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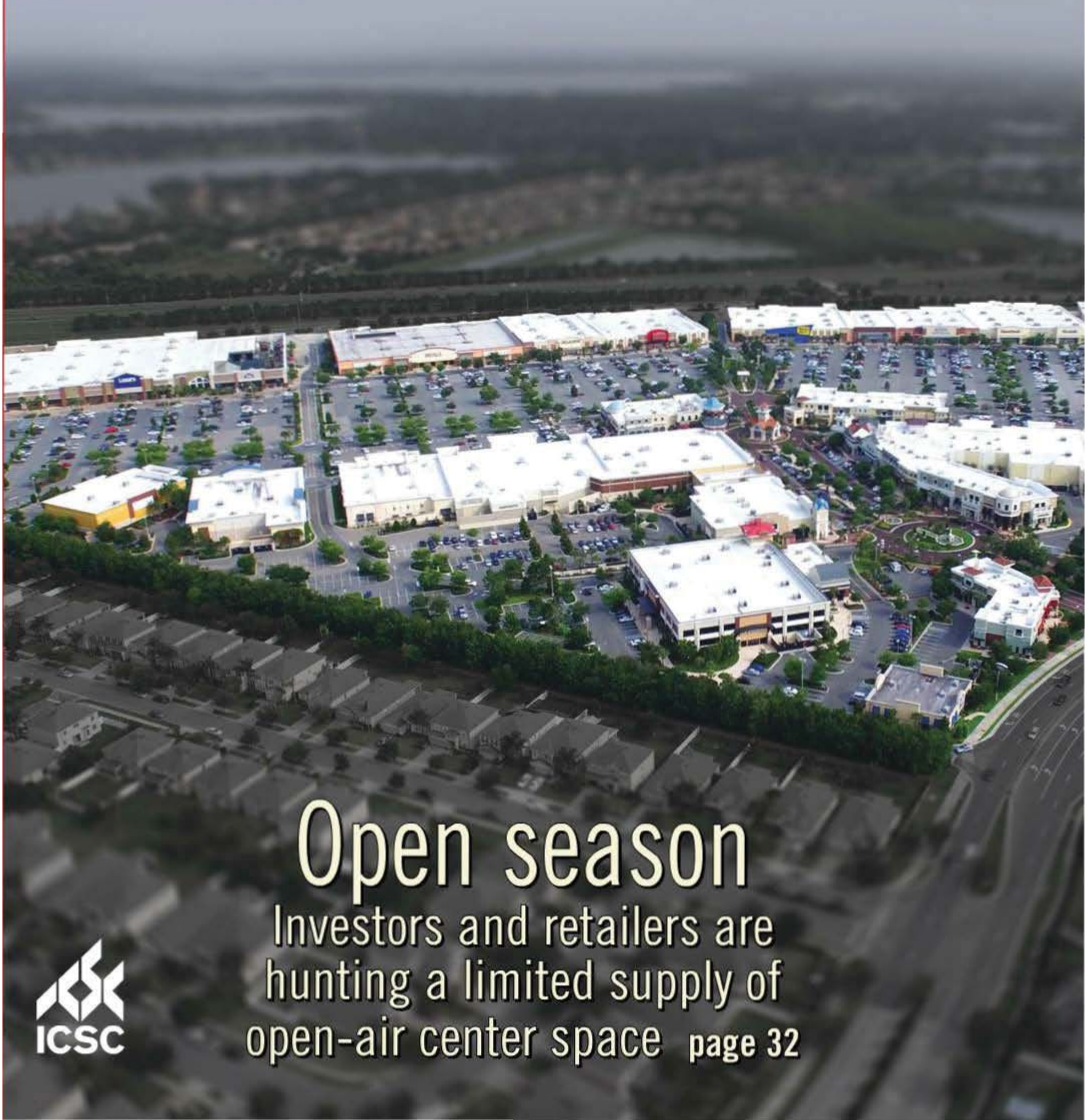

Open season

Investors and retailers are hunting a limited supply of open-air center space page 32

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DDR'S WINTER GARDEN VILLAGE, IN ORLANDO, FLA.

