

## KEEPING BUSY

LANDLORDS ARE FINDING THERE'S STILL PLENTY TO DO DURING THE DOWNTURN

By Joel Groover

**T**HE DEVELOPERS AT DONAHUE SCHRIBER are plenty busy this year, even if new projects are frozen until the economy shows some life. In fact, their calendars have been jam-packed ever since their bosses came to them in January with an unexpected—and unorthodox—change in job description. Instead of moving dirt, these experts in construction, zoning, government relations and the like are now pushing paper as temporary members of the leasing team.

“We saw a void staring us in the face, with a substantial amount of [lease] renewals over the next two years,” said CEO Patrick S. Donahue. “And we felt our developers, due to the market situation, had some time.”

When it comes to coping with this formidable economic slump, flexibility pays. Donahue Schriber’s novel reallocation of talent is but one example of how owners and managers are adapting to stagnant credit markets, cowed consumers, stressed-out tenants, bankrupt big boxes and other seismic shifts in the shopping center business. Weathering the storm is priority No. 1, to be sure, but these companies also aim to make strategic moves now that will give them an edge when the market rebounds. This is no easy task, but those who hunker down and brave this crisis will reap long-term benefits, says Howard Paster, president of Paster Enterprises, a St. Paul, Minn.-based retail development and management firm. “You’re stronger for it,” he said. “If you can make it in a down market, you can make it in any market.”

And what a market it is. Strategies may differ, but industry veterans speak with one voice about the effect of the economic crisis on retail development. For the most part, bulldozers across the globe are sitting idle, they say, at least for now. “There is no question this is the severest and deepest recession anybody has seen since the Great Depression,” said Robert S. Taubman, chairman, president and CEO of Taubman Centers. “What we are seeing is a broad industry—all industry—failure led by the banking dysfunctions, and it is a global event.”

And there are both familiar and unfamiliar aspects to it all. “No single part of this is brand new,” said Steve Yenser, executive vice president and chief leasing and asset-management officer of Cousins Properties. “What is unique is the concept of all of it—the lack of liquidity in the capital markets along with the consumer slowdown—happening at once.”

Rather than sit on their hands amid these extraordinary events, however, landlords are looking within to find ways to slash costs and

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boost productivity. The development pause should be seen as a chance to put existing practices and properties under the microscope, Yenser says. "If you fail to do that, you miss an opportunity to examine the way you go about doing things," he said. "The slowdown of pace can enable you to come up with better processes moving forward."

Some owners are doing "green" audits in a bid to make their centers more energy-efficient, or studying the potential benefits of economic-stimulus incentives such as the \$3 billion New Markets Tax Credit program that Congress approved last December. "They are looking at things to do," said John Eymann, a managing partner at Meacham & Apel Architects, Dublin, Ohio. "Whether it is tax credits or energy efficiencies, they are positioning themselves this year, right now."

Other shopping center owners are shoring up their balance sheets by selling noncore assets. This might sound surprising, given the conventional wisdom that real estate prices will continue to fall. But reports of the utter demise of the transactions market have been greatly exaggerated, says David Oakes, chief investment officer and senior executive vice president of finance at Developers Diversified Realty Corp. The firm netted \$22 million in January by selling Ormand Town Square, in Ormand Beach, Fla., and has already lined up other sales worth about \$100 million in total. "We continue to see transactions happening in the \$5 million to \$25 million size range," Oakes said. "Last year we put together \$200 million in sales, and we plan to get to that number or higher again this year by selling these small- to mid-sized centers, or single-tenant assets."

Ivanhoe Cambridge is now working to position its partnership in Brazil with Rio de Janeiro-based Ancar Ivanhoe for future growth, says Scott Harris, vice president of Latin America at Ivanhoe Cambridge (and former vice president of global business development at ICSC). The joint venture is currently invested in and manages 15 shopping centers throughout Brazil. Communication between the partners, which joined forces

in September 2006, already is strong, Harris says. But in the coming months, Ivanhoe Cambridge's development team will become more directly involved with their Brazilian counterparts in the predevelopment, market analysis and redevelopment processes.

Major owners are even doing a little moonlighting. When housing was white-hot in the mid-2000s, the glut of investment capital lured droves of newcomers to the shopping center industry. Many lenders are now wringing their hands about what to do with the distressed projects of these inexperienced owners and managers, and they are turning to veterans for help on a consulting basis. "The banks don't know what to do," said Emerick J. Corsi, executive vice president of development at Forest City Enterprises. "They're coming to us for guidance and asking, 'How do we get out of this?' or 'How do we finish this project so we can put it up for sale when the market comes back?'"

Full-service firms with decades of experience will do brisk business in such turnaround work as the correction runs its course, Corsi says. (For the right price, they might even take some of those projects off the banks' hands, he says.) Size and experience are working in developers' favor in other ways as well. Competitive retailers in strong financial positions are now being more selective about which landlords they do business with, says Brian Smith, president and chief investment officer of Regency Centers, which has interests in 440 properties. "We are working with retailers who want stores but are concerned that [other] developers can't deliver," said Smith. "For example, we were selected by one grocery chain to be their exclusive developer in a strong demographic area." Other retailers have pursued joint ventures with Regency, he says.

