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Disparity in Mall Values Driven by Powerful Combination of Forces - CoStar Group
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NEWS

Disparity in Mall Values Driven by Powerful Combination of Forces

While Successul Malls Have Unique Attributes, Unsuccessful Malls Have a Lot in Common By Mark Heschmeyer
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The news that Macy's plans to close another 100 stores prompted more speculation over the future of department stores and, by extension, the future of shopping malls.

But as several analysts point out, store closures are a symptom of larger ills affecting retailers right now, ranging from the growth of online shopping to the oversaturation of retail space per shopper, flawed business plans and changing consumer behavior.

An analysis of 10 malls backing loans held in commercial mortgage backed securities found that, in general, malls suffering substantial losses in property values all shared many of the same characterisitics:
1. They were all located in areas with lower than average household income for the market;
2. They all saw sales canibalized by larger super regional malls or large community centers within a five-mile radius;
3. Their anchor stores lost their drawing power as a proliferation of trendy niche retailers increasingly fragmented the market, drawing shoppers away from the big retailers who cast wider nets, and;
4. The weaker malls lacked capital for repositioning and re-tenanting to remain vibrant.

Data Mining 10 Malls Exposes Disparity in Values

CoStar analyzed data on 10 malls backing loans held in commercial mortgage backed securities. All of the loans are in special servicing indicating they have problems with loan repayments or refinancing. Seven of the properties have already been foreclosed. And special servicer comments on the loans indicate that a sale of nine of the properties is expected by year-end.

Based on appraisals done in the past year, these 10 malls combined but not individually had lost 75% of their value from the time of their loan originations. The latest appraised values of the malls gave them an average value of about $66/square foot.

Mall -- City -- State
Arrowhead Mall -- Muskogee -- OK Eastfield Mall -- Springfield -- MA Foothills Mall -- Tucson -- AZ
Great Northern Mall -- Clay -- NY Hilltop Mall -- Richmond -- CA Indian River Mall -- Vero Beach -- FL
North Grand Mall -- Ames -- IA Quintard Mall -- Oxford -- AL Southlake Pavilion I & II -- Morrow -- GA
Yuba Sutter Mall) -- Yuba City -- CA

CoStar looked at the population and household formation within a three-mile radius of each of these malls. The average population within that radius was slightly more than 55,500 in 20,600 households.

Using those population demographics, CoStar then found three malls that have sold this year with similar characteristics for which buyers paid a premium. The three malls sold at an average value of $626/square foot.

Mall -- City -- State
Flatiron Crossing -- Bloomfield -- CO Quaker Bridge Mall -- Lawrenceville -- NJ
University Station - Westwood -- MA

The demographic distinctions between the two groups is striking.

The average income among households near malls favored by investors was twice that of those near the specially serviced malls. The median housing value was almost three times as high. The projected population growth through 2021 was twice as high. And importantly, the number of people living below the poverty level was four times higher near the specially serviced malls vs. the favored malls.

“Those who think that department store and apparel closures are the problem and not a symptom are simply putting the cart before the horse,” said Garrick Brown, vice president, retail research of the Americas at Cushman & Wakefield.

"Up until 18 months ago, wage growth was only occuring at the higher end of the income scale," Brown said. "And that inequality has fractured the consumer market."

And while wage growth has started to happen across the board, shopping centers weakened by the changes in consumer demographics continue to feel the pressure.

Within a 3-Mile Radius -- Spec. Serv. Malls -- Favored Malls
Ave. Population -- 55,529 -- 39,764 % of Population Below the Poverty Level -- 16.70% -- 4.70%
Ave. Projected Population Growth thru 2021 -- 2.40% -- 4.20% Ave. Total Households -- 20,638 -- 15,593
Ave. Households Size -- 2.56 -- 2.5 Ave. Projected Households Growth thru 2021 -- 2.50% -- 4.40%
Ave. Median Home Value -- $142,377 -- $378,746
Ave. Median Households Income -- $50,091 -- $96,870

“Ultimately, that giant middle class consumer demographic isn't willing, or able to some degree, to spend the way they used to,” Brown said. “Consumers in the middle went into discount mode during the recession and they didn’t come back. They’re buying things, but they’re doing it at the off-price stores out at the power center instead of the mid-price stores at the malls in a lot of these communities.”

New Malls Killing Older Malls
Individually, each of the malls in the specially serviced group are experiencing a range of other ills including competition. All 10 faced competition from not only power centers but outlet centers, larger super regional malls and/or large community centers within a five-mile radius.

