Retail development gains momentum

By Beth Mattson-Teig

Following its tepid pace over the past few years, retail development is poised to take a giant leap forward as the pipeline of proposed projects continues to expand.

New construction dropped off a cliff during the worst of the recession, according to commercial real estate services firms. The combined volume of retail space built between 2009 and 2012 totaled 19.3 million sq. ft. Activity began accelerating in 2013 with 17.1 million sq. ft. of new space built in 2013 and another 23.7 million sq. ft. of completions in 2014—just shy of the peak level of 25.5 million sq. ft. built in 2005, according to DTZ, a global real estate adviser headquartered in Chicago.

"We are back to very aggressive construction levels," Garrick Brown, VP of research for the Western U.S. at DTZ, said in a recent webinar. "That makes sense, because we are getting further away from the downturn, and the economy seems to be doing better and better." The company is tracking another 19.2 million sq. ft. currently under construction.

The lows seen in the depth of the recession are gone, agrees Bill Moston, SVP of national retail development at Chicago-based JLL. "We're seeing a lot of activity on the redevelopment front, and we are positive about where things are going for the next couple of years."

Although industry data on retail construction activity varies widely, firms agree that the slow pace of developing is clearly accelerating. Marcus & Millichap reports construction levels that have hovered at roughly 50 million sq. ft. of completions per year since 2009. That activity has been dominated by single-tenant development from occupants such as banks, restaurants, dollar stores, and grocery stores, says Bill Rose, VP and national director of Marcus & Millichap's National Retail Group, Calabasas, Calif.

The company expects that annual volume to double in 2016, 2017, and 2018 as construction expands beyond single-tenant-driven projects to a wider variety of retail properties. "A lot of shopping centers that are in various stages of planning are coming to the market between now and 2018," says Rose. Marcus & Millichap is tracking roughly 300 million sq. ft. of new retail projects. "Not all of those are going to get approved or built," Rose adds.

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>
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The pipeline is expanding to include more multitenant properties. For example, Marcus & Millichap is tracking over 400 grocery-anchored shopping centers that are planned or in some stage of the permitting process. That surge in activity is due to pent-up demand, the improving economy, absorption of space, and accelerating retailer expansion.

In major markets, very large-scale projects are being proposed, such as the Hudson Yards redevelopment in Manhattan. The redevelopment of the former Candlestick Park stadium site in San Francisco includes a proposal for a new 500,000-sq.-ft. shopping center.

The shopping centers built across the U.S. in recent years have been overwhelmingly urban, mixed-use projects. "A lot of that has been chasing the Millennial consumer, who rightly or wrongly, has been described as being an urban dweller, perennial renter who hates the suburbs," notes DTZ's Brown. He estimates that nearly half of the new construction that occurred in 2014 involved urban retail projects, while another dominant source of activity was the expansion of existing centers, phase twos, or additional pad site development.

The majority of activity is focused on the redevelopment and expansion of existing assets, agrees Moston. "That's where we see a lot of opportunity right now," he says. For example, the Mall of America in Bloomington, Minn., is moving forward with a $2 billion expansion that has been years in the making. The mall started construction late last year on a project that will add three levels of new retail space as well as an office building and a luxury hotel. Completion is tentatively set for fall 2015.

In addition, landlords, developers, and lenders appear willing to take on more leasing risks on new projects. About 75% of the 19.2 million sq. ft. of space currently under construction has leasing commitments compared to the 90% pre-leasing that was in place on space built in 2014 and 95% pre-leasing in 2013 completions, according to DTZ.

Yet pre-leasing remains a critical component. "If we can finance these projects under reasonable construction loans, and if developers can secure a good tenant mix, they will all get green-lighted," says Rose. "But you are not going to see the days of old, where spec development would occur and you built it in the hope that retailers will come. Those won't get done."

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