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Vacancy up at Chicago-area neighborhood retail centers

By Thomas A. Corfman

(Crain's) — The vacancy rate at Chicago-area neighborhood shopping centers and strips malls rose in the third quarter, to 11.2%, compared to 10.9% during the second quarter and 9.4% a year ago. Meanwhile, effective rents, which factor in the value of concessions given to tenants, fell 0.7% during the third quarter, to \$17.33 a square foot, compared the same period in 2008, real estate research firm Reis Inc. said Wednesday.

"Tenants have leverage, and any tenant that has capital to expand knows that," says retail real estate broker John Vance of Chicago-based Stone Real Estate Corp. "It's hard for landlords to hold the rents." Nationwide, the vacancy rate at such retail centers climbed to a 17-year high in the third quarter, reflecting the protracted pullback by consumers. The figures include smaller retail developments, such a grocery-anchored centers and big-box stores.

The figures do not include regional malls, which Reis tracks separately and only on a national basis. The vacancy rate of those larger centers rose to 8.6% during the third quarter, compared to 8.4% during the second quarter and 6.6% a year ago. Mall vacancy is at its highest level since at least 2000, when New York-based Reis began following that part of the retail real estate market.

In vacancy, the Chicago market for neighborhood shopping centers ranked 43rd lowest nationwide among the 77 areas Reis tracks. In terms of change in effective rent, Chicago tied for 39th best. "Our outlook for retail properties as a whole is bleak," said Victor Calanog, Reis director of research. "Until we see stabilization and recovery take root in both consumer spending and business spending and hiring, we do not foresee a recovery in the retail sector until late 2012 at the earliest."

Despite that dire prediction, Mr. Vance says vacant stores in top locations are still attracting interest from tenants. But because national retailers have dramatically reduced their national expansion plans, the nature of the competition for those sites has changed.

With fewer stores to open, retailers are carefully picking their markets and choosing only those locations where they can get the best deal.

"The landlord is not competing necessarily with the guy across the street, he's competing with a guy . . . 1,000 miles away," Mr. Vance says.

The national third-quarter vacancy rate at neighborhood shopping centers rose 0.3 percentage points from the second quarter to 10.3%, the highest since 1992, Reis said. Asking rents at community centers slid 0.3% from the second quarter to \$19.22 per square foot and were down 1.9% from the prior year. Asking rents were the lowest since mid-2007.

Factoring in months of free rent and other perks, effective rent fell 0.8% from the second quarter to \$16.89 per square foot, or down 3.8% from the third quarter of 2008. Rents were the lowest since mid-2007.

Rents continued to decline as retail property landlords faced ongoing pressure from tenants who reduced their space requirements, negotiated more favorable lease terms or went out of business altogether.

"Since asking and effective rent growth only turned negative about one year ago, it is daunting to observe this acceleration in decline in what has traditionally been regarded as a stable property type," Mr. Calanog said. Reis expects rising vacancy levels and declining asking and effective rents for neighborhood and community centers through 2011.

"We have yet to observe any unexpected systematic resumption in hiring and strength in consumer spending that may lead us to revise our projections with a more optimistic bent," Mr. Calanog said. Asking rent at big U.S. malls fell 0.6% from the prior quarter to \$39.18 per square foot and was down 3.5% from a year earlier. It was the fourth straight decline in rents and the largest one-year decline Reis has seen.

Whenever the recovery comes, demand for urban retail real estate will rebound more quickly than for outlying suburb locations. Developers had previously pitched those locations based on rosy population projections.

"No retailer is going to accept that the population growth is trending that in 2011 this thing is going to be filled up with people," Mr. Vance says.

Reuters contributed to this report.

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