

SACRAMENTO | RETAIL

Q1 2020

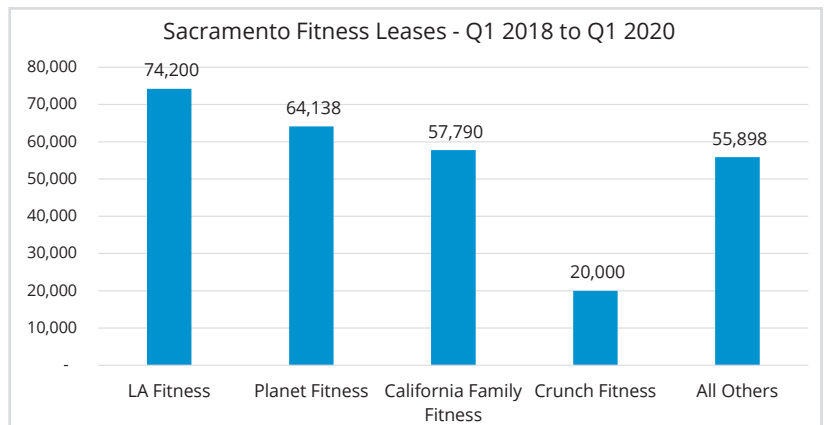
SACRAMENTO'S RETAIL MARKET UNDERGOES A DRAMATIC TRANSFORMATION FOLLOWING COVID-19

REGIONAL SUMMARY

In the midst of the COVID-19 pandemic, retailers and restaurants across the country have been shuttered or gone to take out only since mid-March 2020. The first wave of closures and layoffs were in the retail, restaurant, hospitality, and service sectors, which has rocked the retail market especially hard. According to Coresight, some 630,000 outlets in the U.S. have been forced to close due to COVID-19. Retailers were already planning to close about 2,600 stores across the country as of February 2020, just before the shutdowns commenced. In addition to closures and layoffs, some 30 national retailers are on the brink of filing for bankruptcy protection. Prior to the pandemic, many retailers and restaurants were already struggling with thinning profit margins and shifting consumer preferences. The current crisis will force companies to streamline operations, close marginal locations, and improve online ordering or take out capabilities. In a six week span, more than 30 million Americans lost their jobs with 20.5 million unemployed in the month of April alone. As a result, consumer spending saw a record drop in March, falling by 7.5%, and personal incomes also dropped by 2%, its the largest decrease since 2013. With consumer spending making up two-thirds of the U.S. economy, GDP contracted by an annual rate of 4.8% in Q1 2020, the biggest quarterly drop in economic output since Q4 2008. Sacramento's retail market is now entering a new phase of creative destruction following this steep drop in sales volume. From March 16 to April 15, there were 5,192 employees laid off in the retail or restaurant sectors. However, the recovery could be getting underway soon. As of this writing, Gov. Gavin Newsom announced that some retail businesses can start opening on May 8 in the phase 2 reopening. The following report highlights both local and national trends impacting retail during this rapidly shifting environment.

Fitness industry's growth stopped dead in its tracks

- » Gyms were among the first [businesses closed down in March](#) and many have stopped charging members, resulting in steep revenue declines. Fitness clubs have been gobbling up vacant storefronts for years now, especially in the Sacramento market. Since 2018, approximately 20% of all new leases larger than 12,000 square feet in the Sacramento market were [signed by fitness clubs](#).
- » Since January 2018, there have been more than 272,000 SF of new leases signed by fitness tenants. VillaSport Athletic Club and Spa opened its new [130,000 SF Roseville location](#) last summer. LA Fitness leads the way in new locations planned with two 37,000 SF gyms in the works (Crocker Village and Elk Grove). Planet Fitness leased 64,000 SF across three locations in the last two years while California Family Fitness was planning a new location at the former Orchard Supply Hardware in Antelope. The status of these future openings are now up in the air.
- » Expect to see new fitness location openings delayed or cancelled altogether as companies grapple with the sudden halt in revenue and membership growth as a result of COVID-19. There will likely be some that file for bankruptcy, like [24 Hour Fitness is planning to](#) and as [Gold's Gym already has](#). Vacated gym spaces will provide yet another obstacle for retail landlords with many of these larger 20,000+ SF spaces being difficult to backfill.

