

# Malls: A Dying Breed? Don't Bet On It

*The American Mall May Not Be the Retail Powerhouse it Used To Be, But Most Industry Executives Say Malls are Resilient and Evolving*

Last week's retail article in CoStar Advisor, "Three Mall Owners Struggle With Pressure to Sell," led us to question the current health of the traditional American mall, especially given current market conditions as U.S. consumers tighten their purse strings on discretionary purchases, foregoing purchases that drive sales at mall retailers.

This week we present perspectives on the future of malls from several respected analysts and brokerage firms.

## RETAIL BROKERAGE COMMENTARY

### JONES LANG LASALLE RETAIL

Greg Maloney is President and CEO of Retail—Americas for Jones Lang LaSalle (JLL). The division garnered much recognition in 2007 for winning the leasing and management assignments for several U.S. regional malls.

Maloney says that U.S. malls are generally healthy, especially Class A malls. JLL defines A malls as producing sales of \$400 per square foot or more, B malls produce \$226 per square foot or more, and C malls produce \$225 per square foot or less. "At A malls, there's not really a slowdown. For the most part, B malls are going strong. The troubled ones are C malls," says Maloney.

"We have not had any more stores closing this year than in previous years. And, we haven't seen any more store closings on the mall side than for open air (centers). I would say you maybe have seen more bankruptcies on the mall side," said Maloney. "We have seen vacancies rise, but only slightly. Rents increased steadily until about two quarters ago and since have generally been flat. Effective rents have slid down a little bit in correlation with sales," he said. Maloney added, "All indications are for a stronger second half in 2008."

Maloney said mall landlords are facing longer lease-up times for average and below-average space. "We never seem to have a problem filling good spaces," he said. He also pointed out that retailers continue to be opportunistic and are taking more of a wait-and-see approach on the stores they open

this year, "but they're not cutting back to zero," he says.

Maloney agreed that this tough market is not going to seal the fate of the enclosed regional mall. "For anything to be productive, you have to understand who your customer is and have to market and build to that customer. In certain cases, that may be a lifestyle center, but in many cases it's not. I wouldn't make the conclusion that consumers no longer prefer malls. Malls are not dead."

He pointed out that many mall owners have already or are currently addressing the key issues that consumers didn't like about malls, such as all the stores being the same, the traffic in and out of the mall, and safety.

"We're just in a cycle. This is a good time for everybody to catch their breath, take a look at things, re-strategize what their growth potential is, put a plan together and execute it. We need these hiccups in our business so we can take a breath because we were going pretty strong for the last four to five years."



FRIEDMAN

### RCS REAL ESTATE ADVISORS

Ivan Friedman, President and CEO of RCS Real Estate Advisors, a firm providing real estate disposition and consulting services to retailers across the country, said that he doesn't see malls as being more vulnerable than other retail property types in the current market, even considering those retailers that have announced store closings or gone bankrupt recently.

The major difference for a mall landlord now, Friedman explains, is “take Sharper Image for example, as they’re closing 90 stores—their locations are pretty much 50-yard line, 4,000 square feet, very wanted mall locations and a very wanted size. While landlords would normally have someone for that immediately, now they’re saying ‘it’s great I get this back, but who do I have to rent it to?’, because everybody has pulled back. However, if it’s an A mall or a B+ mall, that space will go rather quickly, regardless.”

Friedman made the argument that while store closing announcements may seem more concentrated amongst mall retailers, that’s not the case. In fact, store closings are more heavily weighted to strip centers if we consider the percentage of square footage these tenants occupy in the malls or strip centers they reside. “I think malls are less affected by the total amount of square footage going dark than a strip center,” he says.

“For the last three to four years, the mall developers and owners have had a honeymoon from retailers closing stores, going bankrupt or cutting expansion plans. This is a cycle they were anticipating. The landlords that have been around a long time are prepared to handle it and this is just a little downturn to them,” said Friedman.

