Trends

Colorado grocers need to revisit their assets

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Real estate considerations in the grocery sector are changing fast – and that stands to affect landlords, supermarket chains and grocery wholesalers across Colorado.

Start with Amazon's plans to disrupt the $800 billion U.S. grocery industry. After opening the first Amazon Fresh grocery store in September in Woodland Hills, California, the company currently has several locations in Southern California and one in Chicago. Amazon is reportedly pursuing numerous new locations around the country and recently confirmed plans to open grocery stores in Washington, D.C., Northern Virginia, Pennsylvania and Maryland. Can certain markets in Colorado – places like Denver, Colorado Springs and Aurora – be far behind?

Meanwhile, on the edited-assortment, hard-discount end of the business, Lidl and Aldi continue with their aggressive expansion plans. Lidl aims to open 50 new stores this year at a cost of more than $500 million, and Aldi has spent $5 billion to open 500 stores in just the past five years. The exact timetable is unclear, but it's a safe bet that grocers can count on Lidl and Aldi eventually arriving in Colorado. Research shows that when these operators debut in a new market, their competitors end up dropping their prices.

Finally, Kroger, which is the parent company of King Soopers, continues to push ahead with its massive investment in e-commerce fulfillment. In mid-April, the Cincinnati-based operator unveiled a 375,000-square-foot Ocado automated warehouse in Monroe, Ohio. It's part of a planned rollout of 20 such facilities, estimated to cost $1 billion in total. While a Colorado Ocado may not yet be in the works, it is a distinct possibility moving forward – an additional source of pressure for competitors in the state.

■ **Maximizing portfolio efficiency.** The bottom line here? Supermarkets in Colorado are likely to face even more intense pressures with respect to both price and convenience moving forward. Amid consumers' ever-increasing reliance on pickup and delivery of online orders, the arrival of large-scale and micro-fulfillment centers could necessitate a thorough reconsideration of store footprints and locations. To rationalize and properly position your portfolio, the first step is to determine your broader strategy given these developments. Where do you want your stores to be and what physical requirements will you need in the future? Which underperforming assets do you need to either reposition or exit? What are your plans for omnichannel fulfillment and your physical stores?

Amazon

Amazon continues to disrupt the $800 billion U.S. grocery industry, with more openings planned for Amazon Fresh grocery stores. Nothing has been announced for Colorado yet, but expectations are several local markets should be on the company's radar.

Grocers should plan early for lease expirations and store closures to give themselves enough time to align their real estate with such goals.

For your best locations, you may want to negotiate a longer lease in exchange for lower rent or other considerations that will bolster your competitiveness. The landlord, for example, could partially fund your remodeling project or agree to spruce up the shopping center.

When the average lease length at a shopping center goes up, so does the resale value of the property. That makes landlords eager to negotiate longer terms with their best operators. Suppose for a moment that a grocer with a 50,000-square-foot store pays $15 per sf, or $750,000, in annual rent. It's a high-performing store, so the grocer intends to allocate $3 million in reinvestment capital for a renovation. Extending the lease for 10 years poses little risk to the grocer, and for the landlord it could increase the resale value of the center by up to $2 million.

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Apart from the convenience and efficiency for chefs, virtual kitchens can offer the following advantages:

• A sense of community and camaraderie to burgeoning chefs and restaurateurs;

• The ability to break into the restaurant scene without paying the full cost of startup for a normal kitchen; and

• More flexibility in terms of the type of space that can be used – they do not need a large parking lot nor storefront visibility.

However, the ghost kitchen model also offers unique challenges, such as raising brand awareness and missing out on the walk-in foot traffic a regular restaurant concept can benefit from.

Still, many retail properties already are seeing tenants leave or downsize. In the Denver metro area, over 830,000 sf of retail space was returned to the market in 2020 and vacancy increased by 1.1 percentage points, according to published statistics from CoStar Analytics. Virtual concepts have the potential to snap up this vacated space and bolster retail demand. Small spaces, especially, are ideal for the virtual concept.

A virtual concept can more easily and cheaply renovate space to fit their needs than a traditional concept that needs a larger kitchen and space for guests. For that reason, virtual concepts can focus more on a location with a strong consumer base than real estate with the existing space and equipment needed.

While the barriers of the pandemic are slowly beginning to fade out, the financial restrictions remain. More chefs and restauranteurs are attracted to the flexibility, low-cost and community-driven aspects of the virtual concept, which is sure to impact retail fundamentals. ▲

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If the landlord has a partnership mentality and recognizes that smart reinvestment is in the best interests of all parties, you will benefit by engaging early and showing a willingness to compromise and be flexible.

Meanwhile, with respect to your underperforming real estate, be decisive. If the store needs to be closed, there's no point in delaying the inevitable. Nobody likes to close a store. All too often, grocers avoid this difficult situation. "The cash flow is enough to cover a large portion of the rent," the thinking goes. "Maybe the situation here will improve." Hesitation is a mistake. To pursue early lease terminations and find suitable replacement tenants takes a significant amount of time. Once you've identified the drags on your real estate performance, cut them loose.

■ **A good time to do deals.** The pandemic has shown in the clearest possible terms that grocery-anchored real estate is among the safest harbors out there. Billions of dollars of investment capital are pouring into the sector. Landlords are eager to add value to their grocery-anchored properties and sell them for a tidy profit. But to do that, they increasingly want to add traffic-driving tenants to the property by introducing more outparcels, drive-thru lanes and other amenities that proved enormously popular during the pandemic.

Typically, they can't do that without the expressed permission of the grocer, per the stipulations of protective clauses in the lease. That means that grocers in Colorado now are enjoying an even stronger degree of leverage than in the recent past. They can selectively cede some of those rights in exchange for better lease terms or more reinvestment by the landlord. Just be sure not to sacrifice too much of your own visibility, parking capacity and customer access in the process.

Margins always have been thin in the grocery sector. Over the past year or so, many grocers were able to operate with a bigger cushion due to the shift in spending away from restaurants, travel and live events and toward groceries and essential services. Moving forward, the sector will get even more competitive as consumer spending diversifies and new competitors continue to expand. For forward-thinking grocers that makes portfolio optimization and planning a strategic imperative. ▲

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shopping and eating. These changes have clear implications for the use of space – what it does, where it is and how it's laid out. Landlords and tenants should take time to reground themselves in their business model and understand where it's headed. How can existing space be made more flexible? Is there an opportunity to work with other brands, consumer packaged goods or restaurants? How can spaces be created that consumers want to visit?

Food and grocery vendors that keep these considerations in mind will be positioned for success in the new normal. And while new innovations are continually emerging, we can be sure to see the ones mentioned above persisting in 2021 and beyond. ▲

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