Retail Development – Keep On Keepin' On

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In last year's forecast for retail developers, the overriding theme was the preservation of the status quo through the maintenance of existing occupancy levels. As the calendar turns to 2011, developers who have been able to navigate the rocky waters of the economy since the downturn of 2008 will likely engage in similar tactics to make it through 2011. Many forecasters believe that the retail market has stabilized, but that recovery is going to drag on for some time. So, for 2011, and until the economy turns around, retail developers will be forced to try to keep tenancies at sustainable levels, while adapting to market changes, such as the consolidation of supermarkets and the changing tenant mix at "lifestyle" centers.

Many of the issues that contributed to the slowing of new retail development beginning in 2008 are still present. Housing starts are still relatively stagnant, if existing at all, so there are no new housing projects or residential neighborhoods for retail development to service. The specter of unemployment continues to hang in the air, affecting both the developers' desire to construct new shopping centers, and the consumers' appetite for spending hard earned dollars. However, the statistics seem to show that consumers are loosening their purse strings at least a little despite uneven economic data. Retail sales for December 2010 rose by 7.9% over December 2009, and were up 0.6% in comparison with the prior month. Sales were especially encouraging at department stores and in the apparel industry. Analysts suggest that the numbers could have been higher, but unusually inclement weather during the month of December may have kept shoppers away from their retail destinations. The numbers represent at least moderately good news for retail developers, but they certainly do not warrant the construction of new ground-up shopping centers.

Since there is currently no need for retail developers to look for new projects to develop, the focus continues to be on infill projects and the redevelopment of existing shopping centers, as was the case in 2010. Possibly due to the lack of new product on the market, vacancy rates for malls and shopping centers were down at the end of 2010, reaching a 7.2% vacancy rate at the end of the year, according to *GlobeSt.com*. In addition, the number of retailers threatening to leave unless they are granted rent relief or other concessions from their landlords appears to have decreased during 2010, signaling what many consider to be a leveling of the playing field between retail landlords and tenants.

While keeping an eye on the vacancy rates at existing projects, retail developers have also been forced to acclimate to changes in the marketplace. For example, the consolidation of grocery stores has resulted in a relative abundance of big box space that is available to tenants who need moderate to large amounts of square footage. This is balanced against the developer's need to replace a traditional "traffic generating" use like a grocery store with something comparable. Some developers are forced to "chop up" existing medium to "big box" spaces formerly occupied by grocery stores, and lease the same in smaller segments to the tenants who are currently doing deals. Others are finding takers for larger spaces from discounters like 99 Cent Only, Ross and Dollar Tree.

Developers who have "lifestyle" centers in their portfolios have been forced to deal with some harsh realities regarding that sector. Lifestyle centers, originally built as an upscale mix of shopping, dining and entertainment, saw huge growth in the seven year period ending in 2008, with approximately 205 such centers built nationwide during that period – more than double the number that existed in 2001. Not surprisingly, construction of new lifestyle centers ground to a halt in 2009 due to a variety of factors including increased online competition, a cluttered retail landscape and the general economic conditions. Owners of lifestyle centers have been forced to adapt quickly as vacancies arise, and many have had to consider alternative uses that would not have been on their radar even five years ago. Uses such as yoga and martial arts studios, eye doctors, community theatre groups, and insurance offices have found willing landlords in lifestyle centers.

Another trend affecting the retail landscape is the apparent resurgence of the enclosed mall. Comparatively impervious to the weather concerns that have plagued some of the open-air lifestyle centers, malls in urban centers have seen a sharp growth recently in the number of visitors, and many chain stores have shuttered businesses in remote suburban malls only to move to busy urban centers. Some of this mall renaissance is likely attributable to developers who have poured millions of dollars into renovations and expansions. Others have redesigned their malls to make it easier for the customer to get around by adding bridges and ramps to connect walkways. Uses such as grocery stores (on a stand alone basis or as part of a larger retailer such as Target), workout facilities, and upscale restaurants are now finding homes in enclosed malls, where such uses were nonexistent before.

Retail developers who are looking to expand their portfolios may experience a buyer's market in 2011, according to some analysts. There are certainly fewer buyers of existing shopping centers than there were five years ago, reducing the competition for prized assets. It appears that grocery anchored centers may be the most attractive to buyers in the near future, with cap rates commonly found in the range of 7.75% to 8%.

Developers not interested in acquiring existing projects, but with some capital to work with, are focused on improving their best properties to ensure that they are maximizing value. Such improvements include renovating existing common area elements such as seating areas, fountains and landscaping, improving parking and traffic flow, modernizing movie theatres and increasing food selection. Those developers hope to recoup dollars spent on improvements through the stimulation of interest in vacant space and increased rental rates.

The changing climate has forced other developers to do deals at rental rates that few would have predicted only a few years ago. Some analysts predict that underlying rents will continue to drop for at least another two years. Retailers with capital and/or a desire to expand even in tough economic times have found the current economic climate fertile for deals in high quality centers. It remains to be seen how these deals, which lock in low rents for the term of the lease, will affect developers in 10 or 20 years when rental rates are likely to have risen elsewhere in the marketplace.

Calendar year 2010 began and concluded with tempered optimism in the retail sector, and that feeling appears to continue in the industry as developers start to navigate the upcoming year. However, there is no panacea available and recovery, by all accounts, will be a slow process. For 2011, it appears that retail developers will attempt to do what it takes to hold onto existing tenants, spend some money (to the extent available) on improving existing high quality centers, and do their best to adapt to market changes.