



Retail and Commercial Development

(front row, left to right)

David Hickman, CB Richard Ellis

Mitch Truster, Beauty Brands

Jeff Berg, LANE4 Property Group

Gail Lozoff, Spin! Neapolitan Pizza

Joe Platt, Grandbridge Real Estate Capital

David Block, Block & Co. Real Estate

Dan Lowe, RED Development (Co-chair, Co-sponsor and Host)

Joe Sweeney, *Ingram's Magazine*

(back row, left to right)

Ed Brownell, Spin! Pizza

Chase Simmons, Polsinelli Shughart (Co-chair and Co-sponsor)

Bob Johnson, R.H. Johnson Co.

Jeff Haney, RED Development

Owen Buckley, LANE4 Property Group (Co-chair and Co-sponsor)

Dave Clafin, RED Development

Jerry White, Grubb & Ellis/The Winbury Group

John Rubenstein, Rubenstein Real Estate

Mike Downing, Missouri Department of Economic Development

Retail is Finding its Way in Changing Marketplace

On one of the last soft days of autumn, a spirited group of retail developers, retailers, attorneys and mortgage bankers met in the conference room of RED Development in the heart of the Country Club Plaza to discuss the state of retail in greater Kansas City.

Co-chairing the group were Dan Lowe, managing partner of RED, Owen Buckley, president of Lane4 Property Group, and Chase Simmons, a shareholder of the law firm Polsinelli Shughart. Their respective organizations sponsored this 10th annual commercial real estate assembly in *Ingram's Industry Outlook* series.

For all the economic doom and gloom of the last two years, little of it surfaced in this assembly. To a person, those gathered have proved to be strategically astute, and they remain stubbornly optimistic about the future of retail real estate.

Staying Viable: Developers

The first question around the room addressed the issue of survival, specifically, “What have successful retail developers and brokers done to stay viable over the last couple of years?”

“On the developer end,” said Jeff Berg, senior vice president at LANE4 Property Group, “I think you’ve seen people have to change their product type to meet the market.” As Berg explained, the days of the greenfield, edge-of-town power center development have been yielding to those of infill, mixed-use development closer to the regional core.

“We’re just back to basics,” said David Block, president of Block and Co., Inc., Realtors. His company continues to look for good property and to nurture relationships with its clientele.

Jerry White, senior retail adviser with Grubb & Ellis/The Winbury Group, observed that retail developers follow retailers, and that retailers are downsizing and shifting modes, specifically looking more in the older areas of the metro.

“It does seem that retailers and developers are focusing on locations that are not dependent upon new housing and subdivisions being developed right over the hill,” agreed Owen Buckley. “They’re coming back into areas that were passed over during the heyday, so to speak.”

As an owner/ operator of retail properties, John Rubenstein, of Rubenstein Real Estate has been challenged to keep the small retailers in business. In many underperforming developments, this has meant a decline in rental rates.

“From a financing prospective,” offered Joe Platt, vice president of Grandbridge Real Estate Capital, “it’s never been more important to understand who you have in there, to follow their balance sheets and to understand what direction they’re going.”

Chase Simmons observed that his retail developer clients were much less likely to accept risk on a project than was the case a few years ago. They can no longer assume that growth will cover the shortcomings of a given deal. Added Bob Johnson, president of the R.H. Johnson Co., “Everyone is back to basics and trying to keep their spaces filled.”

Back to the basics, however, does not mean that developers shed their ambitions. “People are getting very creative in terms of how they go after tenants, how they structure deals,” said David Hickman, senior vice president of CB Richard Ellis.

Jeff Haney, RED’s senior leasing associate, noted that RED Development had been searching the country to find new tenants to look at its projects. “A lot of them are interesting,” he added, “They’ve found the value.” As an example he cited Charming Charlie’s, a fashion accessory store that RED has helped establish in KC.

Staying Viable: Retailers

“The successful retailers,” said Bob Johnson, “offer superior value right now.” They are the ones that kept their inventories down and continued to “refresh their concept” when times were good.

“We’ve heard a few times, as far as what retailers are doing to survive, is really understanding what the consumer views as the value proposition, and then delivering on that value proposition,” affirmed RED’s Dan Lowe.

Beauty Brands has been one of those retailers to deliver value in a challenging time. Founded in 1995 by Bob Bernstein, the company now has more than 50 locations in 10 states.

“What’s helped make us successful the last couple of years,” said vice president of real estate Mitch Truster, “has been controlling our costs—expenses, occupancy costs, inventory costs, utilities, labor—that’s been key, controlling costs.” Beauty Brands, he said, has also been selective in where it opens stores, focusing on demographic trends and co-tenancy.

