

CALIFORNIA  
**REAL ESTATE JOURNAL**

www.CARealEstateJournal.com

June 8, 2009

## Reality Hits RECon Hard

*Attendance fell by 20,000 at last month's ICSC convention, a microcosm for the challenges facing retail real estate today*

By **MICHAEL GOTTLIEB**  
CREJ Editor

It was clear that much of what the real estate industry grew to expect at the **International Council of Shopping Center's** spring convention in Las Vegas had changed once you got past the 45-minute wait for a taxi at the airport.

Gone were the billboards and bus advertisements all over the city promoting real estate investment trusts and commercial brokerages. Gone were many of the lavish real estate parties filling Las Vegas' hottest clubs and hotels. Gone were the long lines at taxi stands to get around town. Some cab drivers, who usually are dialed in for the business conventions weren't even aware that RECon was in town.

Also gone were 20,000 RECon convention attendees. After several consecutive years of record attendance, peaking at more than 50,000 in 2008, the largest retail real estate convention in the world attracted just 30,000 people last month.

"The glitz is gone for now," said Steve Core, chief operating officer for **Riverrock Real Estate Group**.

That sentiment was palpable on the 2 million-square-foot convention floor, which serves as a microcosm of the retail real estate marketplace, where walkways



were easy to navigate during prime hours in prime locations as, for the first time in 12 consecutive quarters, retail real estate posted 23.8 million square feet of negative net absorption last quarter, according to **CoStar Group Inc.**

"The real estate industry, in general, and the retail real estate segment, in particular, has been dramatically affected by the global recession and lingering credit crunch," said Michael P. Niemira, ICSC's chief economist and director of research.

While retail's overall U.S. vacancy rate of 7.2 percent is lower than the industrial or office sectors, the disruption to the retail real estate markets also was reflected on the convention floor in the drop in real estate tchotchkes and other free handouts, as Starbucks, Coldstone Creamery and others no longer provided free samples to long lines of eager real estate players, and ICSC stalwarts like **Simon Property**

**Group** and **Westfield Group** gave up their high-visibility convention locations even as bankrupt REIT **General Growth Properties** retained a large booth. And, while the total number of shopping centers in the United States increased to 102,081 with just over 7 billion total leasable square feet as of April, according to CoStar, the influx of multifamily, office and industrial real estate investors and developers seeking to tap into the mixed-use and lifestyle trends of the past few years also were absent this year.

"I guess the herd has been thinned," said Al Williams, principal of **ExcessSpace Retail Services Inc.** "The people that are here are the ones that need to be here and have been here. The softies stayed home."

The result was a more somber, businesslike convention based on the more than 20 exclusive meetings the CREJ conducted with various real estate services firms, municipalities, investors and others.

For many, this year's convention was *only* about doing business. For example, Darrell Levonian, president of **Charles Dunn Co.**, cut the number of staff attending RECon from more than 20 to 10 this year and still locked in his first deal in his first two hours.

"You can't value the opportunity here. You can't find this environment anywhere else," he said.

**Faris Lee Investments** President Richard Walter estimated that his team ended the convention with 10 to 15 potential new deals to add to the 35 they completed so far this year.

"People here are purposeful," he said. "Everyone wants to do something."

Faris Lee also used the convention to highlight the opening of its new office in New York City to a national audience. That spurred a New York-based

competitor to stop by in order to "see what the enemy looks like."

"Where other people might have given up, we are willing to go to battle," Walter said.

### **Opportunities for the Opportunistic**

With just over \$300 million in California retail real estate valued at more than \$5 million trading hands last quarter, according to **Real Capital Analytics**, the opportunities for opportunistic players have been limited.

Speaking at **Marcus & Millichap Real Estate Investment Services'** annual Retail Trends 2009 event, Hessam Nadjji, managing director of research services, compared the commercial real estate investment market to a deer caught in the headlights.

"The deer should have moved," he said. "Hesitation may be costly."

