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Lifestyle Center Developers Apply Lessons Learned During the Downturn

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As lifestyle centers grew in popularity during the boom years, Poag & McEwen, a Memphis, Tenn.-based development firm often credited with creating the concept, became a rock star within the retail real estate industry. The firm�s founders, G. Dan Poag, Jr. and Terry McEwen, were seen as visionaries, leading the country into the new age of retail development that would make regional malls obsolete. They were frequently quoted in newspaper articles championing the exciting new format.

Five years later, Poag & McEwen was back in the headlines. Only this time, it was for a less glamorous reason: loan defaults.

Last fall, for example, Poag & McEwen lost its 350,000-square-foot Promenade Shops at Dos Lagos, in Corona, Calif., to foreclosure. The center, which opened in late 2006, has been able to maintain occupancy above 90 percent, according to Joshua D. Poag, company president and CEO. The problem has been sales. Sales at the center plummeted by more than 25 percent during the depths of the recession, according to Poag. That�s more dramatic than the 10 percent peak-to-trough dips the firm saw at its other properties. As a result, tenants had trouble paying rents, which cut into the center�s NOI and ultimately made it impossible for Poag & McEwen to keep current on its $125 million loan with CW Capital.

The movie theater at Steiner + Associates� Easton Town Center helps draw traffic to the center.

�That project was hit harder than anything else [our company had] in the country,� Poag says. �The population growth was just enormous during the boom. But when the recession hit, not only did that population explosion immediately end, it ended up deteriorating.�

The center�s location in Inland Empire didn�t help, as the subprime crisis in the area led to a huge drop in housing values and subsequently, a significant drop in consumer spending.

Though he�s not aware if anyone has expressed interest in buying Promenade Shops from CW Capital, Poag believes the center can still flourish if it ends up in the hands of an experienced operator with plenty of capital to invest in the property. As of February, the Promenade Shops remained in REO.

But the Promenade Shops at Dos Lagos was hardly the only lifestyle center in the country to be devastated by the recession. Industry insiders can rattle off a list of properties that ended up in foreclosure in the past two years, including projects such as Downtown at the Gardens in Palm Beach Gardens, Fla., Woodbury Lakes in Woodbury, Minn. and Perkins Rowe in Baton Rouge, Fla., among others.

During the past decade, lifestyle centers proliferated quickly. In 2001, lifestyle centers comprised 0.8 percent of total U.S. retail GLA, with 192 properties containing 49 million square feet, according to data compiled for ICSC by the CoStar Group, a Bethesda, Md.-based research firm. Today, lifestyle centers make up 1.77 percent of the retail universe, with 455 centers featuring 127.8 million square feet. While the amount of total shopping center space in the U.S. grew 18 percent during the past decade, to 7.2 billion square feet, the amount of lifestyle center space increased 161 percent.

Given the new market realities, however, roughly 40 percent of those centers might ultimately prove unviable and will have to be converted to other uses, says Jeff Green, president of Jeff Green Partners, a Mill Valley, Calif.-based real estate consulting firm.

Because lifestyle centers rely primarily on high-end, discretionary tenants they need to be located in markets with appropriate demographics and draw from a wide trade area in order to deliver positive NOI, Green notes. Many of the centers that came on line in the past few years did not meet the criteria. In addition, many lifestyle center developers devoted all of their space to traditional in-line tenants and dispensed with traditional anchors that would bring in the needed shopper traffic day-to-day. This strategy made sense during the boom years, when a line-up of solid specialty retailers was still attractive to consumers. In a recession, however, people have needed more of a reason to visit lifestyle properties.

The success of Promenade Shops at Dos Lagos was predicated on residential growth that never materialized.

�Everybody likes to pick on lifestyle centers because the REITs don�t have a lot of them,� Poag says. At the same time, he admits �there were a lot of centers out there in the world that maybe shouldn�t have been built. There are going to be lifestyle centers that aren�t going to be lifestyle centers� in the future.

