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The Inside Track: Retail in Transition

By Jim West June 25, 2014

During the financial tsunami of 2008 that laid the foundation for the Great Recession, the retail segment of the commercial real estate industry suffered a huge hit. Vacancy rates shot up to record highs, with both large national retailers and many local small businesses allowing their spaces to go dark, putting downward pressure on lease rates. The following two years provided few rays of hope as few properties traded hands and acquisitions were often very distressed situations.

Key factors that some industry analysts said would keep retail down:

1. Consumers completely closed their pocket books to repair household balance

2. The Internet seemed to be consistent in gobbling up increasing retail market share, the outlook for retail and shopping centers was considered grim by some experts.

3. Lending capital dried up, and lending requirements

Much has changed over the past three years. Having attended the recent International Council of Shopping Centers (ICSC) convention this past month, I can report the retail sector is brimming with optimism. First quarter results showed that U.S. shopping centers had plenty of momentum and their profitability had reached new heights. Total income has been up, with rent growth actually increasing at a very steady pace.

Although many retail companies retreated during the 2009-2011 time period, others recognized the opportunity to expand market share and have moved ahead aggressively helping move those vacancy rates back toward more historic averages.

While we've been reading about a future where we'll be buying everything online, our reality is quite different. Amazon.com turns 20 this year, and certainly online sales continue to grow (at close to 12 percent a year), but they are still only a sliver of all retail sales. According to the U.S. Department of Commerce, sales from the internet made up only 6 percent of total retail sales in 2013.

What retailers have discovered is that if they use their brick and mortar platforms, in conjunction with a robust internet program, it allows them to create a more direct relationship with their customers. They can customize the shopping experience and create greater brand loyalty. Many national retailers have harnessed the two components to grow their markets.

As consumers have grown more confident, it is clear the retail shopping experience has an emotional, experiential and social base that online shopping will never have. The leading edge retail companies and companies operating shopping malls recognize this fact and are incorporating it into their development strategies. Don't think the online retailers haven't noticed this trend, and several may try to ride it by establishing brick and mortar locations.

A second sign of revival in retail is the number of shopping centers changing hands. With lease rates, revenues and profitability increasing, shopping centers seem a good bet. Lending rates remain low and lenders are willing to provide capital.

One local example is Hazel Dell Square, which had a recent change in ownership. Built in 2007, it was developed by a local partnership between Gramor Development and CE John. The two companies believed the Hazel Dell market was underserved in the Clark County retail scene. Located on the south side of 78th Street, they brought in LA Fitness as an anchor and surrounded it with over a dozen service and retail businesses. There was some modest turnover, primarily from the closure of Hollywood Video, but a replacement was found in regional grocery chain Natural Grocers, bringing the center close to 100 percent occupancy. It sold several weeks back for $27.6 million.

A second example is MAJ development's complete transformation of the southwest corner of 164th Street and Mill Plain Blvd. Taking a tired restaurant concept and replacing it with a 7-11, a fuel station, Zoom Care, a mattress retailer and Pacific Dental – a national dental practice looking to break into the Clark County market, they harnessed companies who had weathered the recessionary storm and who were seeking to expand their market share. MAJ's investment property division has found investors eager to acquire the stable long-term cash flows these properties will generate.

Plenty of challenges remain for retail center operators, but as our two examples above illustrate, along with timing, the old real estate adage of "location, location, location" is a vital factor in maximizing return. More than ever before, timing and location will continue to drive the retail market.

Editor's Note: The Inside Track is a recurring column written by a local business professional. Authors of these columns aim to provide you with their own perspective on a current trend or development within their industry, getting you on The Inside Track.

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