Friedman said retailers taking closed stores off RCS’ list are not showing any resistance to leasing space in malls. They’re sticking to their current format,” he said and added that when RCS has an A mall space available, it “goes right away.”

Friedman said that a mall has to be a very weak property with blocks of space that can’t be re-let for a mall owner to justify de-malling. In addition, he doesn’t believe adding a lifestyle center wing to a mall has become necessary, but that it’s just the best option for re-purposing a vacant mall anchor space in many cases.

#### **FARIS LEE INVESTMENTS**

Don MacLellan, managing director at Faris Lee Investments, a leading California retail investment sales brokerage firm, says “There’s still a demand for malls and there always will be.”

MacLellan would not say consumers no longer want traditional malls. “They offer restaurants, a community feel, the ability to spend a day, so no, I don’t agree with that.” He pointed out that malls are still generally in highly traveled and well-located areas.

When asked to comment on the viability of malls as an asset class from an investment perspective, MacLellan said, “A lot of the major mall REIT players disposed of their B and C

malls over the last five to ten years. There was quite a bit of growth in B mall activity from a lot of mall industry executives that took opportunistic funds and equity to buy B and C malls and reposition them, so a lot of that has already been bought and sold.”

“Also, the lending environment today makes it much more difficult to get financing for B and C malls. On top of that, whatever issues affecting that mall that made it become a B or C mall are much more pronounced now. With CMBS lending no longer available, which was almost making financing for B and C product similar in structure to A product, banks are now much more discriminatory on B or C assets than on A assets.”

#### **OCCUPANCY, RENT & SALES PER SQUARE FOOT MALL METRICS**

When mall REITs reported U.S. mall portfolio occupancy for 2007, results ranged from 91.4% to 95.6% with an average of 93.3 percent. Change in occupancy over 2006 was little, with the average up 60 basis points.

A survey conducted in CoStar Property Professional of existing super-regional and regional malls across all the markets CoStar tracks showed that vacancy increasing consistently since 2001, however, the current average vacancy rate of 3.2% at U.S. malls is still significantly tighter than other shopping center types (lifestyle centers 6%, power centers 5.7%, neighborhood and community centers 8.7%).

The average base rent for the mall REIT portfolios rose 7.5% during 2007 to \$36.88 per square foot; while the average rental rate on new leases increased 15% to \$40.88 per square foot. Rental rates that mall REITs charge may not represent what’s happening at malls nationally, however; as the CoStar survey showed mall asking rental rates rising consistently through 2006, but decreasing throughout 2007 and now hovering at the level mall landlords were asking in the beginning of 2005.

Mall REITs reported 2007 average sales per square ranging from \$346 to \$555 with an average of \$438, up 2.5% over the 2006 average. This improvement in sales, while much better than the International Council of Shopping Centers’ estimated 1% sales per square foot growth for all U.S. malls during 2007, falls below ICSC’s 4.4% estimate for total retail sales growth during 2007.

The latest ICSC shopping center executive survey, released on March 5th, which Maloney participates in and said is a

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good gauge of what executives are seeing across all property types, showed that current conditions at shopping centers (sales, customer traffic, occupancy rates, rent spreads and capitalization rates), although significantly weaker than a year ago, had improved over January's dire survey results.

"Looking ahead over the next six months, shopping center executives were not optimistic about a quick upturn in retail real estate business conditions. Lingering weakness was widespread among all of the forward-looking consumer and real estate metrics surveyed," stated ICSC.

## CONSUMER TRENDS

### AMERICA'S RESEARCH GROUP

Britt Beemer, president of consumer research firm, America's Research Group, said, "The American mall today is in serious jeopardy of keeping shoppers coming back. Mall traffic over the last five to six years has declined by 35 percent. Over the past three to four months, consumers have told us [via surveys] that they're not 'going shopping', they're trying to spend as little as they can. You don't go to a mall to save money. So, they're going to Wal-Mart or Sam's to save money and Target to save some money. What we're seeing today and will see for some time is that mall traffic will continue to decline and lifestyle centers will continue to grow and be built and those retailers that are mall-based will be seeing negative comp store sales. JC Penney foreshadowed the future two years ago when they announced they would open 500 off-mall stores. They could see the writing on the wall that the mall is not the future of the American department store."