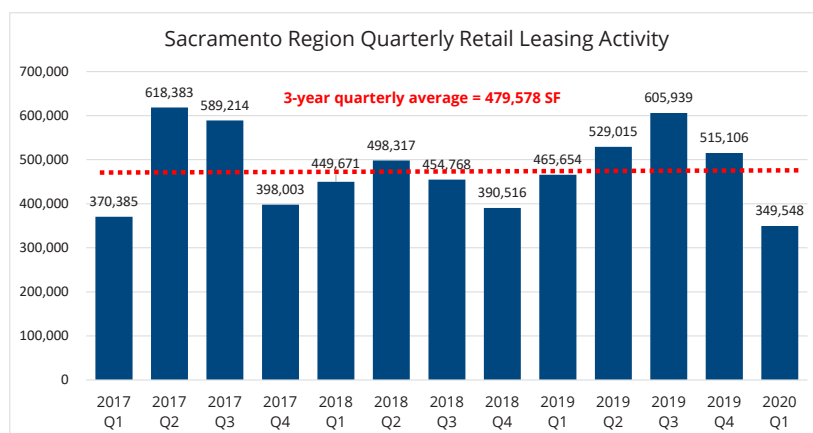


Many bars and restaurants will be gone for good

- » Even prior to the pandemic, restaurants across Sacramento were dealing with a growing storm of issues impacting profitability, including, rising employment costs, growing food costs, and increasing competition.
- » The number of closures per quarter was catching up to the number of openings over the course of the second half of 2019 in Sacramento. From just after Christmas 2019 to January 9, 2020, the Sacramento region saw [10 restaurant closures in the span of 11 days](#), from longtime fixtures like [Jim-Denny's in Downtown](#) to expected closures like the Elephant Bar on Arden Way. Cheesecake Factory made national news in mid-March when it informed its landlords that [it will not pay April rent](#) as a result of the negative effects of COVID-19.
- » *The Sacramento Bee* tracked 45 new restaurants that opened across the Sacramento region in [January](#) and [February](#) this year. However, after the COVID-19 pandemic, many bars and restaurants have temporarily closed and many of these businesses will not reopen. Some are predicting as much as a 30-40% reduction in restaurants over the next year.

COVID-19 Impact: Delayed openings, minimal leasing activity, and increasing vacancy rates

- » Many store openings planned will be [delayed until next year](#). [Target](#) is planning an 86,000 SF location in a former Kmart space near Placerville and its small scale store in Midtown has no set opening date at this time. [Duluth Trading Co.](#) was planning to enter the Sacramento market later this year with a new Roseville store, but it has revised the number of its new store openings this year from 10 to 5. [Five Below](#) was planning to make its local debut as well, with four Sacramento stores in the works as a part of 180 new stores nationwide in 2020. However, that ambitious opening schedule is in limbo at the moment.



- » Q1 2020 leasing activity across Sacramento surpassed 349,000 SF, which is well below the three-year quarterly average of 479,578 SF. Second quarter leasing activity will be quite minimal with many retailers revising expansion plans and new leases being put on hold as many retailers and restaurants grapple with diminished revenues and an uncertain future.
- » Vacancy and availability rates across the Sacramento region will increase for the foreseeable future. With formerly strong sectors like food/drink and fitness now struggling as a result of the pandemic, what retail demand was out there has now all but evaporated. Look for new construction to halt and landlords to offer more concessions and rent discounts over the next year to fill newly vacant space.

Movie theaters will probably never be the same

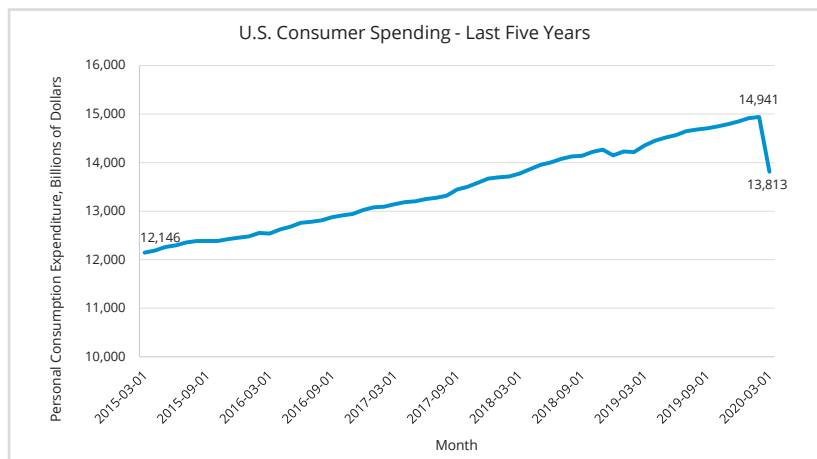
- » Movie theaters have been another driver of retail demand in recent years. However, many market observers are now wondering, in the post-COVID-19 world with all of the online streaming options available, if movie theaters [will ever be the same](#). AMC and [Regal](#), with 1,200+ theaters between them, have closed all of their venues since March 17 for at least 6 to 12 weeks. Once opened, many will likely have to enforce social distancing measures.
- » [Cinemark](#) is planning to reopen July 1 with openings occurring on a state-by-state or county-by-county basis while [AMC Theaters](#) will likely have to [consider filing for bankruptcy](#) based on the company's view that its theaters will be closed until at least August.
- » [Studio Movie Grill](#) was planning on [opening five new locations across the country](#) over the first three quarters of 2020, including a 54,000 SF location at 8501 Auburn Blvd in Citrus Heights where a Kmart once stood.
- » Movie theater attendance has been trending downward for the past two decades. People were attending movies at a lower rate for the past two decades though. People tend to prefer in-home viewing and premium video on demand from the comfort of their living room. \$20-\$30 rentals of new movie releases streamed at home could be the norm moving forward.