The question now is whether the lifestyle concept itself can survive and how retail developers can learn from the mistakes of the past. Most experts point to three key elements that make a lifestyle center work: a substantial critical mass, limited competition from regional malls and the presence of some sort of an anchor, be it a traditional department store or a popular grocery chain like Whole Foods. Becoming an integral part of a mixed-use environment, whether through design or site selection, also helps bring in traffic.

�My advice is don�t do a lifestyle center if it�s under 500,000 square feet, un-anchored and mostly populated by in-line tenants of regional malls,� says Yaromir Steiner, CEO of Steiner + Associates, a

Columbus, Ohio-based retail development firm. �Those projects are very, very difficult to execute successfully. They do not have the critical mass. They will work in some locations, but those locations are very few.�

Getting it right

With the right approach, however, many experts still believe in the lifestyle center concept. To do it right, developers have to exercise intelligent site selection practices and make sure the market can support a property full of discretionary retailers and upscale restaurants. Lifestyle centers work best in markets with higher than average median incomes, a high concentration of families and a prevalence of white collar jobs, says Robert H. Spratt Jr., president of Hill Partners Inc., a Charlotte, N.C.-based retail developer.

Easton Town Center blends a variety of uses, including public space, to serve its customer base.

For example, Spratt says that the company�s Town Center at Levis Commons, in Perrysburg, Ohio, has performed extremely well during the downturn. Perrysburg boasts a median family income of $75,651 a year, about $17,000 more than the national average of $52,175 a year. Approximately 46.9 percent of the city�s residents have a bachelor�s degree, compared to 27.4 percent for the U.S. population as a whole.

The 319,000-square-foot Town Center at Levis Commons opened in 2004 and features a 12-screen Showcase Cinema as an anchor.

The hitch is that the right demographics have to be there when you identify the site, Poag notes. From personal experience he advises developers not to base any decisions on what they think the demographics will be in the future. �Whereas before we were expecting the population to grow, we are looking at where the population is today,� he says. �Everybody realized that history does not predict the future anymore.�

Lifestyle center developers also need to make sure there are either no regional malls present in the trade area or the malls have reached full occupancy and can�t accommodate any more tenants, according to Steiner. Malls and lifestyle centers tend to rely on the same pool of retailers and some tenants have a prejudice against the lifestyle format because they feel it�s not as reliable in attracting foot traffic. Therefore, it�s critical to ensure that their choice of locations is limited.

Too much competition might have been part of the problem for Downtown at the Gardens in Palm Beach Gardens. When Menin Development Cos. completed the 350,000-square-foot property in 2005, the presence of the Gardens Mall, a 1.4-million-square-foot regional mall, less than a mile away wasn�t seen as a problem. Tenants reportedly paid twice the market rate to lease space at the center. But as the economy crumbled, most couldn�t produce the sales needed to justify those prices and left. Vacancy quickly reached 30 percent. Last summer, Berman Enterprises and Ashkenazy & Agus Ventures bought the center�s $138 million mortgage out of foreclosure at a steep discount, hoping to eventually revive the property.

The best areas for lifestyle centers are dense infill sites, where land is scarce and development is difficult, says Steiner�think Bergen County, N.J., not California�s Inland Empire.

Poag & McEwen�s Promenade Shops at Briargate in Colorado Springs, Colo., has performed well in spite of the Great Recession.

After selecting the right site, developers have to consider how to generate a critical mass of retailers to keep shoppers coming back for more. Because most people don�t visit a Gap or an Ann Taylor store more than a couple of times a year, there has to be a varied tenant roster with unique draws in order to pull consumers from a large trade area, says Green. That�s not likely to happen with a suburban project that�s smaller than 100,000 square feet. While small centers can work in thriving urban areas, most experts recommend that a lifestyle center be at least 500,000 square feet and optimally, as large as 1 million square feet in size.

