

## Filling Empty Boxes

By Joel Groover

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National tenants are on the move in Houston — and not just the likes of Carl’s Jr. or Dollar Tree, both of which have been quite active in Texas through much of the recession. As of the spring, Cheesecake Factory and Party City are among those touring Houston-area shopping centers and signing leases, for the first time in years.

“Activity is up, and there is a general feeling among retailers, developers and brokers that things are improving,” said Kenneth S. Katz, a co-founder and principal of Baker Katz, a Houston-based brokerage firm. “Everyone I’m talking to is saying: ‘Tours are up; retailers that haven’t been doing anything here are committed again.’”

This brighter mood extends beyond Texas. Several national credit tenants, including Bed Bath & Beyond, Best Buy and PetSmart, ramped up their leasing activity in the second half and have begun backfilling junior-anchor spaces at shopping centers across the country, according to commercial real estate research firm CoStar. Rent concessions and aggressive retailer outreach programs are part of the reason for this trend, the firm says, but the upshot is that CBL & Associates Properties, Developers Diversified Realty, Kimco Realty Corp., PREIT and others have some good news to report on the leasing front.

Unfortunately, big-box and junior-anchor vacancies remain a daunting problem, as shown by the impact these vacancies are having on major markets, including Phoenix, where at the end of the first quarter CB Richard Ellis recorded 299 empty retail spaces greater than 10,000 square feet, and north New Jersey, where brokerage firm R.J. Brunelli & Co. says landlords struggle to fill spaces following the departures of Circuit City, CompUSA, Home Depot Expo, Linens ’n Things and others. R.J. Brunelli noted in May that the retail vacancy rate for the six-county north New Jersey area had risen to a 20-year high of 8 percent, up from 6.8 percent last year.

Big boxes, 84 percent of which had been dark since at least 2009, accounted for nearly half the market’s 2.2 million square feet of retail vacancies. On the whole, U.S. landlords are now working to lease nearly 9,000 boxes ranging from 15,000 to 50,000 square feet, says CoStar.

National tenants may be stirring from their slumber, in other words, but the overall imbalance of supply and demand is such that many retail property owners have little choice but to seek creative solutions for their empty big-box and junior-anchor spaces. In Mesa, Ariz., GRL Mesa Developments had few options after Mervyns handed back the keys to its stand-alone store at the corner of Stapley Drive and Main Street.

“We entertained a couple of ridiculous offers from some national retailers but decided to go in a different direction,” said Brad Weinstock, a local developer hired to find a new use for the space. “We have always been inspired by the collectivism of places like The Brewery, in downtown Los Angeles. It’s a hugely successful artist colony where the artists-in-residence open up their spaces to the public. We’re now doing the same thing in the retail genre.”

Collectivism and retail are hardly synonyms, of course, but that former Mervyns store is now the site of an unusual experiment called Pool Together, a 41,000-square-foot community marketplace where small tenants are encouraged to pool their resources and expertise to thrive in nontraditional spaces. Rents start as low as \$650 a month. The idea is to give startups, artisans and similar businesses that cannot afford to pay standard rents a way to get started.

Meanwhile, Pool’s merchant services include help with marketing, logo design, business-plan analysis and more. “We’re working with a couple of young guys just out of college who want to open an ice-cream store but have never done any retail work,” said Weinstock,

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a Pool co-founder and its CEO. “We’re going through their business plan, making sure their price points match their demographics and that they have enough capital to execute. We’re working hard to invest in and incubate these new businesses.”

If single users of cavernous retail spaces are in short supply, concepts like Pool are founded on the understanding that potential small-scale users are out there in abundance. “You might have someone who lost their 2,000-square-foot lease last year and has their inventory in storage,” said Pool co-founder and COO Skyler Hynes. “Along comes Pool and we say, ‘No, you do not need to sign away your house for a guarantee.’ Suddenly, being back in business becomes feasible again.”

