

The Renovation of The Shops at Hilltop into a “Mall of the Future”

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Shopping centers are closing all over the United States due to the rise of ecommerce. The shopping experience is shifting and turning shopping centers into dining, leisure, and entertainment spaces. Owners of shopping centers are being forced to reinvent to stay relevant during this change. This paper will examine The Shops at Hilltop, a shopping center in the East Bay that was foreclosed upon and purchased by LBG Real Estate companies to be reinvented into a mixed-use regional hub. It will outline the background of the shopping center and the steps it took on deciding if it was worth the investment. It reviews the importance of location of a shopping center, the advantages of alternative use, the imperativeness of existing capital, as well as absence of current site restrictions, and the importance of a good team. These criteria are imperative in order to successfully reinvent a shopping center. The research results indicate the reinvention of shopping centers have a lot of opportunities for the construction industry.

Keywords: Future of Shopping Centers, Reinventing of Malls, Rise of Ecommerce, Shops at Hilltop

Introduction

“Shopping essentially has always been considered a form of entertainment - an experience that stimulates the senses and often leads to a purchase. Recently, due to the rise of ecommerce, retail stores are dying off and shopping centers with mainly retail stores are shifting towards becoming dining, leisure, and entertainment centers. Online retailing and same-day delivery services have entirely revolutionized the shopping experience. Future shopping trends indicate that more and more department stores will continue to close, and consumers will continue to spend more money on services and experiences instead of apparel” (Bird, 2018).

With this rising trend, malls around the United States are being forced to update and reinvent. When it comes to reinventing malls, many mall developers are adding in more entertainment, restaurants, with less retail in order to keep consumers coming back, as said from expert Doug Beiswenger, who aids the renovation of The Shops at Hilltop into a “Mall of the Future.” This paper is to inform the construction industry of how to take advantage of this change as it provides many opportunities. It is also to encourage many to take action as it is inevitable many malls are going to need to undergo change.

Background

“The Shops at Hilltop first opened in September 1976 in Richmond, California. The 1.2 million square foot mall was developed on 77 acres by A. Alfred Taubman, who also developed several other shopping malls in the East and South Bay Area. Originally, it was anchored by Capwell’s, JC Penny’s and Macy’s. Sears was added in 1990 in a newly built north wing addition, which was the last expansion of this property. On July 2017, LBG Real Estate Companies, LLC and Aviva Investors announced the purchase of The Shops at Hilltop property, which went into foreclosure by Simon Property Group in 2012” (Wikipedia, 2019).

Cadwallader and Jordan (2009) stated, “there are two kinds of shopping center redevelopments. The first kind, which is the simpler approach, is the redevelopment of a project with no change in the real estate product type. A common example of this occurs when an enclosed mall is redeveloped but still remains an enclosed mall after the redevelopment. The second kind of redevelopment, [like The Shops at Hilltop] results in a change in the real estate

product type or the creation of a new product type.” LBG intends to plan a long-term mixed-use Hilltop by the Bay redevelopment that would have a sustainable capacity of more than 9,600 housing units at the property as well as office, hotel and entertainment uses. In March 2019, LBG began The Shops at Hilltop renovations and stated to be completed by spring 2020 with brand new retailers, entertainment establishments and restaurants. A shopping center where you can live, work, dine and shop (Wikipedia, 2019).

This is an overview of Hilltop redevelopment:

- Total acquisition investment: \$35 million
- Cost of repurposing the mall: \$100 million, not including residential/office
- Approved for 16.7 million square feet of building
- Duration of repurposing mall: 1-2 years; opens in 2020
- Total duration of whole development: about 10-20-years

Methodology

In order to fully understand what it takes to renovate an already existing shopping center located in the United States, I decided it would be beneficial to look at The Shops at Hilltop, that is currently in the process of doing so. I interviewed Douglas T. Beiswenger, the Managing Partner at LBG Real Estate Companies. Mr. Beiswenger is on the developing team for The Shops at Hilltop. He has overseen over hundreds of shopping center renovations. LBG Real Estate companies is seen as a forward-thinking and modern developer. Doug answered interview questions on the criteria of what it took to reinvent The Shops at Hilltop.

Research Results

The Shops at Hilltop is slowly reinventing itself and Doug gave me four main criteria on what it took for this to take place:

- Location
- Alternative uses
- Capital
- A Good Team

Location

When deciding whether to renovate a mall or not, Mr. Beiswenger mentioned that location is key. There are shopping centers located all over the United States that should be refurbished, but location has been the ultimate deciding factor on which malls are worth fixing and those that are not.