Is this finally the end of the department store?

- » Sears' struggles are well documented. J.C. Penney is [negotiating for bankruptcy funding](#). Barney's New York filed for bankruptcy last year. Nordstrom announce on May 7 that it will be permanently closing its 190,000 SF Arden Fair Mall location, one of 16 closures across the country for the Seattle-based department store chain. And Macy's recently announced that it is [furloughing most of its 125,000 employees](#) (but [reopened 68 stores on May 4](#)). Is the COVID-19 disruption the final nail in the coffin for department stores? Sales of clothing/accessories fell by more than half in March and department stores were already failing slowly but surely for the last decade while e-commerce sales spiked. After COVID-19, [very few are likely to survive](#).

What about malls?

- » Both retailers and restaurants continue to note declining mall traffic. As more sales shift online, Thanksgiving 2019 shopping traffic declined 0.8% and Black Friday traffic declined 4.4% compared to last year, according to ShopperTrak. Restaurants have noted [challenges with mall locations for some time](#), with Red Robin closing 10 locations in malls last year. US retailers [closed 5,000 more locations in 2019 than they opened](#), according to Coresight. Brick-and-mortar retail is far from dead and many retailers perform quite well in malls. But consumer preferences are shifting away from the regional mall concept toward more targeted destinations. Sunrise Mall's mixed-use redevelopment plans have narrowed down to the three options.



Experiential tenants hit harder than anticipated

- » Entertainment and experiential tenants have been retail's saving grace in recent years. But the coronavirus has hit these tenants harder than many anticipated. [Dave & Buster's](#) has been forced to temporarily close all units, furloughing more than 15,000 employees – a life or death moment for the Dallas-based chain. The company is now discussing a possible stake sale with private equity firms since it reportedly has only [15 weeks' worth of operating cash as of early April 2020](#). Less than nine months after becoming the primary investor in [Punch Bowl Social](#), [Cracker Barrel](#) announced in late March that it will [not put any money into the temporarily shuttered "eatertainment chain."](#) Punch Bowl Social [closed its 23,000 SF DOCO location in March](#), laying off 115 people.

Private Equity's destruction of retailers continues

- » Private equity continues to create carnage in the U.S. retail industry. Over the past decade, nearly 600,000 employees working for retailers owned by private equity firms and hedge funds [have lost their jobs](#), according to a report from the Center for Popular Democracy and the Private Equity Stakeholder Project. In addition, 728,000 employees in related industries lost jobs as a result of those eliminated retail jobs (1.3 million total jobs).
- » 10 of the 14 largest retail chain bankruptcies since 2012 were at private equity-acquired chains, from [Payless ShoeSource](#) and [Sports Authority](#) to [Claire's](#) and [Toys "R" Us](#). The report also stated that Wall Street firms are on track to impact an additional 1 million people working in retail in the coming years at companies like [Michael's](#), [J. Crew](#), and [Nieman Marcus](#).

Q1 2020 Sacramento Leasing Activity

- » [Ross Dress For Less](#) leased 23,557 SF at Laguna Crossroads in Elk Grove, where Five Below recently leased 10,005 SF and [Ulta Beauty](#) leased 10,858 SF, though the opening dates for all three locations are unknown at this time.
- » [dd's Discounts](#) leased a 31,666 SF former Toys "R" Us location at 700 W Onstott Rd in Yuba City. The discount retail chain sells clothing, shoes, and home décor. The company's Sacramento store is at 5924 Stockton Blvd.
- » [Dollar Tree](#) subleased two locations from Walgreens: 17,268 SF at 1420 Meadowview Rd in South Sacramento and 14,490 SF at 5020 Madison Ave in North Highlands.

