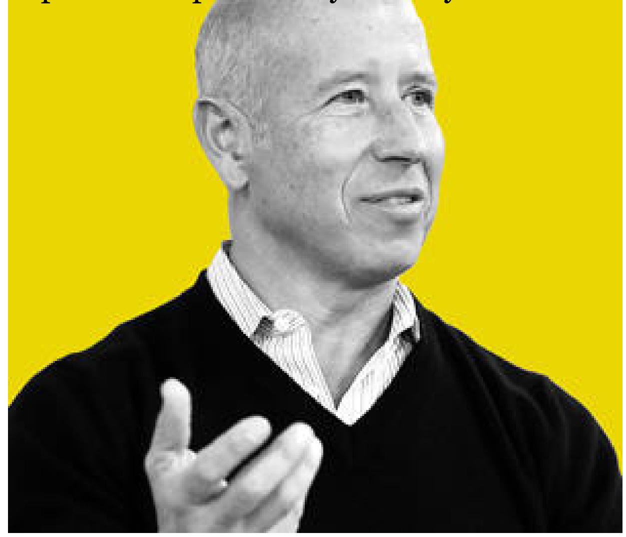
Embrace the saboteur

Retail developers tend to see Amazon as an enveloping force of evil that has severely weakened brick-and-mortar stores and made lenders reluctant to invest in physical shopping centers.

"They are demolishing the Main Streets of America," Starwood Capital Group's Barry Sternlicht said of Amazon in a May interview with *TRD*.

After all, as mall REITs saw declining revenues in the second quarter, the Seattle-based company raked in $106 billion in online shopping sales, a 40 percent year-over-year leap.

But Amazon has become so omnipresent, analysts and brokers say it might actually be wise for mall owners to embrace their enemy. One such partnership that may already be in the works entails using mall space as Amazon distribution hubs, or “fulfillment centers.”



Barry Sternlicht, Starwood Capital Group

“The argument is that if you want to have a viable long-term mall, we’re all taking emergency steps to get through this together, and that’s why this is a pill that might need to be swallowed for now,” said Casey Sobhani, head of DLA Piper’s U.S. leasing practice. “It’s a good argument, because it’s a true argument.”

Simon Property reportedly entered into talks with Amazon in August to convert space now leased by imperiled department stores such as J.C. Penney and Lord & Taylor into fulfillment centers. (Simon Property also teamed up with Brookfield to buy J.C. Penney out of bankruptcy.)

Casey Sobhani, DLA Piper

Messages left with Simon Property were not returned.

> “The brands that sold clothing did so well in the past, but it is now a bizarre, different time.”

A spokesperson for Amazon declined to discuss those negotiations but told *TRD* that the e-commerce giant has warmed to malls. Amazon has even opened 23 bookstores in both enclosed and outdoor shopping centers throughout the U.S. — perhaps a cruel irony for former mall stalwarts such as Borders and Waldenbooks that argued they were pushed out of business by Amazon.

“It made sense to open a bookstore, because books is how Amazon began,” the spokesperson said. “There are still things people want to touch and feel before bringing them into their home.”

Besides 4,500-square-foot bookstores, Amazon is also opening pop-up shops in several malls. A store at Unibail-Rodamco-Westfield's Century City mall in Los Angeles, for example, is currently showcasing rotating televisions for sale.

Some smaller mall REITs want to go one step further: Offer Amazon and other e-commerce sites affordable rents and other concessions in exchange for incentivizing shoppers to come pick up their purchases.

Lou Conforti, CEO of Columbus, Ohio-based Washington Prime Group, said he sees distribution hubs replacing department stores as the anchor tenants that draw customers into the mall.

"Amazon is a partner, not an enemy," Conforti maintained. "For us to completely negate and stiff-arm a mode of getting a good or a service — primarily e-commerce [products] — to a consumer is the dumbest darn thing on the planet."

Find new essential tenants

Jay Luchs, a retail broker at Newmark Knight Frank, argued that "malls are confused as to who is going to stay and who isn't."

"The brands that sold clothing did so well in the past, but it is now a bizarre, different time," he said.

Department stores such as Neiman Marcus and apparel chains like the Gap, the backbone of American malls in the late 20th and early 21st centuries, have either stopping paying rent, face bankruptcy, or both.

The "inessential" tag for many retailers amid the pandemic, Luchs said, mirrors the pre-Covid trend that consumers no longer need the mall for clothes — just as malls no longer need department stores to anchor their space.

Jim Sullivan, a managing director at the financial services firm BTIG, said it would be a "good trade" said for malls to replace their department stores with anything that would help bring in more wanderers. "Retailment" options such as restaurants like the Cheesecake Factory and Dave & Buster's are a proven traffic generator, even as malls reopen, Sullivan argued.

In contrast to that, along with fading department stores, are essential tenants: pharmacies, grocery stores and other businesses that have seen increased foot traffic and in-store sales amid the pandemic.