For the Shops at Hilltop, the main reason it was decided to be pursued by LBG was because of the location. As said from Mr. Beiswenger, “this is 77 acres in the East Bay, you can’t replicate that.” Richmond is located so close to San Francisco, making the average earnings in the area above average. “While the U.S. national level average income is estimated at \$73,298 annually, the average annual household income in Hilltop by the Bay’s total trade area exceeds \$124,021” (The Shops at Hilltop, 2019). Richmond, despite being located in the Bay Area, has been known in the past as having high crime rates. Although Richmond has a past reputation, where Hilltop is located, crime is not a huge issue, and this has also been an advantage to them. Hilltop is located very close to the waterfront and the city of San Francisco (see figure 1). In February of 2019, there was a new ferry service put in that runs from Richmond to San Francisco that will take commuters only 27 minutes, for \$7 to get to San Francisco (Perez de Acha, Tensuan, & Yadegari, 2019), making Richmond an even more appealing area. With the new ferry stop added and the current reputation Richmond has - the city has been eager to move up their housing growth. The community around the property, as well as the city and state were very cooperative about giving them entitlements to add so much residential to the site, as they knew the ferry would bring an influx of people and other benefits to Richmond since it is so close to San Francisco.

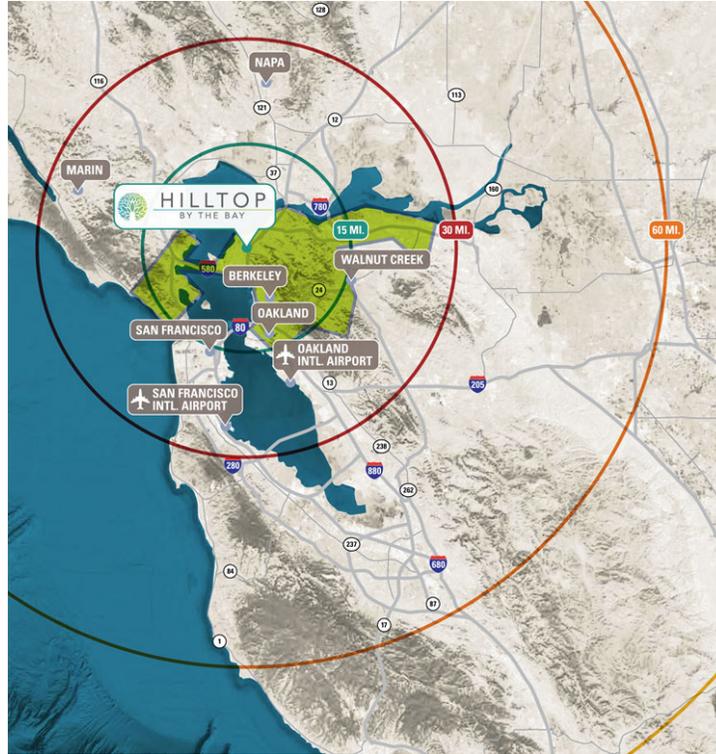


Figure 1: Map of The Shops at Hilltop.

Another important aspect of location is the size of the location. The reason Hilltop was so appealing to LBG was because of all the open space. Hilltop is a total of 77 acres with only about 27 acres of it built on from the previous owner. Most traditional malls are about 27 acres, but are not typically on that much land, which LBG recognized as an advantage. When they first purchased the land from Simon group, they had it rezoned to be able to build more than just retail space. They acquired entitlements to build up to 16.7 million square feet of residential and commercial space. In the future, they will be leasing residential units with parking for about and steel-framed commercial space for office use. With all this extra land comes more opportunities for the mall; thus, location is the most important factor when deciding on refurbishing a mall.

Alternative Uses

After finding a shopping center with a good location, the next important factor is what can be added in order to optimize the space to make it a more appealing place. Hilltop has been zoned to be able to add much more uses to the land than retail. The benefit to having so many alternative uses in a shopping center, such as residential or office space, is to keep the foot traffic constantly flowing. A lot of issues current mall owners have is keeping the daytime population and nighttime population always high, so adding in more options for uses of the shopping center can aid that from happening. As LBG is in the works with current tenants on how the space will be utilized, it is also imperative that the mall is built in a way that the buildings are versatile to lend future uses.

