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Retail woes fueling growing Valley vacancies

By Donna Hogan
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INCENTIVES NEEDED: Jim Pederson, president of the Pederson Group, shown with Margaret Lloyd, vice president of leasing and development, says incentives are key in keeping retail spaces leased during an economic downturn.

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HAYDEN PEAK: The Pederson Group built, owns or manages various East Valley shopping centers, including Hayden Peak Crossing in Scottsdale.

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Linens 'n Things, Mervyns and Shoe Pavilion stores are holding clearance sales.

When the merchandise is gone, they will be, too, leaving big empty spaces in shopping centers around the East Valley and around the country.

Whitehall Jewelers is vacating smaller but prime spots in nearly every local regional mall.

Bill Heard Chevrolet's exit from choice Scottsdale space near the freeway and from more than a dozen other locations around the country may be the most glaring reminder that the retail industry is in trouble.

And that doesn't bode well for shopping centers or the developers, owners and managers trying to keep their properties bustling and find new tenants for planned projects.

"Are we concerned? Absolutely. These are unprecedented times," said David Larcher, executive vice president of Vestar, which pioneered the so-called power center concept in Arizona with Scottsdale Pavilions, turned it into a combination entertainment-shopping-dining complex with Desert Ridge Marketplace in northeast Phoenix, built Gilbert's Crossroads Towne Center and Gateway Towne Center, and recently debuted Tempe Marketplace.

So far, Larcher said, Vestar hasn't lost many shops in the 13 East Valley shopping centers it owns or manages, but retail expansion has slowed significantly, and any stores that do close are hard to replace.

So shopping center owners are scrambling, offering months of free rent, helping fund the improvements that turn an empty shell into a yogurt shop or shoe store, and staging lots of special events aimed at luring shoppers.

SCARY TIME

“It’s a scary time when major retailers are collapsing,” said Jim Pederson, chairman of the Pederson Group, which built, owns or manages various East Valley shopping centers from big — Promenade in Scottsdale and Casa Grande — to medium-sized — Chaparral Plaza and Hayden Peak Crossing in Scottsdale.

“If there is a tenant, we’ll chase that tenant and offer all the incentives we need to get that tenant,” Pederson said.

But retailers still expanding are rare, and the vacant storefronts in local shopping centers are not likely to fill up any time soon, industry experts said.

Big retailers nationwide are closing stores, not opening them, and some are flat-out folding. And there’s likely more of the same coming in the short term, the experts said.

“There are no signs of recovery right now,” said Tom Rex, associate director at the W.P. Carey School of Business at Arizona State University. “The fundamentals are still very negative for the foreseeable future.”

“We are in a recession, which has hit retailers especially hard because of the housing boom-then-bust,” he said. “It’s going to be a long downturn.”

When people are losing jobs and their houses — or if they fear that could happen — they spend their money on food, gas and other essentials of daily living, not on purchases they can delay to more prosperous times, Rex said.

That’s why food stores are still bustling, but other businesses, especially those related to home furnishings or new car purchases, are in the worst shape, Rex said.

“The last two months have been horrendous,” he said.

And the longer the recession hangs on, the more stores we’ll see disappear.

“The economic environment is tough. Real estate is even tougher,” said Michael Niemira, chief economist and director of research for the International Council of Shopping Centers. “You have to believe unless economic conditions turn around dramatically, there is probably more downside.”

“I’d look for more vacancies near term. (A turnaround) may be two years away,” Niemira said.

And the outlook for Valley shopping center owners and developers is worse than for many of their peers around the country.

OVERBUILT?

Rampant building in flush times can bite back in a recession, and the Phoenix area has long been dubbed “over-retailed” by some industry veterans — jargon meaning too many stores for the population.

Niemira doesn’t use the term. He said if shops are flourishing it would be hard to claim there are too many of them.

But according to the numbers, the Phoenix metro area is faring worse than the national average during the downturn.

As of midsummer, 7.8 percent of the retail space around the Valley was empty, and that's not counting the upcoming exit of any of the big stores mentioned above. The national average vacancy was 6.6 percent, Niemira, said, citing CoStar Group, a national retail real estate analysis organization.

In fact, the Valley fares worse than the national norm in every category, according to the CoStar studies.

Malls were least affected by the economy locally and nationally, with vacancies at a reasonable 3.7 percent around the country, 3.9 percent in the Phoenix metro area.

Vacancies at so-called power centers, that is shopping plazas with lots of "big boxes" like Home Depot, Best Buy, Pier One and the smaller stores that cluster around them — think Tempe Marketplace, Promenade in Scottsdale, Chandler Festival or Gilbert Crossroads — are at an uncomfortable 5.2 percent vacant rate nationwide and 6.6 percent in the Valley, according to CoStar.

Hardest hit are the neighborhood centers, which are frequently, but not always, anchored by a supermarket or drugstore and shops serving neighborhood needs such as pizza parlors, dry cleaners, card shops and other small specialty stores.

Nationally, shop space in the neighborhood centers is 9.3 percent empty, while 10.3 percent of the Valley's neighborhood shops are vacant, Niemira said.

Malls may be "better managed," and that is keeping them better populated, he said, while many of the specialty shops in the neighborhood centers are "ma and pa" businesses.

HELPFUL TOOLS

The only real tools a shopping center owner has for filling up those spaces are lowering rents, offering a few months rent free, or shelling out for tenant improvements, Pederson said.

"A couple of years ago all a retailer got was an empty shell," Pederson said. "Today they want a complete build-out, which costs an average \$35 a square foot."

But Pederson said he'd rather spend money once for tenant improvements than live with a reduced rent for the length of a multiyear contract.

Nevertheless, rents overall for new retail contracts are down about 10 percent from a year ago, he said.

And Pederson said it's easier to fill up any empty spot in an existing center than finding retailers to take a chance on a new one.

"We're having difficulty getting new projects going," he said.

At least one project already under development is doing well recruiting retailers.

Related Urban, the retail partner for the massive 144-acre retail-residential-office project CityNorth in northeast Phoenix, has had to delay a planned regional shopping center a year because of the economy, despite having three department stores already on board.

But the project's Main Street-like specialty center, dubbed High Street, has filled almost all of its 47 shop spaces with such upscale chains as Chico's, Gymboree and Bebe and is planning a mid-November opening.

Related Urban was able to tenant High Street in the face of the national retail contraction because of extensive research and planning, a national reputation for developing high-quality and highly successful shopping centers, and a long-term relationship with major retailers, said Webber Hudson, executive vice president.

"We spend a great deal of time and energy carefully selecting and defining our tenant mix," Hudson said. "We structure our deals with the retailer's needs in mind by understanding their unique margin requirements and adjusting accordingly. We also understand the importance of balancing unique local tenants with strong, well-recognized national brands like Talbots, Chico's, White House Black Market and Guess who have the staying power to ride out these types of cycles."

He did not say what incentives the company may have offered to "structure the deals."

Marty DeRito, whose company DeRito Partners builds and owns shopping centers and provides leasing services for dozens of shopping centers around the Valley, said the retail business is cyclical, and while this downturn is deeper than most and made worse by the simultaneous collapse of several industries at once, particularly financial services, the market will come back.

And strong retailers and strong shopping centers will survive the slump, DeRito said.

"Once the housing market hits bottom, we'll start to climb," DeRito said. "The shopping center development business will still be down for two or three years, but leasing will (start the comeback)."

And DeRito said Arizona's population is still growing, unlike some areas of the country, and that will help.

"I'd rather be in the shopping center business in Arizona than anywhere else in the country," DeRito said. "When it comes back, Arizona will come back bigger and better than ever."