Gail Lozoff, who also co-founded Bagel & Bagel, is hard at work on her newest co-creation, Spin! Neapolitan Pizza. “Being sensitive to what the consumer needs has really been what we’ve had to focus on,” said Lozoff, “particularly in relation to value perception.” Spin! now has four locations in greater Kansas City. Lozoff’s partner, Ed Brownell, reiterated the importance of “staying fresh.”



1. Flanked by co-chairman Chase Simmons, left, and Dan Lowe, Owen Buckley observed that the decline in subdivision construction had turned developmental attention back to the metro core. | 2. David Block said the economic fallout had pushed commercial real estate back to the basics. | 3. Bob Johnson concurred, saying there was a sharpened focus on keeping retail spaces filled.

Trends

Owen Buckley asked his colleagues what trends they were seeing in the world of retail development.

Dave Hickman cited the emergence of “pop-up temporary tenants” to fill space during the holiday season and drive traffic to projects. Hickman has also been seeing a re-use of existing boxes like the former Dillon’s building on Metcalf Avenue in Johnson County. That erstwhile store that has been sold to a church.

Dan Lowe was curious as to the evolution of “junior boxes.”

Bob Johnson expressed his belief that the local market was in good shape compared to other Midwest cities like Chicago and Minneapolis. “You look at the six or eight prime power centers in Kansas City in all four corners of the city,” said Johnson, “and there’s not one 20-to-30,000-foot vacancy in any one of those, and there hasn’t been, which is remarkable.”

Johnson argued that the Kansas City market was more stable and that rents never got out of hand here as they did elsewhere. “The combination has really created opportunity to build here,” added Johnson, “if you can get the right rental rate and the right deal.”

On the finance front, Joe Platt pointed to pre-leasing as a requirement for new development. He noted, too, that lenders are looking more at infill, given the understanding that residential growth will be lagging for some time to come. One potentially useful trend is that there is “a whole lot more capital available than there was in 2009.”

On the retail front, Gail Lozoff suggested that the vibrant trade areas are becoming saturated with restaurants. Although she would like to expand, she cannot take the risk of moving into an area unless it has the density, population, and demographics Spin! needs. “We’re seeing a lot more competition in our primary trade areas,” she noted.

Beauty Brands is likewise being more selective on where to develop new stores. “We’re backfilling existing markets, capitalizing on our existing management strength and advertising, and we’re always looking to lower our occupancy costs,” said Mitch Truster. “We have a controlled managed growth, and that will remain the way for us.”

Buckley asked David Block whether there were pockets of the market that could handle new development. On the other hand, ventured Buckley, “Is new development just something that is off the table for the next few years?”

“I think we’re running out of room,” said Block. “Without a lot of new development, it’s going to be more infill, more redevelopment.” The problem, as he saw it, was finding tenants “that will pay the rent in order to make the deal.”

Public/Private Partnerships

When David Block suggested the need for alternative financing to make new deals possible in infill areas, the attention turned to Mike Downing, deputy director of the Missouri Department of Economic Development, who had driven in from Jefferson City to participate.

“I’ve been in this business for a number of years and seen a lot of ups and downs,” said Downing, “and I think we’re going back up.” He cited an uptick in state revenues in the past few months and a more positive outlook in the business community.

His department has tasked 41 executives from around Missouri to construct a strategic plan for statewide economic development, looking at all sectors of the economy 20 years into the future. “We’re more focused on trying to figure out key redevelopment strategies, incentives for redevelopment that would really have a dramatic impact on a surrounding area.” One local focus is the Bannister Mall area.



1: Beauty Brands, said Mitch Truster, is being more selective on where to open new stores. | 2. Gail Lozoff said vibrant trade areas were becoming over-saturated with restaurant options. | 3. Existing big-box stores that have been vacated are being repurposed, said Dave Hickman. | 4. John Rubenstein noted that the metro area had multiple bright spots with active retail.

Buckley questioned whether as a society we were “becoming too dependent on incentives” from the public sector.

“There are some who say incentives ought to be eliminated altogether,” said Downing. “Some say we need to expand certain incentives. So this is going to be a difficult legislative session.”

When questioned once again as to whether political jurisdictions had

become too involved in the development process, Browning answered: “I know it looks like public sector is involved in most projects, but it’s probably not as much as you think we are.”

Although Chase Simmons recognized the problems implicit in government involvement, he noted, as well, that until rental rates go up, or construction costs get slashed, incentives will remain a critical part of development, especially in infill areas.

“Ten years ago,” said David Block, “we were doing stuff conventionally. We didn’t have TIF and tax incentives, but that’s when restaurants and retailers and other people were paying the freight. Volumes were there, and everything was good.” Times have changed. “You have to do what you have to do.”

