

SHOPPING CENTER BUSINESS

An Adapting Market: Realities are changing, but New York is still a strong market for retail deals

Shopping Center Business recently held its annual New York retail roundtable at the offices of Goulston & Storrs in Manhattan. This year, we decided to take a look at some of the national trends and see how they are affecting the tri-state area, as well as examine some ongoing projects.

In attendance this year was: Ken Bernstein, Acadia Realty Trust; Joe Montesano, Northwest Atlantic Real Estate Partners; Alvise Casellati, American Continental Properties; Steven Kushner, Northwest Atlantic Real Estate Partners; John Hirschfeld, Class Green Capital Partners; Christopher Day, Coventry Real Estate Advisors; Nina Kampler, Hilco Real Estate; Darren Pinsker, HSBC; Douglas Taliaferro, HSBC; Matthew Harding, Levin Management; Aaron Fleishaker, Fairway Stores; Patrick Breslin, Grubb & Ellis; Steve Siegel, Marcus & Millichap; Kathy Crocco, S.L. Green Realty; Franklin Zuckerbrot, Shalom Zuckerbrot Realty; Frank Shea, Frank Shea Consulting; Stephen Stephanou, Madison Retail; and David Rabinowitz, Philip Herman and Matt Epstein of Goulston & Storrs.

SCB: There is a lot of development still ongoing in the New York area. Ken [Bernstein], can you give us an overview of what your company has been up to?

Bernstein: We are developing in the Fordham Road corridor. We have concentrated on high barrier to entry markets, where it is difficult for retailers to penetrate. We are still seeing a fair amount of pent-up demand, albeit not nearly as significant as a year or two ago. Fordham Road, which is the Number 1 retail corridor in the Bronx, a retailer like Best Buy can open and do extremely well, even in a difficult economy. The retail at our project is 100 percent leased.

SCB: Joe [Montesano], will you speak to your client's entry into Manhattan?

Montesano: We do Costco's work in North America. East River Plaza actually started 12 years ago for us. This project has been going along time. From Costco's perspective, the time to get into the urban markets is now. Costco waited out the boom. They weren't prepared to pay the retail

prices that land was commanding in the bubble. We sat on the sidelines and watched, accumulating cash while we were doing that. Its balance sheet is very strong. Now, the opportunity to buy market share is there because you can gain market entry at a much more reasonable price. We are aggressively ramping up expansion. We are looking at every opportunity in the boroughs to see if there is a chance to bring the brand and more heavily penetrate the market.

Stephanou: The larger users used to be frightened by pricing here. How do you answer the question, 'Do we wait and get a better deal?'

Montesano: We watch the markets as much as developers watch the markets. We look at the access to capital the way a developer would. We are sitting back, watching and waiting for the opportunities to expose themselves in the cycle. We think the next holiday season will bring another churn in retail space.

Fleishaker: Why do you have to wait? I see a lot of retailers who are willing to pay; they want the landlord to make their deal now at their terms. There are a lot of retailers who are picking through the various vacant big boxes around the metropolitan area and who are willing to pay extra at the end of the lease. If anyone here can figure out how to pick the bottom or the top [of rents] let's stop the meeting now and go get rich.

Montesano: We think there is more opportunity to come, but we are aggressively trying to find locations.

Zuckerbrot: Aaron [Fleishaker]'s point is on the money. We are at discount [with rents] already. Who deserves the bottom? I think that is what is getting retailers off the fence a little bit. This is an opportunity, especially for big boxes looking for space in the city.

Breslin: The tax incentives are going to be disappearing eventually. I don't think the city is going to be giving retail development tax incentives forever.

Zuckerbrot: Anyone who is not on a subsidized



(From left to right) Stephen Stephanou, Steve Siegel, Douglas Taliaferro and Frank Shea

program is starting to feel the decline in real estate. It is a serious issue. It is an interesting time in the city. We have these vertical big box centers, some of them with small shop space, all open at the same time. When you look at East River Plaza, Gateway [Center] — we have all the big retail names testing it out right now.

SCB: Who are some of the names looking or launching in the city?

Breslin: Target, Best Buy, Wal-Mart, Kohl's — really any player that is greater than 60,000 square feet. They are all looking at this market.

Montesano: We just executed our Rego Park deal yesterday. It was an opportunity. The Home Depot pulled away and we jumped in and took the deal. In a matter of a year, we finalized two large format spaces that you couldn't have easily capitalized on before because those numbers were higher.