�You look at the lifestyle center as a magnet and the smaller the center, the smaller the magnetic attraction, therefore it�s more vulnerable,� Green says. �If retailers are going to close stores, those are the centers where they are going to close stores first.�

For the same reason, most lifestyle centers can benefit from having an anchor on site (unlike regional malls, these projects often forego anchor tenants). As the lifestyle center construction boom got underway, many developers felt that a wide selection of popular in-line stores would serve as a substitute for traditional anchors like department stores. But it turned out that in-line stores alone can�t bring in shoppers on a regular basis. A lifestyle center doesn�t necessarily need a department store anchor, but an entertainment venue like a movie theater or a bowling alley can be a good draw for regular foot traffic. Green says one of the best strategies today might be to bring in an upscale grocer like a Whole Foods or a Wegmans because people shop for groceries at least several times a month. Whole Foods has been among the few original tenants at Downtown at the Gardens that has brought in healthy sales and remains open. The strategy works equally well if the grocery store is already there when the development site is picked.

Being a part of a mixed-use development can also be a boon, experts say. A nearby apartment complex and/or office park can generate a solid customer base and visibility.

As an example of a lifestyle center done right, Green points to Legacy Place, a 675,000-square-foot project that opened in Dedham, Mass. last summer. The median household income in the area is estimated at $79,350 a year, according to the 2006-2008 American Community Survey, $27,175 above the national average. The median value of a home is $403,800, twice the national figure. More than 40 percent of local residents finished college.

In addition to having a large GLA for a center of its type, Legacy Place features five anchors, including Whole Foods Market, Showcase Cinema de Lux, Borders, L.L. Bean and Kings bowling alley. The 60,000-square-foot Whole Foods has proved instrumental in bringing shoppers back to the property on a regular basis, says David Fleming, corporate marketing director with WS Development, the Chestnut Hill, Mass.-based firm that built the project. Having tenanted the center with many chains and restaurants that are not available elsewhere in New England, the firm found that Legacy Place has exceeded its expectations for trade area reach, Fleming notes.

Legacy Place also features 50,000 square feet of office space that has been set aside for the marketing department of Citizens Bank. In February, Boston Globe Magazine named the center �Best of the New� in the Shopping category.

�It�s got convenience, as well as destination retail; it has an entertainment base and it�s part of a mixed-use development,� Green says. �I think that�s the best example of the format that�s going to provide the greatest success in a �lifestyle center� going forward.�

Broken

Unfortunately, the lifestyle centers that lack critical mass, don�t have solid anchors and are built on the wrong sites will likely not survive this down cycle. Other candidates for demolition would be lifestyle centers built in very cold markets like Minnesota, where the open-air format works only half the year.

The weather may have been a problem for Woodbury Lakes, a 398,000-square-foot lifestyle center in a suburb of Saint Paul, Minn. developed by Opus Northwest and RED Development in 2005. (The center was sold to Cornerstone Real Estate Advisers in 2006). Demographics in the area seem to fit the lifestyle model�the median household income is $92,276 per year, the median value of a home is $305,500 and 55.5 percent of local residents have a bachelor�s degree. There is a Trader Joe�s on site.

To be sure, one of the center�s largest tenants, Linens �n Things filed for bankruptcy and closed its doors in 2008. Yet by 2009, vacancy at Woodbury Lakes reached 23 percent�reportedly higher than the average for the market. The only review of Woodbury Lakes on Internet site Yelp dates back to March 2008 and gives the center three stars out of five. The reviewer, a Woodbury resident, mentions being somewhat surprised that a lifestyle center would choose to be located in a place that has bad weather nine months a year, adding, �if I want to do serious shopping, I�ll drive to a mall, but if I�m going shopping more as a social activity, we�ll come here.�

Last fall, after Cornerstone defaulted on its $78.5 million mortgage, the lender, LNP Partners, took the property back. The center is currently up for sale.

Steiner says his firm has been getting an increasing number of phone calls from lifestyle center owners asking for help repositioning their projects. But he notes that in many cases, a redevelopment won�t solve the problem of the wrong property being in the wrong place.

�We find that regional malls are much more fixable than lifestyle centers,� he says. �Very often, these centers are not regionally accessible and they don�t have the size. I think they will be demolished; I don�t think there is any way to [save] them. Some are going to disappear entirely.