Retail Development - Holding On For Better Days

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As we attempt to forecast what will happen with retail developers in the coming year (and beyond), it helps to review where we were at this time last year. In January of 2011, the statistics showed relatively large growth in retail sales for December of 2010, especially with regard to department stores and the apparel industry. This news, along with other general economic indicators, gave some analysts reason to believe that the tide had turned, and that shopping center owners and retailers were in for a much better 2011. The news proved to be a bit overly optimistic, however, as 2011 ended up being only modestly better for the retail industry than 2010. And, as was the case in 2011, many forecasters believe that, while the retail market has stabilized, recovery is going to drag on for some time. So, for 2012 (and until the economy turns around), retail developers will attempt to hold on to existing assets, while creatively dealing with the square footage that is being returned to the marketplace. Opportunity may exist for those looking to expand their shopping center portfolios, but it is unclear how the current economy will impact pricing.

Unfortunately for retail developers, 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. Uncertainties in the global economy, as well as uneasiness regarding the upcoming Presidential election, also have contributed to the lack of new retail development. Unemployment, while having dropped slightly recently, continues to plod along at a high rate, which impacts both the developers' desire to construct new shopping centers, and the consumers' willingness to spend hard earned dollars. In fact, many analysts believe that, until more Americans are able to work, the shopping center industry will remain in a relative status quo, with little to no new development occurring.

An analysis of the data from the latter part of 2011 seems to indicate that consumers are willing to spend money at a rate at least slightly higher than in prior years. Retail sales for December 2011 rose by 6.2% over December 2010, although the numbers may be skewed a bit as an unusually harsh winter in 2010 likely hurt sales in December of that year. In addition, same-store sales for U.S. chains posted an increase of more than 3% during the November/December period, compared to the same period in the prior year. Sales were especially encouraging in the clothing and footwear industries. Again, the news is tempered by the fact that many retailers were forced to offer aggressive discounts and extreme promotions such as an early kick-off of Black Friday, which started at midnight for some retailers, even earlier than in recent years. While these numbers represent at least moderately good news for retail developers, they do not necessarily warrant the construction of new ground-up shopping centers.

Since it does not seem that retail developers are looking 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. As of the end of the third quarter of 2011, national retail shopping center vacancy was at 9.3%, down slightly from the 9.4% mark where it had been since the fourth quarter of 2010. Also during the third quarter, the market absorbed over 5.8 million square feet of space, which may seem high, but is much lower than the 15 to 20 million square foot amount typically seen in a pre-recession quarter. One reason for the lack of absorption of space is the returning of square footage to the marketplace due to some large scale bankruptcies which hit in 2011. For example, the Borders bankruptcy and liquidation resulted in nearly 12 million square feet of space being returned to the market, and Blockbuster, which closed approximately 1,000 locations in 2011, was not far behind, returning approximately 5 million square feet back into the market. While it is difficult to predict which, if any, large scale bankruptcy filings will occur in 2012, one cannot rule out the possibility that other prominent retailers will be forced to shutter their stores, which will give retail developers more space to lease.

Another trend that is resulting in additional square footage of second generation space hitting the market is the downsizing of “mid-box” or “junior anchor” tenants like Old Navy and Best Buy. Such tenants are often willing to “give back” space to retail developers in exchange for their exercising one or more options, giving the developer additional security that a credit worthy tenant will continue to occupy a majority of the space it originally leased for the next 10 or more years. While such second generation, moderately sized space may have been attractive to “mom-and-pop” tenants a few years ago, this category of small tenant, typically with a specific product type, has yet to rejoin the marketplace. Again, the less than favorable job market, coupled with a continuing difficulty for smaller tenants to get start-up loans, has kept the “mom-and-pop” tenant on the sidelines. Instead, discounters like 99 Cent Only, Ross and Dollar Tree, who continue to see relatively solid sales, are willing to absorb some of that excess space, often at attractive rental rates.

As has been the case in recent years, retail developers have been forced to acclimate to changes in the marketplace. Not surprisingly, much of the current landscape has been driven by the demands of the consumer. As the ability to shop on the Internet grows, and with the cost of gasoline holding steady at a robust $4 per gallon, retailer developers are forced to use other tactics to entice customers to visit their shopping centers. In fact, the online retail market share is now nearly 10%, according to a recent report by the Urban Land Institute. Shoppers are also able to compare prices without leaving the comfort of their homes (or by using their laptops, tablets or other similar mobile devices), which also reduces trips to retail stores for comparison shopping purposes. While it is difficult to quantify exactly how many fewer trips consumers make to shopping centers based on the information they are able to obtain over the Internet, it is pretty clear that the ease of access to such information can only have a negative effect on foot traffic in a shopping center.

To attempt to lure customers to their shopping centers, some developers are attempting to use the very same Internet to their advantage. Social media promotions, involving Facebook and similar sites, are becoming a way to offer customers a reward (such as a gift card or a preferred parking space) for logging into a center’s page to learn about special promotions. Other retail developers are offering sweepstakes over the Internet, giving customers who frequent their centers a chance to win everything from free dinners to dream vacations. The goals of such promotions are to generate “buzz” among the social media savvy consumers by creating the impression that a particular shopping center is “the place to be”.

Other retail developers are looking at vacant space as an opportunity to introduce new concepts, and non-traditional tenants, to their shopping centers. Such tenants include go-cart tracks, trampoline facilities, day care centers, cooking schools and even swim schools for kids. Of course, the ability to add such non-traditional tenants must be balanced against the rights of other existing tenants that may have the ability to keep certain uses out of a given project. A non-traditional use may allow a retail developer to temporarily fill space and get some rent in return, but it may also serve to upset major or anchor tenants at a project, who may decide to aggressively fight the new use, or to leave the project when their current term expires, rather than renew or exercise available options.

Retail developers who are looking to expand their portfolios may continue to experience a buyer's market in 2011, according to some analysts, who view the market as undervalued and ripe for investors. Indeed, during the third quarter of 2011, cap rates for shopping centers were among the lowest among commercial real estate product, averaging 7.2%, according to a survey published by PricewaterhouseCoopers. Not surprisingly, class-A product is the most attractive to buyers, but owners of that type of asset appear reluctant to sell in the current economy. Large scale acquisitions occurring in 2011, such as Blackstone's purchase of Centro Properties Group's 585-property U.S. shopping center portfolio, will be rare in 2012, according to some experts, with most of the deals taking place being single-asset transactions.

When it comes to the world of retail development, not a whole lot has changed from the end of 2010, as the glow of the halcyon days of the mid-2000's further dims in our rear view mirrors. In 2012, retailer developers may be forced to tighten their belt buckles another notch. Not surprisingly, it appears as if those retail developers who are able to adapt to the changing marketplace (by incorporating the benefits of social media and creatively introducing non-traditional uses into their projects) will be the best suited to weather the (now, four year old) storm and reap the benefits of what most are hoping will be a more pronounced recovery beginning in 2013.