But the spirit of anticipation for future opportunities was visceral at RECon.

"Our presence is a microcosm of what's happening," said Steven Jaffe, executive vice president and general counsel for **BH Properties LC.**

Jaffe marveled at his firm's booth next door to General Growth's on the convention floor. BH Properties, founded in 1997 to acquire under-performing assets, hasn't made an acquisition in a year and hadn't made a California acquisition since before that, but Jaffe expects that to change as property owners look for exits on properties with few options.

"We're only now beginning to look at California again," he said. "In other markets there has been a realization that the world has changed."

Larry Krasner, managing director of the Capital Markets Group for **Jones Lang LaSalle**, which moved its booth to the area once occupied by Westfield, said the

"paradigm of debt underwriting has changed."

"There are really very few signs of improvement out there at this point," he said. "I don't think anyone out there has an answer."

Krasner advised to watch small, private capital sources that are more entrepreneurial and willing to take risks, not the large funds or institutional capital sources that often are the last to get into the game.

"We're all just trying to get to the point where we see the light, to get to the point where we see some transactions," he said. "You have to talk about them first," and that's what gathering the industry at RECon was all about.

One deal that Krasner and many others were talking about at RECon was General Growth's plan to wrap the special-purpose entities that own many of its retail properties into the REIT's corporate bankruptcy. Many were concerned how the commercial mortgage-backed securities market might be impacted by the REIT's bankruptcy since the SPEs, many of which have CMBS financing, were thought to be bankruptcy-remote.

General Growth's bankruptcy strategy might change how and when the structured finance market comes back, Walter said, but he couldn't blame General Growth for trying every strategy possible in today's market.

"I don't know if in the long run that will be a healthy thing," he said.

### **A Premium on Value Creation**

With the credit markets in a state of suspended animation, the emphasis at RECon returned to creating value through bricks-and-mortar real estate management.

Core said that Riverrock's management portfolio has grown to more

than 10 million square feet from 7 million square feet a year ago. He expects that to grow as banks reach out for help managing distressed portfolios.

"It's the time for us," he said. "We are providing clients with services they can no longer afford."

Property owners will need the help as they seek to hold the line with their lenders and their tenants. Sharing space in its client Blockbuster's booth, **KPMG Corporate Finance** is working on restructuring more than 4,000 retail leases, according to Matthew Bordwin, managing director and co-group head of real estate services.

"Every retailer in the last four months has called their landlord," he said. "The landlord has to do triage"

Bordwin said that about three-quarters of the retail landlords he contacts are willing to work with tenants to reduce occupancy costs. He still finds some posturing from landlords, who say that they do not do rent reductions.

"I feel like I am negotiating with three-year-olds then," he said.

Bordwin said that not negotiating with retail tenants on occupancy costs will cost more in the future because when a retailer goes bankrupt today, the lack of available financing makes it difficult to come out of bankruptcy.

"In today's marketplace if you strip away the bravado of the owners, every property is struggling," he said.

Like Bordwin, Nadji said that no market is immune today because "the ability of the consumer to propel the economy is tapped out." The Marcus & Millichap economist said that markets are separated by a matter of degree.

Christine Deschaine, principal with **Lee & Associates**, finds her market is stronger than most. Her clients, primarily West Los Angeles retail property owners, are making more concessions. But with retail

vacancy in markets like Santa Monica at 2 percent or less she said owners are not dropping rents.

"I think we are going to see the trend move back in favor of landlords by the end of this year," Deschaine said.

One area of value creation that lost some luster at RECon was the move toward sustainable retail real estate. In 2008, ICSC's Green Pavilion was placed in front of the main entrance to the largest area of the Leasing Mall. This year, it was moved to the back of the Trade Exposition, replaced by the new Reconnect Pavilion, which offered recruiting and retaining resources for real estate professionals.