Stephanou: Economically, was the deal much more incentivized this go around?

Montesano: Absolutely.

SCB: Is this true not only with big boxes but also with smaller spaces within the city as well? Five years ago, everyone at the roundtable was griping because the banks were taking all the corners.

Breslin: Now the banks have given up all the cor-

ners! We have looked at a lot of corner locations over the last 2 years for a number of small users between 4,000 to 5,000 square feet. Real estate taxes here in New York are more than the base rents that landlords are asking in other parts of the country. Retailers coming into New York have that issue in front of them when they are doing triple-net deals. The taxes can be \$30 to \$40 per square foot. That goes right to the bottom line. They have to get themselves accustomed to the New York way of business.

Rabinowitz: There are other issues that come with the incentives. I think the incentives are going to continue and that is going to spark more re-development in this area, as well as the boroughs and New Jersey. With the incentives come a little bit of baggage, which is the compliance requirements for the retailers. They are all manageable.

Breslin: Even if you are not a public entity, there are a lot more people looking at how we are doing business and the way we do business.

SCB: There is more scrutiny on the lease side?

Rabinowitz: Because there is more money flowing in from the government, they want to make sure that retailers are incentivized to hire locally. There are a lot of guidelines in place.

SCB: There are some new retailers entering the market. Steve [Stephanou], are there any notable new retailers to the market?

Stephanou: Nordstrom Rack did a deal in Union Square, which was its first store in New York City. It has been looking at the boroughs and Manhattan for a long time. We had looked at the deal before August 2008. It was much more friendly when we finally completed it. That is a perfect example of a retailer in the current climate who will have a lot of opportunity.

SCB: Kathy [Crocco] Can you give us an update on the appetite for ground floor retail space in office buildings in Manhattan?

Crocco: SL Green is the largest landlord in Manhattan. We are not a shopping center developer, but my background is in retail leasing. Given our locations, which are for the most part prime Midtown and Grand Central locations, the interest still remains strong. We have one space in the Times Square area that is getting lots of interest. If a space is the right location, tenants are going to have a lot of interest in it.

SCB: What streets are holding up in the economy?

Stephanou: If you look at the streets that have maintained significant value, I would point to Broadway in SoHo as being the best example. It has continued to have the excitement as well as the numbers. There is a lot of opportunity in some of the previously hot areas, like the Flatiron District. Retailers used to put a store on the East side, then on the West side, then they would go to SoHo and the Flatiron District. When the economy was great, some of the areas were more desirable. Because of the fewer dollars being spent, now the more tertiary locations in the city are feeling it more so than main and main locations.

Harding: In the suburbs, you see that with the apparel retailers as well. Those tenants used to fill a lot of space in shopping centers. They've really shut down in terms of expansion. The exceptions are the TJX stores and other value-oriented retailers who are taking advantage of this market. The guys in the 5,000- to 7,000-square-foot store range aren't there. It is a tough category to fill.

Stephanou: Two areas I would point to are Greenwich and Westport [Connecticut]. The rents had gotten crazy. National tenants with mall and street stores were backing away from deals on Greenwich Avenue because the numbers didn't work. Now, the number of opportunities that are on Greenwich Avenue is really unfortunate. A lot of owners bought those stores at the top of the market. If you can find a tenant, frequently the landlord has to subsidize part of the rent.

Harding: It may also change the complexion of those streets a bit also because of the different types of retailers who are making deals.

Breslin: I agree with you. A few years ago if you went to a main street in Westport or Greenwich, the landlords wouldn't talk to you if your tenant wasn't up to their rating. Now, if your tenant is willing to pay rent, the landlord will talk to you.

SCB: New York is an unusual market, compared to the rest of the country. Retail is king here. You have a lot of flagship stores. Has that thought process changed? You see droves of people here. We don't know if they are spending money. Isn't the branding aspect an important part of having a store in New York City?

Breslin: Retailers ambitions for that type of real estate have not changed. They all want it; they all want to be here. Now it is a matter of looking at the numbers, and the numbers have gotten so out of proportion here compared to other parts of the U.S. Rents on Fordham Road in the Bronx are more expensive than some of the best real estate on North Michigan Avenue in Chicago.

SCB: Are the owners still not realistic on where the market is?