Even as the global recession has slowed the pace of development, it has had precisely the opposite effect on leasing and property management. Donahue Schriber, which is based in Costa Mesa, Calif., and has interests in 93 West Coast centers, turned those aforementioned developers into leasing agents

in direct response to this faster pace. "We had been doing renewals with our [property] managers, but their jobs have been much more difficult because of the need to collect rents, hold the hands of the tenants and make sure centers are running as efficiently as possible," Donahue said.

Once-routine renewals are now likely to turn into thorny renegotiations in which tenants plead for lower rent. Indeed, some landlords report being besieged by letters, phone calls and e-mails from such beleaguered retailers even as their leasing teams scramble to fill vacancies. (According to the New York City-based Reis research firm, the U.S. vacancy rate in the fourth quarter hit 8.9 percent for neighborhood and community centers and 7.1 percent for regional malls. Both figures, which Reis has tracked for a decade, were at their highest on record.)

"The days of sitting in the office and waiting for the phone to ring, or just calling the different brokers in town that represent national tenants, are gone," Paster said. "When things were good and people were paying on time, you did not have to spend all this time and energy. Now you work twice as hard for half as much."

Leasing specialists are now pounding the pavement in search of promising local and regional retail concepts, or scouting for medical, office or educational tenants that could drive traffic and fill vacancies. Their market-adjusted strategies include courting more value-oriented chains, such as fast-food joints or dollar stores, or using low rents to woo successful stores from competitors' C-class properties to their own B-grade centers, Paster says.

This new paradigm can come as a shock to younger executives who have spent an entire career thus far in the relative comfort of an expanding economy. "If they've never been in a leasing environment prior to 2002, they thought it was easy, quite frankly, and that the deal flow would always be this way," Yenser said. "Now that it has come to a screeching halt, we spend a lot of time coaching them on how to lease in this kind of an environment."

But this also means a new generation is

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learning lessons and forging relationships that will strengthen companies and pay personal dividends for years to come. Yes, some underperforming executives will lose their jobs in this more Darwinian environment, but the industry will be stronger for the shakeout, says Yenser.

On the development and acquisitions front, meanwhile, it is a different shakeout—this one among national retail chains—that could have the biggest impact. The bankruptcies of such household names as Boscov's, Circuit City, CompUSA, Linens 'n Things and Mervyns signal the triumph of the category killers, says Ivan Friedman, president and CEO of RCS Real Estate Advisors, a New York City-based retail real estate advisory firm.

“There was a time when the economy could afford three retailers in a category,” he said. “In the linen business, you had HomePlace, Linens 'n Things and Bed Bath & Beyond. What's left? Bed Bath & Beyond. So the category killers are narrowing things down to one survivor. There is this contraction, and much of the slack is being picked up by Wal-Mart and Target.”

Landlords fortunate enough to have these powerhouses in their portfolios are benefiting as they gobble market share from defunct competitors, says Oakes. Developers Diversified counts Wal-Mart and Target as its top anchors. The stronger chains are snatching up leases, too. Last December Kohl's and

Forever21 jointly acquired 46 Mervyns stores at auction for a paltry \$6.25 million. The owners of those centers were able to replace dark spaces with viable tenants—but at a stiff price. “When Kohl's entered the East Coast in the late '90s and bought all of those bankrupt Caldor locations, they paid 10 or 15 times that [\$6.25 million] amount,” Friedman said.

Less fortunate owners, though, are staring at empty boxes and losing sleep over the ultimate fate of other lessees. This uncertainty is why so many are hoarding cash reserves, says Paster. “They're saying, ‘Let me lay out my worst-case scenario: What if X, Y and Z tenants end up closing? Do I have enough to cover my property through this downtime?’”

Even if the credit markets were to roar back to life tomorrow, many lenders would balk at backing new developments or acquisitions until they had a better sense of the ultimate scope and scale of this big-box shakeout, says Paster. “They have no idea what the rents are going to be in the future, what the vacancies will be or even which retailers will be in business,” he said.

As one might expect, portfolios focused on necessity retail are managing to hold their own amid the turmoil. One casualty of the past few months is the once-popular notion that luxury is a safe harbor, Donahue says. “We have a luxury center that is off 23 percent on its annual sales,” he said. “But our necessity-based, grocery-anchored centers are plus or minus in the low

single digits.” Today 85 percent of Donahue Schriber's centers have a grocery store, a strategy that grew out of the recession of the late 1980s and early 1990s. Those centers are about 95 percent occupied, and their rents are rising, albeit slowly. Other necessity-focused owners, including Regency and Edens & Avant, report similar results. “People are still going to buy milk, butter, diapers and beer,” Donahue said.

Regency, in fact, is on the lookout for select development projects, says Smith. Like others with strong balance sheets, however, it is mostly waiting for that magic moment, perhaps in 2010 or 2011, when a buying spree makes the most sense. “Those opportunities will grow as owners [of distressed centers] face refinancing hurdles, including the requirement for more equity,” Smith said.

And that hints at yet another shakeout, this one of less experienced owners who got in over their heads in the days of a housing bubble, exuberant shoppers and easy credit. Veterans want to be ready to pounce when the best of these assets hit the market at the right price. They also are keeping core development teams in place so they can crank up the bulldozers when the economy rebounds.

“We are positioning ourselves to take advantage of a circumstance where we have less competition,” said Donahue. “Out of calamity there always comes a lot of opportunity, if you can see your way through it.”

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