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RETAIL REPORT

Cash registers in Canada were busy in 2005 as the year concluded with retail sales increasing approximately 5.0% over 2004. Not surprising, the booming Alberta economy recorded the largest increase, which was a major boost to the overall numbers nationwide. Electronics, furniture and home décor, and women’s apparel categories enjoyed the largest gains whereas men’s apparel, general merchandise, and fashion accessories categories were flat or realized only modest gains.

Retail continues to adapt to diverse market influences and the constant changes on both the landlord and tenant side of the business. The following provides an overview of ten topical issues or trends in retail and retail related real estate in Canada that will continue to be the subject of debate and discussion in the industry during 2006.

POWER CENTRE EXPANSION VS MAJOR MALL RE-INVESTMENT

Other than Vaughan Mills, there have been no new enclosed regional malls constructed in Canada for approximately fifteen years. With Wal-Mart, Home Depot, Costco, Winners, Future Shop/Best Buy, Indigo/Chapters, and others expanding steadily since 1990, power centres have introduced tens of millions of square feet of new retail space to the Canadian market. The regional mall sector, which dominated the retail market from the late 1960’s to the early 1990’s, has been somewhat overlooked during this explosion of power centre development, but in reality the re-investment of capital by mall owners has been significant.

Almost every major shopping centre in Canada has been renovated, expanded, or both. Mayfair Mall, Loughheed Town Centre, Coquitlam Centre and Metropolis at Metrotown have all been renovated; Park Royal expanded with a “lifestyle” project called Village at Park Royal; Chinook Centre, Market Mall, Sundridge Shopping Centre and St. Vital, have all been renovated and expanded; Georgian Mall is expanding and Square One has been renovated and is planning another expansion; Yorkdale underwent a spectacular renovation and re-merchandising in 2005; Pickering Town Centre, Oakville Place, Bramalea City Centre, Carrefour Laval, and Mic Mac Mall were renovated; and the Toronto Eaton Centre, St. Laurent Shopping Centre and Rideau Centre are all expanding.

While much attention has been focused on power centers, the major malls have been steadily re-investing in order to preserve and, in many cases, improve their market share. One could debate at length which of these two shopping experiences customers will prefer in the future, but for now both formats continue to evolve, each taking something from the other.

LARGE FORMAT STORES IN MALLS

In years past, the mall formula was simple – anchor stores at both ends and ancillary stores in between. A new retail hybrid format has appeared which developers call “Large Non-Majors”. These retailers are 20,000 to 50,000 square feet and range from fashion to housewares to electronics. They occupy deep spaces, add to the curb appeal of the centre and, most importantly, help traditional malls compete with nearby power centres. These retailers are productive and can generate considerable traffic with obvious spillover benefits for smaller in-line retailers. Examples include Winners, HomeSense, H&M, Zara, Sport Chek, and Indigo. Expect to see these retailers continue to locate in traditional shopping centres throughout 2006.

SMALLER SHOP SPACE IN POWER CENTRES

Just as larger format stores are appearing in enclosed malls, smaller shops in the 800 to 2,000 square foot range are being planned in power centres. These smaller users are typically clustered into buildings with shallow depths and offer developers more flexibility and higher rates of return. Power Centres are now proven commodities and many impulse and service based retailers are locating in these properties.

INCREASING DEMAND FOR URBAN RETAIL REAL ESTATE

Generally speaking, retailers are not pioneers. They need a marketplace to serve in order to conduct business. Fuelled by low interest rates and empty nester downsizing, condominium projects are popping up in the downtown core and fringe areas of every major city across the country. Consequently, retailers are increasingly interested in urban locations. Most cities have their traditional “high street” areas like Bloor Street in Toronto, Robson Street in Vancouver, St. Catharines Street in Montreal, and Spring Garden



WINNERS STORE – 110 BLOOR STREET WEST TORONTO, CANADA



Road in Halifax to name a few. But, with the growing residential population, large daytime working population, and urban revitalization in downtown areas, retailers are eager to find new downtown opportunities.

POLARIZATION OF RETAIL

Luxury brands and high-end retailers enjoy a niche that is stable and steady while, at the opposite end of the spectrum, many customers are more focused on value. Retailers offering either real or perceived value are the ones experiencing the largest increases in sales volume. Retailers operating in the middle, in terms of merchandise and price points, are the ones struggling to capture market share. Retailers are increasingly distinguishing themselves by operating at one end of the scale or the other.

BROADENING OF PRODUCT LINES

In an effort to attract more customers and compete in today's retail environment, many retailers are adding a broader range of merchandise to their regular assortment. In addition to food and food related products, major grocery store chains are allocating considerable amounts of space to children's wear, housewares, flowers, garden supplies and furniture, along with wine shops, ATM's, and often pharmacies. Drug stores are devoting more and more space to food and household products; fashion stores are adding more accessories and home décor products; music retailers are devoting more space to the sale of videos and DVD's; electronic stores are selling cell phones, music, videos, and major appliances. Consequently, writing use clauses in retail leases, which set out what tenants are able to sell, has become simpler. However, on the flip side, landlords are now finding themselves specifically restricting tenants from selling certain merchandise or limiting amounts of selling space to be used for display of specific products.

LIFECYCLE OF A TREND

They say that imitation is the greatest form of flattery and while that may be true, the ability to copy in today's marketplace is lightning fast and somewhat frightening for many retailers. With vertically integrated companies like Zara, the time from sewing machine to shelf is measured in weeks. With information available everywhere, a hot product or item is duplicated quickly and a competitor is in place in no time. It is very difficult to stay ahead of the competition for any length of time. This increased level of competition is great for the consumer and not likely to change any time soon.

STRUGGLING DEPARTMENT STORE SECTOR

The US has had a struggling department store sector for quite some time, although recently there have been positive results with strong sales gains posted in 2005. In Canada, after the departure of Eaton's, many thought

Canada's remaining department store chains would stabilize and find their own niche. However, that has not happened and with the growth of Wal-Mart, Winners, new specialty stores like H&M and Zara, along with the many large format stores like Future Shop / Best Buy, Linens 'n Things, and others, our two major department stores continue to face enormous competition.

FUNDAMENTAL CHANGES TO LEASES

As the retail business matures, competition increases, international retailers introduce new concepts, formats change, etc., the concept of a standard lease is fading. Many retailers are resisting operating covenants, eliminating percentage rent, inserting rights of termination, and insisting on broader use clauses and broader rights to assign. They are fighting for shorter lease terms, fixed rents for renewals, caps on operating costs and often resist promotion programs. All of these changes are a reflection of the uncertainty in an ever changing industry and the desire to control costs and be more flexible. Not all retailers get what they want, but retailers are increasingly becoming more risk adverse.

EUROPEAN RETAILER INTEREST IN CANADA

There are always new retail concepts coming to Canada from the US but the stability of our economy and a perception of limited competition has attracted a number of new arrivals from outside North America including: Sephora from France, Geox from Italy, FCUK from the UK, Olsen from Germany, Michael Hill Jewellers from New Zealand, Cobs Bread from Australia, Zara and Mango from Spain, SYSK from Denmark, and H&M from Sweden. These retailers are challenging the existing stock of companies operating in the Canadian market to improve or face elimination.

Although in life, death and taxes are the only certainties, 2006 should be another strong year for the retail sector in Canada with many new additions to the retail landscape.



HOME OUTFITTERS—YORKDALE MALL TORONTO, CANADA