Foothills Mall in Tucson, for example, competes with six other malls or centers larger than 250,000 square feet within a five-mile radius, including Tucson Mall, which is nearly twice its size. Those six centers total more than 3 million square feet.

“The rise of the super-regional mall killed the small suburban generic mall,” said Soozan Baxter, principal of Soozan Baxter Consulting, a New York-based landlord-focused retail advisory firm. “While people may visit the super-regional mall less frequently, they do big shopping hauls there. Plus they generally stay for dinner, see a movie, and make a day of the experience. It pulls from a bigger region, and the common refrain is, ‘I don’t want to go to a smaller mall because the selection isn’t as good as a bigger mall.’”

When a major retailer such as a Macy's has to decide whether to close redundant stores in a market area, they will more likely close the store at the smaller, older, suburban mall - pushing the super-regional into an even more relevant position, Baxter said.

Dept. Stores Lose Cachet to Fragmentation
In addition, department stores have lost their consumer drawing power for mall owners and in-line tenants as evidenced by department store sales, which have been on the decline for some time, according to U.S. Census Bureau monthly data. Annual department store retail sales peaked in 1999 at $230.3 billion and have declined every year but one since then finishing 2015 with a total of $165.5 billion -- a 28% slide.

year but one since then finishing 2015 with a total of $105.5 billion – a 23% slide.

“Traditional retailers are being subjected to death by a thousand paper cuts where the competition is no longer the big-box retailer across the street, but rather a myriad of new players; this represents a sea change for the industry,” said Kasey Lobaugh, principal, Deloitte Consulting LLP and chief retail innovation officer. “Conventional wisdom might also say the loss of share by traditional retailers is simply an online vs. bricks-and-mortar battle, with traditional retailers losing the e-commerce game, which our research also shows to be untrue.”

Out of the top-25 brick-and-mortar retailers, 16 have robust and growing e-commerce sales that have consistently outperformed the broader e-commerce retail market. Between 2010 and 2015, these brick-and-mortar retailers grew their e-commerce business by an average of 20.9%, compared with a 15% growth rate in the overall market- indicating these retailers are actually taking share from those others who operate in the e-commerce space, Lobaugh noted.

Starting in 2009, something interesting changed as the retail industry shifted, Deloitte analysts noted. Since then, we’ve seen a marked acceleration of fragmentation, with significant acceleration in 2015. Smaller, more nimble players started stealing share from larger, more traditional, at-scale retailers.

The retail fragmentation trend in particular gives smaller retailers the upper hand in the market as they focus on niche products and experiences compared to the big retailers who cast wider nets.

“Anchors stopped being anchors,” Baxter said. “Often their sales people looked bored, didn’t understand the product, were not serving every department, and were slow. The shopper goes online and knows more about what is being sold than the salesperso. The stores became messy and the brands were all the same, no matter where you went. That isn’t an anchor problem. That’s an every single store problem.”

“The role of technology in this has just made it easier for consumers to be value-oriented shoppers,” Cushman's Brown said. “So there is the chance that this is a structural shift.”

Lack Capital to Reinvest

“There is a significant gap between strong and weak shopping malls in their ability to retain tenants and attract capital, owing to competitive pressures within the retail industry,” Moody's Investors Service noted in a new report this past week.

“The recent wave of department store closures and the growth of online retail have helped accelerate the widening gap between winners and losers among malls. When assessing loan collateral, our goal is to determine how well positioned a mall is to survive over the next 10 to 20 years, since most mall loans within CMBS are structured with 10-year terms, with a balloon balance that comes due at maturity," said Moody's analyst, Robb Paltz.

When weak malls fail, the losses can be considerably higher than on other property asset types in CMBS holdings because in many cases it's the mall's business model that has failed, Paltz said.

Retail has long been a business of “creative destruction,” he explained, with some established tenants failing and new ones springing up to replace them. Very few of the top tenants in malls 20 years ago are still strong performers - or even in still in business - today.

“The repositioning and re-tenanting of a mall requires substantial capital and may be necessary every 10 to 20 years,” Paltz noted in the Moody’s analysis. “For highly productive malls the cost can be justified, but for less productive malls it cannot. As a result, weaker malls are forced to sell at a large discount to reflect the capital that a new owner would have to put in to keep the mall competitive. Depreciation for malls is not just an accounting concept; malls need to stay current and vibrant or risk a reduction in their earnings power.”