

Last updated: October 23, 2008 11:53am

## Retail Developers Halt New Plans in Slowdown

By Cari Brokamp

CHICAGO-Following a spike in retail vacancy and a lessening in tenant demand, local analysts expect occupancy and demand to sharply decline further into Q4 and 2009. A Marcus & Millichap third quarter market report predicts occupancy rates will continue to fall to around 90% in the Chicago metro area, as about 7.5 million sf of retail space will be added to the market in the near future. The report says the increase, coming from new developments completing, will add about 2% of inventory onto a market already oversaturated by some accounts with product.

Andy Hochberg, founder and managing principal with Chicago-based Next Realty, says he foresaw the decline in demand about a year ago, causing the company to reduce emphasis on new developments of larger shopping centers and other spaces. "I felt there was too much supply in general, and mostly of larger format stores," Hochberg says. "I'm comfortable now that we don't have those commitments."

The company has continued focusing on retail development of 7 acres or less, which Hochberg says offer more manageable spaces. Next has recently redeveloped Roosevelt Plaza, a 125,000-sf shopping center in Lombard, originally built in the 1960s, which is about 91% occupied with asking lease rates for the remaining 11,000 sf around \$11 per sf net. The company is also nearing completion on development of a 30,000-sf center in Volo, about 92% occupied with lease rates around \$24 per sf net. "We're continuing with that because in the smaller centers, you're not as dependent on anchor tenants," Hochberg says.

Marcus & Millichap's recent market report suggest that Hochberg's move was a good one, showing that pressure on operating conditions will result from large amounts of new product on the market from new developments. "Demand for the city's single-tenant assets will likely be robust through year end," said Greg LaBerge, regional manager of the Chicago office of Marcus & Millichap, in a statement. "Multi-tenant interest is expected to remain modest, but could pick up if yields continue to rise."

But Hochberg thinks in the next year, development deliveries will slow substantially. "My sense is that the development pipeline is mostly stopping," Hochberg says. "The developments started years ago are being completed, but new development is pretty much stopped." Hochberg said buildings in a good location will still see demand, and that location is important now more than ever.

A large indication of the health of the retail markets and the ability of stores to remain open and successful will be seen with the coming of the fourth quarter reports, experts say, which will report on sales in the historically strong Christmas season. Hochberg says the true impact of the economy on the retail market won't be completely seen until Christmas, the time of year retailers depend upon for strong sales.

"Christmas is going to tell the story," Hochberg says. "For most people, September and October numbers have not been good, but those are generally small months in the course of the retail world, so the question is are people deferring third quarter purchases to make 4th quarter

purchases, or cutting back all across the board."

However, Hochberg says the recent decline of gas prices may free up discretionary spending for consumers and allow for larger and more purchases for the holidays, which could make or break the health of some businesses. "Tenants can only pay so much in occupancy costs as a percent of their sales. If their sales go down, occupancy costs may go down," Hochberg says. "Rent increases are going to be hard to come by and you might even see some rent decreases coming upon renewals."

Hochberg says he has been surprised to see leasing activity continue at a slower pace from an unexpected source. "National retail chains have cut back expansion significantly and have delayed expansions, cancelling commitments made and deferring commitments yet to be made," Hochberg says. "However, we're still seeing good activity from new independents and small businesses, many formed by people laid off from their job who want to take a new direction with their life. There are people less connected with the big financial problems out there, (and) want to grow their business."

Despite this new energy, Hochberg questions whether it will be enough to sustain the market, and still expects a substantial increase in vacancy. "The thing I'm most concerned about with the stores that are closing is whether there is enough velocity of new retail concepts to absorb that space, and the ability of the market to create the tenants," Hochberg says. "When you look at what venture capital is back or where private equity is flowing, there aren't a large number of concepts. You have a market that's arguably overbuilt, and who's the new player?"

Hochberg says he doesn't see the market recovering for more than a year, possibly into 2010 or later. "It's not going to be that fast," Hochberg says. "The amount of time it takes to get a deal done is longer now, because companies and tenants are more careful. Landlords want to make sure they have a tenant that's going to be around or a while, because if you're putting in a tenant that doesn't have financial strength, they'll find themselves back with the space."

Additionally, Hochberg says the events of the past month may have a longer term impact that anyone has predicted, and have the potential to have permanently altered the way people spend. "The impact of all of this on retail is very interesting," Hochberg says. "You're going to see a significant turn toward a consumer mindset of greater savings rather than consumption, and there's going to be a trend toward great savings rates in the long-term as people try to replace what was in their 401K, and realize greater financial prudence is a good idea. But it's really going to depend on your product offering, and if you have merchandise people need and a niche people want to shop in, you're going to be fine."

Copyright © 2008 ALM Properties, Inc. All rights reserved. Reproduction in whole or in part without permission is prohibited.

For reprint information call 410-571-5893 or e-mail [afaulkner@remedianetwork.com](mailto:afaulkner@remedianetwork.com).