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Where real estate, retail and development meet

THE FUTURE OF DRUGSTORES?

Duane Reade's uber upscale Wall Street store is just one example of the sector's evolution. p.12



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FEATURES

12/ **The Right Prescription**

A two-part package evaluates the latest trends in the design and operation of drugstores and what net lease investors are getting when buying Walgreens, Rite Aids and CVS sites.

20/ **No Relief**

Materials prices and labor costs have declined, but with little new development, that's little solace for retail builders.

25/ **Heavy Lifters**

Retail Traffic's annual rundown of the top contractors of interior and shell space.

28/ **Grand Designs**

Retail Traffic presents the 22nd edition of the Superior Achievement in Design and Imaging awards.

61/ **Cost of Doing Business**

Shoppers no longer see mall apps and mobile Web sites as a perk. They now expect them.

DEPARTMENTS

2/ **Editor's Letter**

We've had some changes. But it's just a first step in the future of *Retail Traffic*.

6/ **Traffic Patterns**

Delinquencies continue to rise for CMBS, but not other lenders; cap rates fluctuate.

10/ **Tenants Perspective**

Flip Flop Shops wants to take a giant step forward and increase its pace of openings.

67/ **Advertiser Index**

68/ **Last Call**

Having succeeded in urban environments and shopping centers, Apple now wants to open stores at universities and transit hubs.

Cover Photography: Curt Goodwin



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THE FUTURE OF DRUGSTORES?

Drugstores are targeting the market share of other sectors.

Story by Elaine Misonzhnik / Photo by Curt Goodwin

This summer a new store opened in New York City that created more buzz than retail industry insiders had witnessed in quite a while. The store does not belong to a luxury apparel brand on swanky Madison Avenue, however. It's a 22,000-square-foot drugstore in Manhattan's Financial District.

The store, operated by regional chain Duane Reade, which is owned by Walgreen Co., blows apart the very idea of what a drugstore is supposed to be. Located on 40 Wall Street, in a former Chase Manhattan Bank building, it features on-site hair and nail salons, an in-store health clinic, an expansive grocery, fresh food and a makeup section worthy of a department store.

There is a stock ticker running near the entrance to the store, to update Wall Street professionals on the direction of the market. There is a holographic Virtual Assistant that greets customers at the door, provides recommendations on available products and gives information about store operating hours and services.

And just so there is no mistake about the message Duane Reade is trying to send with its new store, the word "Upmarket" is displayed in big bold letters above its front doors, and repeated throughout the aisles.

To be sure, this Duane Reade is located in a part of town populated by high-flying hedge fund managers and Wall Street brokers used to ten figure bonuses, so it's catering to very affluent consumers. And with its uber-extensive list of services, this particular store is more likely to be a marketing play designed to get Duane Reade's name into media outlets than a prototype of a sustainable merchandising strategy portfolio-wide, according to Mike Tesler, head of Retail Concepts Management, a Norwell, Mass.-based retail consulting firm.

At the same time, it does serve the same purpose as other drugstore chains' efforts to expand their product selections: to set Duane Reade apart from the competition.

The store at 40 Wall Street happens to be on the extreme end of the spectrum, but Duane Reade has been remodeling its stores throughout the city to forge a better connection with its customers and project what its executives call a "New York attitude." The strategy has allowed the chain to become more geared toward specific neighborhoods instead of selling

the same products using the same techniques in areas as disparate as the Upper East Side and Coney Island, according to Brendan Langan, director of retail insights with Kantar Retail, a Columbus, Ohio-based retail consulting firm.

Duane Reade's parent Walgreen Co. has also been remodeling its namesake stores throughout the country, and recently announced plans to upgrade its location at the iconic Empire State Building in New York, taking over 10,000 square feet on the second floor. Walgreens previously operated on the ground and concourse levels, but with the new move visitors to Empire State's Observatory deck will be able to enter the drugstore right after they finish their tours.

CVS Caremark and Rite Aid Corp. have not stayed far behind, each launching new store formats and introducing new initiatives to target multiple consumer segments. In fact, all three national drugstore operators expanded their product selections and store fleets over the past few years. They realize that with thousands of locations already operating they have little room for new store growth, but continue to face stiff competition from discounters and dollar stores.

That has meant that the best way for drugstores to establish relevance with consumers has been to create new reasons for people to make frequent trips to their stores.

"They are really trying to clarify what their value proposition is in a very crowded retail landscape," says Langan. "What we are starting to see is a lot of momentum against it. They really look to define what their positioning it."