OPEN SEASON

OPEN-AIR CENTER VALUATIONS ARE SKY-HIGH AS INVESTORS AND RETAILERS VIE FOR A LIMITED SUPPLY

By Steve McLinden

DR. SEUSS MIGHT WELL HAVE BEEN WRITING about today's bustling open-air shopping center industry when the celebrated children's book author wrote long ago: "It's opener, out there, in the wide, open air."

While premium enclosed malls hold up, open-air centers will be extending their industry dominance well into the future, retail REIT executives and analysts say, given present trends of development, leasing and investment. "The open-air retail landscape is healthy," said Conor C. Flynn, president and CEO of Kimco Realty Corp., in an earnings call last month. "Big-box retailers are back looking for space; junior-box players continue to be the most aggressive; traditional and specialty groceries are active; and our small-shop leasing also indicates a healthy trajectory."

The tight supply is also pushing rents higher for open-air REITs, most of which report occupancy rates between 93 and 96 percent. "Most of these centers are full or close to full, and there is a line of tenants looking to find space," said REIT analyst Rich Moore, a managing director at

INVENTRUST BOUGHT THE 42,492-SQUARE-FOOT SONTERRA VILLAGE, IN SAN ANTONIO, FOR $21.5 MILLION.

RBC Capital Markets. New anchors as well as shopping center expansions and reconfigurations offer landlords the opportunity to extract additional value from already strong centers, according to Moore. "These usually yield double-digit returns," he said.

Lack of supply has made it harder to achieve cap-rate compression, says Steven Grimes, president and CEO of Retail Properties of America, Oak Brook, Ill. "And that causes developers to really focus on the value of growing centers organically," said Grimes. Meanwhile, buyers seeking prime properties continue to outnumber sellers. "Open-air centers are such a hot ticket for investors that it's hard to find good properties to buy these days," said Andrea Olshan, CEO of New York City–based Olshan Properties. Strong industry fundamentals have institutional capital sources – pension funds, insurance companies, mutual funds and investment banks – chasing top-tier retail assets at robust prices, says Grimes.

Open-air REITs are also taking advantage of the up market to fine-tune and deleverage their holdings. DDR Corp., which completed two power centers in the past few years – at Seabrook Commons, on the Massachusetts–New Hampshire border, and Belgate Shopping Center, in Charlotte, N.C. – is improving its asset base by parceling off parts of its portfolio. DDR closed on some $564 million in acquisitions last year, including seven prime shopping centers in the fourth quarter alone that totaled $404 million, while disposing of some $1 billion worth of shopping centers. "We expect to continue to take advantage of the competitive transactional market," said CFO and Treasurer Luke J. Petherbridge. "We will use sale proceeds to selectively acquire prime assets and further reduce leverage."

Source: ICSC Research

Small-shop space is faring well, thanks to a resurgence of mom-and-pop leasing. Regency Centers says it posted a 96 percent occupancy rate in the fourth quarter, with small-shop space at a respectable 91.5 percent. Brixmor Property Group, whose 522-property U.S. portfolio is 70 percent grocery-anchored, said in February that some 40 percent of its small-shop space is leased by local businesses and 60 percent by national and regional tenants. Brixmor, which told analysts that its centers are 93 percent occupied, says it plans to reposition anchor spaces at 160 locations by 2018, with an investment of $450 million.

There is speculation in the industry that additional public REITS will go private in the wake of open-air developer Inland Real Estate Corp.'s agreement in December to be bought for $2.3 billion by funds managed by DRA Advisors. The Inland board needed to address the disparity between the long-term discount at which the REIT traded and the private-market value of its assets; management said the best way to bridge the gap and provide shareholder value was to take Inland private in a merger, according to Chairman Thomas P. D'Arcy. The deal is expected to close by late this spring.