Knowing the “live-work-play” lifestyle is a growing priority for area residents, as well as to keep the entertainment, dining, and retail spaces busy, LBG is adding in residential units for rent in the center. They can fit up to 9,670 housing units knowing the demand for housing will continue to grow in the area. Hilltop will also feature a 4-story, 104 room Residence Inn by Marriott. It is a mix of suite types and will be appealing to family travel. Having residential units and a hotel so close to the mall will keep people using the shopping center at all times and keep the nighttime traffic high.

Some of the entertainment options that LBG is adding include tons of restaurant options, a bowling alley, and a movie theatre. Offering an abundance of entertainment options will keep the nighttime population high for the

shopping center. As for daytime traffic, in order to keep it alive, they are adding in health clubs, and creative office space. Currently they are in the works with Kaiser Permanente, as well as other tech companies, about potentially converting half of the mall into 600,000 square feet of office spaces, according to Mr. Beiswenger. Having an office space at the shopping center, will also bring a lot of business during the day time to the restaurants especially. The long-lasting future success of a shopping center could not be done without multipurpose construction. Mr. Beiswenger mentioned, “although we plan to still bring in a lot of retail, how it’s built is critical, it should be built in a way that lends itself to future office space. It’s critical to be able to strip what is there, down to the columns and make it into a creative office.” To keep up with trends and be able to constantly lease to new businesses and companies, the layout must be done in a way that can be flexible. Mr. Beiswenger mentioned having a lot of open space in the buildings with a lot of natural light is the key to the layout so that they can change into either retail space or office space in the future years of the shopping center (see figure 2). What malls have done wrong is the past is having their huge box chain stores close down, then being unable to fit other retail stores in the same three-story space.



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Figure 2: Future office space example.

Having other alternative uses in a shopping center is important, but supporting the new type of online retail shopping is also beneficial to the future success of a mall. LBG is aware of how ecommerce affects the everyday shopping experience, so they added in an online pick up center to Hilltop. This is where consumers can “buy online, and pickup in store” (Agius, 2017). Some of the reasons for this huge trend of buying online and picking up in store is the convenience. Consumers are able to see what is available at the time in the store quickly and purchase it, ensuring they will receive the item they need before making the trip to the mall. LBG has decided to do this in their shopping center to appeal to the online shoppers who are still looking for an item that is readily available to buy in person. LBG is thinking ahead and utilizing the space entirely to ensure this shopping center will maintain business despite the rise of ecommerce.

Capital

Mr. Beiswenger mentioned how having availability of capital “is a big issue for a lot of mall owners, and as you can imagine the cost of effectuating substantive changes just to existing mall buildings is easily into the hundreds of millions of dollars.” Shopping centers all over the country do not have the funds to update their space. For a

developer, a shopping center that is worth the investment is one that future income streams can outweigh its initial investment. Some ways that can be determined is by its current existing debt/ lender restrictions and it's CC&R's.

Existing shopping centers are redeveloped for a variety of reasons. One common reason is the closure of an anchor tenant caused either by consolidation or by the tenant's going out of business or into bankruptcy (Cadwallader & Jordan, 2017). Many mall owners either do not have the capital or have so much debt on the property that by the time they invest more capital behind the debt, the completed value of the property is less than the total of the debt and equity capital invested. That was why LBG was able to purchase Hilltop, because it was foreclosed and was being sold at such a good price, so the initial investment was way lower than the projected revenue. They are able to makeover the mall at a "high impact with low-cost improvements." (Beiswenger, 2019).

Some of the reasons Hilltop was so attractive was because it was in foreclosure and they could avoid 1. Existing debt/lender restrictions and 2. Strict CC&R's.

1. Existing Debt/Lender Restrictions

Mr. Beiswenger revealed how "an owner of a commercial property cannot just make changes as they wish," thus many mall owners are unable to completely change a mall. Major changes in a property require lender approval. Typically, it is nearly impossible to get the bond pool manager, someone who oversees a pool of many loans in one bond pool, to agree to changes. This is because the bond pool manager often does not even have the rights in the bond indenture agreements to allow major changes. This type of debt is called Commercial Mortgage Backed Securities debt and is very restrictive if you have property in need of changes. Due to the foreclosure, the CMBS loan on the shops at Hilltop was voided and LBG was able to have full rights of the property.