The leasing team at PREIT’s South Mall, in Allentown, Pa., also went with a vendor-based approach after Steve & Barry’s closed its 49,000-square-foot store in January 2009. The closure cut occupancy from 90 percent to 78 percent and threatened to sap South Mall’s drawing power. Taking advantage of the popularity of antiques in the Allentown area, the leasing team converted the space into a second location for the Black Rose Antiques & Collectibles, which had performed well at another Pennsylvania mall. The new site was started with 70 vendors but quickly doubled in size. Indeed, it was such a hit with customers, the antiques community and the media that PREIT says it may try to bring the Black Rose concept to other properties in its portfolio. The deal enabled South Mall to replace 80 percent of the net operating income lost through the Steve & Barry’s closure, PREIT says. It also boosted the property’s value by \$2.3 million and eliminated the specter of a highly visible vacancy at center court.

Bringing in unconventional concepts that rely on multiple rent-paying vendors certainly can work, but Weinstock and others emphasize the importance of due diligence and discrimination. Through in-depth market analysis and adherence to high design and leasing standards, developers can steer clear of the “anything goes” atmosphere that often prevails at flea markets. “At Pool, we have very strict market rules with regard to display, merchandising, what can be sold, hours of operation,”

Weinstock said. “We want cohesion in all of those areas. We also want the right to ask someone to leave if they don’t follow those rules.”

With its mauve carpet, T-bar ceilings, Formica fixtures and tile walkways, the Mervyns store in Mesa had changed little since it was built in the 1970s. Weinstock and Hynes, however, have thoroughly redeveloped and redesigned the space, which is about 40 percent leased and could eventually house 100 vendors, a specialty restaurant and a farmers’ market. In addition to putting in social gathering areas and a 4,000-square-foot entertainment venue called The Living Room, the partners have replaced all the old fixtures, taken the ceilings up to 24 feet in height, cut in about 40 skylights, installed new lighting and put in a surround-sound system, among other improvements.

“We refloated the floor for a polished-concrete look, and the space is now bright, modern and airy,” Weinstock said. “In the next phase, we’ll be cutting in firehouse doors that roll up at certain times of the year.” The total investment in Pool, which opened in July, will be about \$3 million.

This approach illustrates how real estate veterans can apply years of experience in leasing, development and management to give unconventional retail concepts a better chance of success. Jeffrey Langfelder, whose résumé includes co-founding the Atlanta-based Shopping Center Group real estate services firm in 1983 and running The Home Depot’s real estate operations, never imagined he would one day head up a farmers’ market. But when Langfelder’s friend Andrew Bauman, a longtime apartment developer, approached him with the idea, Langfelder was intrigued. The city of Sandy Springs had bought an eight-acre parcel that included a vacant Target store. Well aware that community-building is a top priority for the Atlanta suburb, Bauman wanted to bring a weekend farmers’ market to the Target parking lot.

The partners approached the endeavor as though it were a new commercial real estate project. They hired an architect to do a layout, studied competitors’ strengths and weaknesses, and toured farms across the state in search of the best potential vendors. “We thought we’d

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go at this from an entrepreneurial rather than a nonprofit standpoint,” Langfelder said. “There was a right way and a wrong way to put it together.”

City officials, who had rejected similar proposals on several occasions, responded positively to the partners’ well-organized presentation. The Sandy Springs Farmers Market launched in May and may move from the parking lot to inside the former Target store during the winter months. “We had somewhere between 1,500 and 2,000 people come out on our first Saturday,” Langfelder said. “We only expected about 500. Buckhead Bread Company had to go back three times to bring more bread into the market. It has been a great success so far.”

Even as they court traditional junior and big-box tenants, other real estate veterans are backfilling vacancies by doing strategic deals with nonretail users. Though medical, dental, office or municipal tenants might not be perfect for every space, they are often worth considering, says Jim Ezell, executive vice president of Marietta, Ga.-based Retail Planning Corp. “These tend to be credit deals, good uses for the community, and they fill up space,” he said.

Rather than build a ground-up library at far greater cost, officials in Cobb County, Ga., worked with Ezell on a 20-year lease for the 16,800-square-foot East Cobb Library, which opened at the Parkaire Landing shopping center in February. “Because Cobb County is one of the strongest counties in Georgia as far as

its bond rating, what the owner ended up with was a long-term tenant with a triple-A-rated bond credit,” Ezell said. Likewise, medical and dental tenants often must spend huge amounts on infrastructure improvements when they move into former retail and restaurant spaces. This up-front investment means they are reluctant to relocate. “You get a long-term credit tenant,” Ezell said, “instead of another restaurant that’s going to go out of business in three years.”

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