“I haven’t seen a pro forma yet with structured parking in retail that works without incentives,” added Simmons. “If we want this group to focus on infill, they need incentives to get them done.”

Buckley observed that the way to attract families to infill areas begins with good schools, but does not end there. “If we can develop good quality shopping in these infill areas,” added Buckley, “I think we can bring a lot of people back.”

Department Stores and Hot Spots

Owen Buckley asked Dan Lowe of RED Development, who works with numerous department stores, how these operations seem to have shaken the doldrums and made a comeback.

As Lowe noted, the department stores that have remained viable today—J.C. Penney’s and Macy’s in Lee’s Summit, for example—did a great job of understanding what their consumers were looking for and providing it.

“What I think is most interesting with Macy’s,” added Lowe, “is that they understand the definition of value as much broader than simply price.” Among the things that add value to a shopping experience, according to Lowe, are convenience, easy parking, and good customer service.

As Jeff Haney noted, the Lee’s Summit Macy’s and J.C. Penny’s opened without the support of a true lifestyle center with other tenants but have prospered nonetheless. Beauty Brands and other shops have opened there, as well. “It’s a mixture,” said Haney. “It’s not a pure high-end lifestyle center; it’s a mixture really of what works.”

Other parts of the metro are prospering as well. John Rubenstein said of Barry Road and I-29, “It’s booming.” He also cited Missouri-291 and I-70 in Independence. “That whole quadrant is doing well,” he added, “and I think Johnson County does well, although it’s horribly over-stored.”

Owen Buckley countered, quoting a sage within the industry, “We’re not over-stored. We’re under-demolished.”

Jeff Berg observed that the Village West area around the Kansas Speedway also was doing well. He cautioned, however, that within each category of retailers there are fewer players these days.

David Block pointed out that the Liberty Triangle area “is as hot as anywhere in town.” He added, however, that the ground costs in that area were covered by tax-increment financing (TIF). Without those incentives, Block added, “It’s going to be hard to see new development happen.”

As a result of incentive packages and increased competition for good tenants, David Hickman argued, retailers are relocating and taking advantage of some very aggressive tenant packages. “We’re definitely seeing some shifting going on right now,” he noted.



1: Dan Lowe, left, addressed the broader interpretation of customer value as moderator Jack Cashill listened. | 2. Jeff Haney cited examples where a lifestyle-center infrastructure wasn't a prerequisite for retailing success. | 3. Jeff Berg asked about whether non-traditional businesses, such as medical or dental offices, would be appropriate for driving traffic in retail centers.

Retail Fundamentals

“I’m sure you focus on fundamentals even more so today than before,” Dan Lowe said to the retailers in the room, and he asked them what they looked for when considering a new location.

“Obviously, we’re trying to shrink our box a little bit,” said Ed Brownell of Spin!. He noted too that with banks looking harder at finances, the retailers must weigh the impact of tax incentives, taxes, and CAM charges [common area maintenance]. “The states are still getting big tax money,” he added. “It would be nice to be able to put some pressure back on them to get some relief on the tax side.”

Chase Simmons asked the retailers how they felt about a shopping area whose other properties were shifting to non-retail uses like churches or tennis facilities.

“It’s important for us to maintain a certain image,” said Brownell. “So I don’t know how I’d feel about a church going in a center that was a premium grocery store site. Co-tenancy is important for a brand.”

Jeff Berg wondered whether other uses—medical or dental, for instance—were detrimental in that they, too, draw regular traffic.

“I think it’s all on an individual basis,” said Gail Lozoff. She did not have a problem with most other types of tenants as long as the fundamentals were in place, such as easy access and good parking.

“Our preference would be to have retail,” said Mitch Truster of Beauty Brands, especially if those retailers are advertising and bringing customers to the center. “The non-retail uses don’t excite us.” David Block noted that in some of the lesser centers, “GSA-types of uses,” like a driver’s license center, produce useful traffic even if they do increase CAM.



1. The Internet, said Chase Simmons, may change retailing, but its reach wouldn’t make coffee shops, restaurants or bars obsolete. | 2. The conference room at RED Development was full-up for a candid discussion of commercial realty and retail operations. | 3. Even the Plaza, said Jerry White, had seen some non-traditional uses for retail space. | 4. Mike Downing pointed out that the state’s programs for developmental incentives were under an intensive review.

Home-Grown Business

The question was raised as to how friendly the Kansas City area and the current environment were to the creation of new business, especially new retail business.