To achieve this goal, drugstores are rolling out upscale concepts, urban store concepts, co-branded stores and value store formats; they are focusing on wellness initiatives and launching private label lines, as well as adding on more non-traditional products like liquor.

Ways to be different

Last August, for example, CVS Caremark launched an initiative to convert up to 300 of its units to an urban store concept, devoting more space to non-drug-related items. In some of the converted stores, the amount of space allocated to consumables



EXTRA MILE

Fresh food and a hair and nail salon are just two of the amenities featured at Duane Reade's new upscale on Wall Street.

has doubled. The project proved successful enough that CVS Caremark has opted to expand the roll-out. After completing 200 urban store remodels last year, it plans to do another 200 by the end of 2011, according to comments made by President and CEO Larry Merlo during the company's second quarter earnings call with analysts on Aug. 4.

Rite Aid Corp., meanwhile, announced a partnership with supermarket operator Supervalu to operate 10 co-branded stores with Supervalu chain Save-a-Lot in the Greenville, S.C. market. The stores carry Rite Aid's health and beauty products and Save-a-Lot groceries under the Save-a-Lot Food Store/Rite Aid Pharmacy name. The partnership has delivered strong same-store sales growth and Rite Aid Corp. is in discussions with Supervalu about expanding the program.

In addition, Rite Aid Corp. converted at least eight of its stores to a "wellness model." The stores, designed with wider aisles and lower shelves than regular Rite Aids, carry an expanded selection of organic foods and personal care products, as well as homeopathic medicines. "Research shows that with baby boomers aging and the high cost of healthcare, people are increasingly focused on staying well and living longer," said Rite Aid Corp. President and CEO John Standley during the company's earnings call with analysts on June 23. "This new format is all about empowering our customers in their pursuit of wellness."

Rite Aid Corp. plans to make these remodels the prototype of its store renovation program in fiscal 2012. It will also try out a value store format, which company executives hope will help it compete in markets where price is a main advantage.

Walgreen Co., meanwhile, has come back to selling beer and wine at 3,500 of its more than 7,000 stores since last year. The chain used to carry liquor in the 1990s, but abolished the practice after it became too cumbersome to maintain.

In addition, drugstores have been putting more and more emphasis on private label products. Duane Reade recently introduced new private label lines, including DR Delish for premium foods and Apt. 5 Goes Green, an eco-friendly version of its long-standing Apt. 5 line of household products. Walgreen Co. has come out with its Nice! line of consumables. Last year, Rite Aid Corp. spun off Simplify, a value-oriented private label brand of household items and snacks. This year, CVS launched Just the Basics, which encom-

passes groceries, household products, personal care products and baby care items.

"People are in [drugstores] so frequently that [drugstores have] found it's very easy for them to sell toilet paper, bottled water and paper plates," which have not traditionally been drugstore items, says Tesler. "Anything that gets people in, they are fighting each other for it."

Why now?

All of these changes are taking place because drugstores suddenly find themselves operating in a fiercely competitive retail environment at the same time as their industry is reaching maturity, according to Langan. Prescription medication used to be drugstores' main traffic draw, but today it's no longer necessary to visit a drugstore to pick up prescriptions. In fact, many insurers insist that their subscribers use mail orders instead, says Jay McIntosh, president of Consumer Foresight LLC, an Illinois-based consulting firm. Consumers also have the option of asking for home delivery or going online.

Meanwhile, discount behemoths Target Inc. and Wal-Mart Stores now operate pharmacies within their stores, taking away drugstores' market share in both drug and convenience categories. This year, both retailers launched small format stores in order to be able to enter urban markets, threatening to take on drugstores on their most established turf.

Supermarket chains, including Kroger, Publix and Safeway, started putting pharmacies into their stores as well. And all of these retailers are very aggressive on price, offering 30-day supplies of many generic medications for only \$4.

Over the past decade, drugstores also lost another traffic driver in photo development, which used to bring multiple store trips for every roll of film, notes Langan. Those trips have all but disappeared with the prevalence of digital cameras.

Nor can drugstore chains beat the competition by blanketing the country with more units. At this point, all three major drugstore operators—Walgreen Co., CVS Caremark and Rite Aid Corp.—are at or near the point of market saturation. In Walgreen's case, for example, "With many of the best opportunities already accounted for, its newest retail outlets may never achieve the profitability of established ones," according to Morningstar analyst Matthew Coffina.