Forest City Enterprises went the other direction, converting from a private to a public REIT on Jan. 1. The move stemmed from a streamlining initiative suggesting an exclusive focus on core real estate assets. As part of the process, the Cleveland-based company divested its stakes in the Brooklyn (N.Y.) Nets basketball team and that team's Barclays Center home, in Brooklyn, to team majority owner Mikhail Prokhorov.

High prices on open-air centers in major markets are driving Kimco Realty Corp. to focus on improving its existing properties instead of looking for new ones to buy, according to Kimco CEO Conor C. Flynn. When the firm does cut a deal, it is to buy out its joint-venture partners and wholly own a property, Flynn told investors on a fourth-quarter earnings call. Kimco spent some $2.1 billion last year buying out partners in 57 properties. In contrast, Kimco bought only two assets in the open market, for a total purchase price of $155 million.

Meanwhile, the firm is taking advantage of low cap rates to offload properties in secondary markets. "We have some assets on the West Coast that we've sold at very aggressive pricing," Flynn said. "And when you look at the statistics for our fourth-quarter sales, our average cap rate was 6.5 percent, which was the lowest cap rate that we've had on our dispositions that we've tracked."

KIMCO'S WESTLAKE SHOPPING CENTER, IN DALY CITY, CALIF.

The REIT reported surprisingly strong leasing to independent retailers for the year. "It's all about supply and demand," he said. "Right now we see retailer interest in all categories, whether it's small-shop, midsize, junior boxes or the big-box anchors. They all have been very aggressive in growing store count, and that continues to lead to bidding wars, which will bid up rents."

Many of the enclosed-mall REITs are developing open-air centers of their own or adding open-air components. In January Taubman Centers canceled plans for an enclosed regional mall for the mixed-use Miami Worldcenter development, announcing that it will pursue instead an open-air high-street concept more conducive to the site, with partner Forbes Co. "We've invested a significant amount of time on the project," said Chairman, President and CEO Robert S. Taubman. "Unfortunately, we were unable to structure an enclosed-mall program that meets our investment criteria." Taubman's deci-

sion was probably driven at least in part by the abundance of already successful enclosed centers in the Miami area, according to Soozan Baxter, principal of New York City–based Soozan Baxter Consulting, a landlord-focused retail advisory firm. "It makes it hard to rationalize other options in that market."

Westfield's open-air extension of the enclosed Westfield Topanga Canyon mall, in Woodland Hills, Calif., called Village at Westfield Topanga, opened in September with Costco and REI as anchors. General Growth unveiled a major expansion at its open-air Ala Moana Center, Honolulu, in November. The new Ewa wing has nearly 40 stores and restaurants, including Hawaii's first Bloomingdale's. In Lafayette, La., CBL's 60-acre outdoor Ambassador Town Center, slated to open later this month as a venture with Sterling Properties, is another new outdoor build. The 438,000-square-foot Costco-anchored center is 95 percent leased or committed, according to Katie Reinsmidt, CBL's senior vice president of investor relations.

REITs recapture premium anchor space

Confident in the growing demand for quality space, more landlords are pushing out underperforming tenants to make way for those that are more promising. Increasingly, landlords show that they are willing to sacrifice short-term cash flow and occupancy for long-term gain.

Federal Realty Investment Trust, for one, allowed supermarket chain A&P to reject four leases totaling 185,000 square feet, despite the high likelihood that the leases would be quickly purchased by other tenants at bankruptcy auction. Federal Realty is willing to let the stores sit empty while it hatches redevelopment plans that will make both the stores and the shopping centers more valuable, according to Donald C. Wood, the REIT's president and CEO. "We want to use these favorable economic conditions to re-lease," he said. "We see a good sampling of mediocre retailers that have been holding on for years that are either giving up or who will soon. We're fine with that. We are anxious to get it to either re-lease or redevelop."