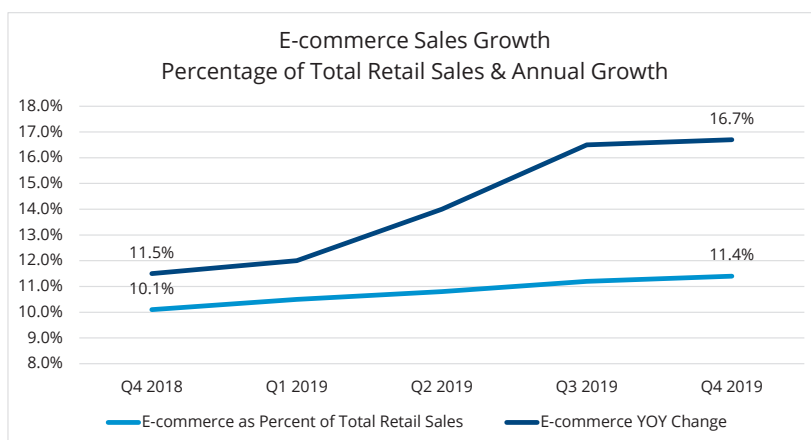
- » [Five Below](#) also leased a 10,800 SF in-line space at the Promenade @ Sacramento Gateway in Natomas and a 7,800 SF end cap space in Citrus Town Center in Citrus Heights.

Q1 2020 Sacramento Openings & Closings Activity

- » The new [Costco Business Center](#) in the Country Club Centre at 3360 El Camino Ave is [on track to open in early June](#). The location will cater to small businesses and is one of 19 locations nationwide, offering same-day delivery for businesses. The 138,801 SF store is taking the place of a former Sam's Club.
- » Raley's closed two underperforming [Food Source](#) stores in March, [citing declining foot traffic](#): 6366 Mack Road (54,000 SF) in South Sacramento and 4401 Broadway (51,000 SF) near UC Davis Medical Center.
- » [Stein Mart](#) [closed its 33,800 SF Citrus Heights location](#) in the Marketplace at Birdcage at the end of February. The off-price retailer opened this store in 2004 and has three other local sites in Rocklin, Folsom, and Elk Grove.
- » [Arden Fair Mall](#) [closed indefinitely on March 17](#), impacting 165 stores and more than 1,000 employees.
- » [Windsor Fashions](#) filled a 6,500 SF space previously occupied by Charlotte Russe at Folsom's Palladio at Broadstone. The store [opened on March 5th](#).

E-commerce growth exploding and retailers adapting to shifting consumer demands

- » [Omnichannel is now the only option](#) for retailers to survive in today's climate. Customers will now expect an online presence for every retailer, the same shopping experience in-store and online, and flexibility from retailers with a wide range of shopping and delivery options. Click-and-collect will be a growing trend, in addition to mobile order-ahead and cashierless checkout.
- » March 2020 was the first time in U.S. history that consumers [bought more groceries online than in-store](#) with 22% more consumers shopping online. According to [The Salesforce Q1 2020 Shopping Index](#), e-commerce revenue will increase 20% year over year in Q1 2020 with web traffic growing by 16% compared to Q1 2019. U.S. e-commerce sales [increased 16.7% year over year](#) as of Q4 2019 but still only made up 11% of all retail sales in 2019.



- » Amazon's first quarter sales [rose 26% from a year earlier to \\$75.5 billion](#), a record-high during what is usually the slowest time of year. Amazon's fulfillment centers have seen unprecedented volumes this year due to the spike in online shopping from consumers sheltering in place. Amazon is on track to add more than 600,000 SF of distribution space in Sacramento by the end of this year and hired 175,000 additional employees for its warehouse and delivery network.

New Construction & Conclusion

- » [Ryan Companies](#) is building a 110,000 SF furniture store for [Living Spaces](#) at 1851 Freedom Way in Roseville, due to deliver at the end of this year after [starting construction last fall](#).
- » [Donahue Schriber](#) is developing the 100,000 SF Sienna Ridge in El Dorado Hills, anchored by a 55,000 SF Safeway [set to open this spring](#).
- » [Raley's](#) [opened its new 55,000 SF South Land Park](#) store on April 15 in The Park, a new shopping center being developed by [Preserve West Capital](#).
- » Retail will take some time to recover. The strong, smart, and agile will survive. Those that do not adapt to changing consumer demands will continue to fall by the wayside. There is no retail apocalypse underway, despite the national media's dark headlines. This is creative destruction. Though the sky appears to be falling, retail will live on, though in a somewhat different form.

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