That change could not be overlooked by Mark Peternell, vice president of sustainability for **Regency Centers**, which has six projects seeking certification by the **U.S. Green Building Council**. Peternell said that about 50 percent of his green real estate peers are no longer with their companies.

"I have to be extremely tactical," he said. "In this economy being theoretical doesn't work. You have to prove the value. You have to save money."

Despite a drop in construction costs, the challenge of going green is compounded by the changes in underwriting standards.

"I've seen projects where the underwriting changed and small incremental costs couldn't be overcome because margins were razor thin," Peternell said.

### **High Stakes for Cities**

The city of Rancho Cucamonga was the first city to set up shop at the ICSC convention. This year more than 50 municipalities were represented at the convention, including a dozen from California. Considering the state's fiscal

problems, California cities had a lot at stake at this year's RECon.

For example, officials from the city of Rialto were discussing a project where 20,000 square feet just became available when representatives from Dollar Tree Stores Inc. just happened to be walking by the city's booth. Dollar Tree had looked at the space originally and ended up taking the vacant space in an example of success that only can be achieved at the convention.

"Usually when we have been here we can help small developers with projects," said Robb Steel, Rialto's economic development director. "Those guys stayed home this year."

This year the city focused on convincing tenants to stick with projects in anticipation of future growth.

The city of Victorville had a busy agenda at RECon to work with retailers to overcome perceptions of California's inland markets after the disruption to the region's housing markets.

"The onus is on us to work harder to describe the opportunities in Victorville, but our story hasn't really changed that much," said Collette Hanna, Victorville's business development manager.

As important as the convention was to Victorville, the city got the most important retail news of the year before RECon: It would not be losing car dealerships.

"It just says that this is an economically viable area for that type of retail," Hanna said.

The city of Ontario may be further along in terms of the maturity of its development, but the stakes were just as high for it. Economic Development Director Mary Jane Olhasso had critical meetings with developers and potential tenants for two large mixed-use projects - Piemonte and Guasti - and received commitments that those regionally significant projects would proceed.

Olhasso said that maintaining a presence at the ICSC convention demonstrates the city's support of development that is critical to Ontario's long-term growth plans.

"You have to stay in the game," Olhasso said. "ICSC Las Vegas is a must. Whether you have a mature market or a development market, you have to stay current and you have to be in contact with developers."

### **Limited Innovation**

ICSC's convention is a place to bring new retail concepts to market, but in recent years the wellspring of new ideas emanating from the convention seemed to run dry. Cutting-edge development concepts stopped at mixed-use and lifestyle centers, many of which are under stress today.

Meanwhile, new retailers largely were derivative of not-so-new concepts. This year, the ice cream-injected cupcakes were gone from the convention floor as retailers sought to provide value for cautious consumers and shareholders.

"The retailers have realized that cannibalization is real," said Robert Michaels, vice chairman of General Growth.

With so many national-credit retailers closing their doors, the pendulum may have moved back in favor of established mom-and-pop stores and proven regional chains as lenders look more deeply into retail performance.

"The last year showed that there really isn't any real comfort with a lot of national retailers," Jaffe said. "For the moms and pops, the store is their livelihood. If they lose that store they lose their house. They are really committed."

Among general concepts, quick-service restaurants, optical, automotive, beauty, do-it-yourself brands, pet stores, banks, wireless and drug stores along

with new foreign concepts were the most sought-after retail tenants. Some established brands, such as Kohls and JC Penney, which announced plans to open 17 new stores this year, generated surprisingly positive buzz considering recent challenges. But the biggest buzz centered on Forever 21 and its junior anchor concept to help fill spaces. Unlike Target moving into malls next to Nordstrom in the last cycle, RECon provided no obvious answers to the question of what would fill the empty spaces increasingly appearing in retail.

"There's no new Starbucks in the room," Williams said. "Game-changing concepts, I'm sure they are out there somewhere, I just haven't seen them yet."

*-E-mail*

*Michael\_Gottlieb@DailyJournal.com*