2. Strict Covenants, Conditions and Restriction's (CC&R's)

One of the main reasons many mall owners cannot kick out current anchor tenants that are drowning the mall is because of the strict CC&R's. "As those in the commercial property industry well know, CC&Rs are the rules of the road when it comes to the use, maintenance, rules of ingress and egress and numerous other matters in regard to commercial centers such as strip malls. But what happens when the CC&Rs do not accurately reflect the parcels in the commercial center, or do not exist whatsoever? Put simply: a mess" (Balducci, 2013). CC&R's are restrictions that limit the use and development of property, they can make the altering of a commercial space very difficult and limited. Due to the foreclosure of Hilltop, there were no existing CC&R's with any tenants, thus giving LBG a blank slate on what to add to their shopping center.

A Good Team

According to Mr. Beiswenger, rebuilding malls is one of the most complicated things to successfully do in the commercial sector, thus having close relations with your team is imperative to have a successful project. There are many players involved when it comes to redeveloping a mall. Mr. Beiswenger says he is in constant communication with his whole team to ensure everyone is on the same page for such a large and complex project. They work, "unbelievably closely." He is on the phone over five times a day, refining and going over the project. To imagine how many different players go into a project of this size, below is the team of people working with him.

- Architecture for Mall Building Repositioning / Retail / Office – Onyx Creative Santa Monica office, but based in Ohio
- Residential Architecture / Land Planning – KTG out of Oakland.
- Hotel Architecture for Marriott Hotel – Design Cell in Las Vegas.
- Landscape Architecture (interior and exterior) – CDPC
- Civil Construction – Kimley Horn out of Alameda.
- Structural Engineering – Hohback Lewin out of San Francisco.
- General Contractor – Currently in bidding process.

Looking to the Future

The success of a new shopping center does not just end after construction. LBG has made numerous plans such as having aggressive management and future marketing plans to ensure the long-lasting success of The Shops at Hilltop.

Aggressive Management

Where a lot of mall owners go wrong is letting stores that are not bringing in a lot of income stay in the shopping center. In order to maintain the quality of a mall you must continually have management stepping in and kicking out tenants that are not bringing in revenue, thus having control over leases is important so shopping centers can be in charge of maximizing the space. This is a trend that is becoming more common in the mall industry. As said from the Chief Financial Officer Jack Tonckens “our objective is to turf out 10% of our tenants in all of our shopping centers every year, proactively. That is those that no longer fulfill a reason to be in a center. Free-riders are not very interesting to us. Those that don’t drive footfall shouldn’t be in a center, so they are a free-rider; turf them out” (Phillips, 2019). Doug mentioned how this is becoming a huge trend in new shopping centers and they plan to do something similar to this at Hilltop. In order to succeed in retail today, with the shift in shopping because of ecommerce, owners have to leave behind the mindset of leasing a store for the highest rent and switch over to short-term leases. Having short term leases is better because it does not cost as much money to terminate a lease if the tenant is not bringing in enough revenue (Phillips, 2019).

Continual Marketing

Thinking forward, LBG decided to do a tourism outreach program called Shop America Alliance to ensure continual business at Hilltop. “It is the travel trade organization representing hundreds of the premier shopping tourism destinations, retailers, shopping centers and outlets in North and Central America” (About Shop America, 2019). Through this program, Hilltop reaches out to visitors overseas and offers them rewards for visiting and purchasing at the shopping center. They also have buses marketing the retail stores at the shopping center and shuttles them from airports to the shopping center ultimately making it a tourist destination.

Conclusion

It is important to note that not all shopping centers are worth the time and money to be fixed up, and they also cannot be rebuilt overnight. LBG plans for Hilltop will start by opening up the retail part by 2020, as well as the Marriot Hotel and office space. Eventually, in the next 10-20 years, they will slowly introduce the residential units, in order to not shock the economy by putting over 9,000 units of residential space on the market at once. The process of redoing a shopping center is very time consuming and strategic to ensure a successful outcome.

“The current rash of bankruptcies and stores closings as well as the rise of e-commerce and discount chains means that as many as 25% of U.S. malls will close by 2022” (Wahba, 2017). With this new trend of online shopping, malls are having to adapt accordingly in order to maintain relevance. This is something many mall owners are lacking to take action on, that they have to change and reinvent their space. When it comes to choosing a mall worth fixing, location, adding in alternative uses, having existing capital, and working with a good team, is imperative. This sector of construction and development provides a lot of opportunities for the industry. One way it benefits the industry is by providing new jobs that can last up to 20 years or more due to the life cycle of redoing a shopping center. It is important for us, as construction managers, to be aware of the shift in consumer’s wants and needs and take advantage of this sector of the industry.

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