Commenting on mall owners repurposing vacant department store boxes into, or adding on, a lifestyle center wing, Beemer said, "You can't build a lifestyle center and attach it to a mall. It doesn't add any of the ambiance of a lifestyle center. I won't argue that a lifestyle center addition might be a plus in the short term, but long term, it's not going to help them with the basic problem, which is the fact that all the stores in the malls are identical, they're boring, they're expensive, and are now an inefficient place to shop. With Americans trying to figure out where to save money and spend less time shopping, I think the inefficient place to shop is now the Achilles heel for malls."

To support the continued success of lifestyle centers at the expense of malls, Beemer cited a study ARG did in January, "we talked to consumers in markets where there was a lifestyle center and in those markets, of consumers under the age of 40; 55% of men and 45% of women were shopping the lifestyle center regularly. In addition, they said they're not shopping at any malls."

"If a mall is struggling with sales and has a hard time keeping its tenants—a dead mall—the owner can hope for divine intervention or just may face losing their investment," said Beemer.

### AUGUST PARTNERS

David Lobaugh is president of August Partners, which provides consulting services to retail real estate owners and developers in the areas of consumer and trade area research, strategic planning, economic trend work and more. Lobaugh shared the following U.S. mall trends August Partners has identified:

**Age Segmentation:** "In general, malls draw lower than their proportionate share of shoppers age 35+, the very consumers who tend to spend more per visit. The top-spending 35-44 shopper spends \$125 per visit, but is at the bottom of the list for shopping frequency at malls—2.6 shopping trips per month (versus 3.4 times per month for the 18-24 shopper, who spends only \$75 per visit.)," said Lobaugh.

**Household income Segmentation:** "Malls have re-established their ability to 'outdraw the market' in terms of average household income; that is, shopper household income is running higher than ambient trade area income. However, when malls are experiencing challenges, research frequently shows that the mall is not as strong at concentrating visits from \$100K+ consumers," stated Lobaugh. He added that lifestyle centers excel at drawing shoppers with \$100K+ household income.

**Shopping Patterns:** Mall shopper "frequency has eroded subtly over the years and is down to 2.9 visits per month on average...from a 3.1 level just a few years ago. That two-tenths of a drop in frequency translates to a 7% drop in overall visits, which in turn takes a toll on sales," said Lobaugh. He added that buyer conversion rates, the ratio of consumers who actually make a purchase during a visit, have also dropped—from 48% to 45% over the past few years, which further impacts total mall sales.

Mall department store consolidation and loss of freshness and appeal, as well as the low concentration of specialty stores catering to 35+ shoppers in malls, are among the reasons Lobaugh says malls are losing ground. Lobaugh says that malls lack the clarity, convenience, and experience lifestyle centers offer. "At a mall, a shopper spends an average of 77 minutes, at a lifestyle center it's 57 minutes. That may sound like malls have the advantage, but they don't," said Lobaugh explaining that convenience is an increasingly important parameter that determines where and how often a consumer shops.

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Malls are not fated for doom, insisted Lobaugh saying he is “optimistic”—it all depends what a mall owner does with their asset when sales begin to wane. “For the most part, malls sit on great real estate and the trade areas are good. This is a great period to make your property relevant not just to the demographics, but the dynamics of the customer in your market.”

Lobaugh says there’s no one answer to making a mall relevant, it all depends on what the customer in that market

wants and what changes the mall owner makes to respond to those demands—whether it be renovation, re-tenanting, adding a lifestyle wing, or taking the roof off.

“This industry is resilient. This is an exciting time, a time for reinvention that is going to challenge the creativity of developers and owners,” said Lobaugh emphatically.■