During Macerich's second quarter earnings call, its CEO Thomas O'Hern practically serenaded supermarkets. "We think it's a great use," he said. "In many cases we've had interest from the grocery store but we haven't had the space."

With J.C. Penney and Macy stores on their way out of several Macerich-owned malls, O'Hern said, "it's going to give us the opportunity to do more of that."

Another business with perhaps a more reliable customer base is medical clinics.

Gary Weiss, a commercial real estate leasing agent in Century City, pointed to the Westfield Century City mall's recent placement of a walk-in UCLA Medical Clinic as a shrewd idea — perhaps the patient strolls around the shops after getting a clean bill of health.


Thomas O'Hern, Macerich

More radical ideas, Weiss said, include converting movie theaters into public storage space. "Even when these theaters were built there was the idea that one day people would stop going to the movies, and these could be repurposed," he noted.

Perhaps the most "essential" mall tenant yet is to be found in the struggling Mall of America. The Minnesota Transitions Charter School is paying a monthly cost to lease space at the 5.6 million-square-foot property, the Minneapolis Star-Tribune reported earlier this month. The charter school was damaged in the unrest following the killing of George Floyd.

School officials told the paper that the mall could lead to "job shadowing and internships for students" as well as using the mall's famous indoor roller coaster for physics lessons.

Curate space with purpose

More broadly, for some, the typical U.S. mall — once seen as a den of mind-rotting teen consumerism — is now being reimagined as a public square.

> "It's work. This isn't: I'm gonna sit back on my ass in the mall office and wait for the rent checks to come in."

One retailer lessor mentioned using mall space for voting booths and community meetings, for example.

"We're evolving beyond the mall," claimed Dominic Lowe, executive vice president of design, development, and construction for Unibail-Rodamco-Westfield. "We want to reshape our asset to become a more diverse micro city or micro village."

In order to assure lenders and maintain a baseline relevance to customers, each mall may need to more intentionally define its focus.

“Mall operators need to find ways to make the mall experience less homogenous and more curated,” said retail strategist Marshall Kay. “Some have operated more like the owners of flea markets, who are filling stalls.”

Dominic Lowe, Unibail-Rodamco-Westfield

For some high-end urban malls in Los Angeles and New York, Newmark’s Luchs noted, that can be as simple as doubling down as a spot for luxury brands.

But such curation may not play out the same way in smaller markets like Peoria, Illinois.

Conforti of Washington Prime, which has malls in Peoria and other mid-sized cities throughout the Midwest, said his general managers walk the downtown streets and seek to lure businesses that can provide an antidote to (often struggling) national chains.

Lou Conforti, Washington Prime

“It’s work,“ Conforti said. “This isn’t: I’m gonna sit back on my ass in the mall office and wait for the rent checks to come in.”

Local tenants could help malls’ hoped-for reputation as community gathering space.

“Communities have used shopping centers as a way to provide a sense of normalcy,” said Sandy Sigal, CEO of Woodland Hills-based retail REIT NewMark Merrill. “That is the role retail is going to play in the long term.”

Keep an e-friendly mindset

Brokers and analysts say they would like to see mall REITs use tech to their advantage instead of viewing it as a threat to their business models.

Specific innovations include virtual reality advancements for “virtual dressing rooms.”

“Mall-based apparel retailers can utilize virtual dressing rooms to attract customers back to stores to inspect products, yet offer the safety of not having to try them on physically," said Jie Zhang, a professor of retail management at the University of Maryland business school.

Another example cited is the widespread use of radio frequency identification technology, or RFID, which tracks inventory, making it easier to ship products from store to store and reduces the labor costs of refilling inventory.

Beyond any specific fixes, many mall owners are frustrated with tenants they view as not trying to modernize.

Sigal, at the California-based mall owner NewMark Merrill, grumbled that Covid non-rent payers like Bed Bath & Beyond are guilty of "self-inflicted" damage.

But perhaps the onus to modernize rests more on the mall than the tenants.

Reposition, in part

While mall REITs have their fair share of financial troubles looking ahead, many of the malls still sit on extremely valuable property.

"Communities have, in a lot of cases, been built up around these malls," said Donald Bredberg, managing director of the retail advisory firm StoneCreek Partners.

That means that if all else fails, in some cases, mall owners can make a tidy sum either selling off their land or repurposing it.

The latter is happening now in Los Angeles, where Unibail-Rodamco-Westfield's Westside Pavilion is being rented out to Google, and in New York, where the shuttered Neiman Marcus in Hudson Yards is being marketed as future office space.

Bredbreg noted that repositioning part of a mall can help bring in more foot traffic to the remaining retail.

As with other facets of the U.S. economy, mall post mortems are already being penned.

But in revising the make-up of their tenants, understanding which companies are friend and foe, and making a few modernizations, Bredberg said: "Not all is lost."