Jerry White observed that one need not go far to find the answer. Downstairs from RED Development on the Country Club Plaza is a seasonal outlet for DERMAdoctor, a growing Kansas City-based company headed by physician Audrey Kunin. The company manufactures a line of skin-care products and is moving into retail as well.

“It seems like you’re seeing a lot of new restaurants,” added Owen Buckley. “A lot of people are tired of the chains, the big national chains. They want to go to something that’s authentic and real.”

One obstacle for small start-up retailers, said Gail Lozoff, is the difficulty of finding an appropriate location. She noted a relative lack of shopping areas like Brookside and Prairie Village, main streets with both traffic and quaintness. “I feel like there’s kind of a dearth of that kind of development in Kansas City,” said Lozoff, “maybe that’s the infill thing.” These kinds of start-ups, Lozoff believes, would feel lost at a Town Centre or Country Club Plaza.

Investments

“Two or three years ago,” observed Owen Buckley, “the big talk was opportunity funds. Everybody was starting an opportunity fund to get ready for the crash. What’s happened to all those great buys?”

“Still lots and lots of dirt. You can buy dirt at 10 cents on the dollar if you’re in the residential lots,” said Dan Lowe. As he explained, these funds, for the most part, were created to buy income-producing properties. For appropriate properties, there is a great deal of competition.

As Joe Platt observed, long-term money is chasing grocery-anchored developments with strong backing and good location. “Cap rates, more so than ever, follow interest rates, and I don’t see that trend going away. It’s all based on your borrowing costs and what you can buy it at, and what your spread is. That’s true for every asset class, multifamily, industrial-office.”

Bob Johnson noted that there were still some “sentimental buyers,” people who thought they had to invest their money and as a result were paying too much. “With decreasing rental rates and stagnant renovation-construction costs,” he added, “if you didn’t buy it right, you’re upside down.”

Dan Lowe observed that he had seen any number of projects that should not have been approved in the first place. “Money was easy,” he added. “Wall Street was forcing them to do deals. They had no purpose.” In those projects that were market-driven, rents have held; those without purpose have had problems.

“The thing is,” said Bob Johnson, “not every bad property can become a good property. That’s why you have to have discipline in these things.”

An added burden, as Dan Lowe pointed out, is that city planners were forcing greenfield development into urban molds, citing one particularly difficult intersection in Johnson County. “That was the peak of the Town Center craze,” Jeff Haney confirmed. Planners would put out RFPs demanding “New Urbanism.” Haney added, “They wanted to move their city out there. Nobody should have touched that thing.”

Long Term

Owen Buckley asked his colleagues what they projected 10 years down the road.

“In our industry,” volunteered David Block, “pretty much everybody tries to be a surgeon and get good at something and do that.” He believes that in Kansas City, there is enough for everyone, and that those at the table would find ways to carve out their own slice as they have been doing for the past 10 or 20 years.

Dave Hickman observed that the Internet was obviously influencing retail, noting that companies like Blockbuster had already been overtaken by shifts in technology.

One unknown variable, John Rubenstein offered, is whether the government was going to tax Internet sales based on where the product was shipped. “I wonder if that’s ever going to happen,” mused Rubenstein. “Every municipality and state is looking for everything they can to fix their budget deficit,” said Dan Lowe.

Not all the influence is negative. As Mitch Truster noted, Beauty Brands had set up an e-commerce site. “We try to get every e-mail address of every customer that comes into one of our stores. Facebook, Twitter, those all complement our stores, and we see that expanding our brand.” And, as is true in Spin!’s case, Hickman added, some retail entities—those selling food, for instance—will remain untouched by electronics. **i**

A Retail Rut

Relative to other metropolitan areas in the broader region, the Kansas City market is having a harder time filling its available retail space. According to the market research firm Costar Group, Kansas City’s vacancy rate for all retail combined was the highest among these cities:

City	Vacancy Rate 3rd Quarter '10
Kansas City	10.1%
St. Louis	8.8%
Denver	7.9%
Omaha	7.7%
Oklahoma City	6.8%
Wichita	6.3%
Des Moines	5.8%

Source: Costar Group

Shopping Center Hangover

Accounting for nearly 40 percent of the square footage that can be leased in the Kansas City market, grocery-anchored centers account for more than half of the retail vacancy rate. The 3rd Quarter of 2010 showed a shopping center vacancy rate of 14.8 percent, higher than all but one quarter in the past four years:

Quarter	Vacancy Rate
3rd Quarter 2010:	14.8%
2nd Quarter 2010:	14.5%
1st Quarter 2010:	14.7%
4th Quarter 2009:	14.9%

Year	Vacancy Rate
2010 (Q1-3):	14.73%
2009:	14.38%
2008:	13.45%
2007:	12.35%
2006:	12.10%