Federal Realty is planning to let some 465,000 square feet of anchor space go empty this year as leases expire on tenants at 10 properties, representing roughly $6 million in rent losses. "The investment and downtime this year should pay significant dividends in the future," said CFO and Treasurer Jim Taylor. "We are very excited about the opportunity to unlock value at these centers — to redevelopment, repositioning and re-leasing. Overall, we expect to significantly exceed the prior in-place rent of approximately $1.350 a foot on these larger spaces. We will deliver better retailers at better rents and significantly improve these assets."

> "We see a good sampling of mediocre retailers that have been holding out for years that are either giving up or will soon. We're fine with that."

Malls are doing this too. "We are also proactively reducing exposure to traditional anchors where they are underperforming," said Stephen D. Lebovitz, president and CEO of CBL & Associates Properties, on a fourth-quarter earnings call. The firm is negotiating with such tenants as JCPenney, Sears and Shopko to end leases early at underperforming locations in favor of the likes of Dunham Sporting Goods, Ross Dress for Less and Ulta.

Wood said in 2008 that Federal Realty would go to great lengths to keep an anchor tenant such as Party City, which is now moving out of one of the firm's Chicago properties. "We would have lowered the rent, we would have done whatever we needed to do to keep the occupancy and to keep the income coming in the drawer," he said. "In 2016 we view that differently. We are certainly willing to play hardball on the lease terms effectively, and say, 'Yes, you've got to go.' If we simply re-leased it to the same anchor and extended those existing leases, we would be losing the shot to create significant value for a decade or more." SCT

SIMON CONVERTED THE FORMER NANUET MALL INTO AN OPEN-AIR CENTER CALLED SHOPS AT NANUET.

At the Owings Mills Mall, in Baltimore, meanwhile, Kimco is buying out joint-venture partner General Growth, along with some anchor parcels from J.C. Penney and Macy's, to acquire full ownership and revitalize the property as an open-air center. "That allows us to really start from scratch and take down the mall," Flynn said.

While the development trend in Manhattan, including the likes of Hudson Yards and Westfield World Trade Center, continues to be for enclosed projects, warmer climates keep lending themselves to open-air center development, according to Baxter. But cool-weather outdoor retail properties in New York state, such as COR Development Co.'s Towne Center at Fayetteville and Simon's Shops at Nanuet, which replaced Nanuet Mall, are an exception. They are succeeding thanks in part to their convenient access and practical design, she says. "They have shined despite being near large [enclosed] super-regional shopping centers," she said.

Though some retailers thrive mainly in a large, enclosed-mall environment, thanks to the foot traffic, compatible adjacencies, overall experience and other factors, those that are facing Wall Street or internal pressure to control costs are opting increasingly for open-air centers. This is because common-area-maintenance and marketing expenses are higher in the enclosed malls, says Baxter. But there is a trade-off, she says: "A cheaper center does not always equal a great experience and lots of foot traffic."

With fewer options in major markets, institutional buyers have begun looking at the best properties in secondary and tertiary markets, according to Olshan. "Obviously, return on cash remains so low that [large investors] need to put the money out."

Smaller investors are more likely to balance their holdings using REIT allocations this year, since real estate finally became its own official sector in the Global Industry Classification Standard in January. GISC had previously listed real estate under "financials," according to a Kimco company blog.

Neighborhood grocery-anchored shopping centers stand dominant among shopping center investors for now, says Naveen Jaggi, president of retail brokerage at JLL. "But they are also liking quality A-plus power centers in major markets," Jaggi said.

Because retailers are accelerating store growth, construction of new open-air centers is imminent, says Moore, who notes that fewer retailer bankruptcies than had been projected bodes well for higher occupancy rates. Retail REITs, he says, will launch most of the projects "as they have access to capital, whereas the private guys may not. For owners of the best shopping centers in a market, the sky is very blue." SCT