Breslin: I think they would get realistic a lot quicker, but a lot of people bought their real estate in very high times. Low rents won't work on some of these properties for some landlords.

Rabinowitz: I just got a call yesterday from a department store who wants to come to New York. They are very close to making some deals. That makes me believe that the market is still attractive.

Fleishaker: As a retailer, it is Retail 101. New York City and the tri-state area will always be strong for us because you can't beat the density of population and spending power. Fordham Road is a good example. If you walk out of the subway at 5 o'clock on Fordham Road, there are more people on that block than there are in most states in the country. It is pure density. Westport and Greenwich are suffering; those markets are lined with high income people. When they stop shopping, there is an enormous dent [in sales]. In the boroughs, there is tremendous foot traffic. Even if they are buying less, the amount of traffic drives sales. A few years ago, if you had a chain that was

flying high across the country, you felt you had to open a store here so that people would know your business. Today, very few retailers are making branding decisions. Every store has to stand on its own success.

Stephanou: We represent a lot of tenants. Most retailers will not look at this as branding. Maybe there were some deals that were done where part of the rent came from an advertising budget. But most people on the operations side would argue that the store makes money. Part of the challenge is that luxury will be shrinking as a category. It has rapidly expanded over the last 10 years and become a broad category. A lot of people were aspirational luxury shoppers. The moderate shopper is coming back. That's one of the reasons we saw JC Penney open at Manhattan Mall this year.

Fleishaker: I can't tell you how many retailers I deal with on a daily basis who, if they are candid with you, will say, 'My Number 1 volume store in the chain is in Manhattan. It is my Number 743rd in profit.' They will say it's worth it because having that store appear in Law & Order or Good Morning America so their customers can see them. You will see billboards sitting empty when people were paying \$1 million a month without thinking twice about it. The stores are going to be empty because no one will have the luxury of saying that their highest volume store is not the moneymaker.

Kampller: You have the retailers who have taken the loss leader now struggling to justify that while their juggling their P&Ls to make their businesses profitable. When that lease is over, if that landlord doesn't figure out how to get the lender — that invisible third party — to agree, that store is history. When all of these leases come due, all of these retailers with these expensive stores are going to take them off. They are going to realize that real estate doesn't have to be their Number 1 marketing tool. There will be some opportunity for retailers who haven't been in New York. I have spoken with the C-suites of six restaurant chains in the last month. None of them have a presence here, but they are ready to gobble up space. They think the market has been reset.

Montesano: I can go to almost any other market and do two stores for the price of one in New York. The retailer is really looking at it from a very simple perspective: how much money can I bring to the bottom line?

SCB: How easy or difficult it is to find financing these days?

Harding: We recently purchased a grocery-anchored center and found the lending market to be very tight. More recently, in the last 30 to 60 days, we found things are loosening up a little bit. The insurance companies, especially.

Kampller: People need to get out and shop to change things.

Fleishaker: In the food business, volumes are strong. The customers are visiting as often as before, but they are eating out less. They are also trading down. They are buying less luxury and they are buying a lot more staples. You have to make sure your merchandising meets the needs of the customer. That has been the biggest

change of this downturn, and I don't think it's going to change in the near future.

SCB: Has this begun to impact retailers, with doors closing? This has impacted restaurants and apparel the most.

Fleishaker: There's no question. The fast casual chains have developed a dinner for two package. Customers are trading down.

Kampler: Starbucks has done something interesting. Starbucks closed 600 stores and then looked at its remaining 10,000 or so stores and figured out how to reposition them. It was a good move.

Shea: Today, you have a benchmark on sales volumes. Best Buy has enough stores in the market to know what its sales should be. As much as we talk about rents, you really have to start with sales. Last week was one of the best for sporting goods retailers in Manhattan. You have all the people in for the marathon who have to buy last minute supplies. One of the challenges in this climate is tracking the changing shopping behavior and seeing what people are buying.

Zuckerbrot: The value players are out there. We represent several companies who have really been sidelined over the last few years. Some of them are still pretty strong today. Take a company like Party City. They have 1,000 stores. A store like that is where people can go buy supplies for a party for a value. Men's Wearhouse was another one that was sidelined. They are looking around to see what the environment is like.

Day: This goes back to the point earlier: perhaps there is a bargain in rent to be had. The third-party banker behind the scenes might say to the landlord that he can't make the deal unless they write the note down, and they may not be prepared to do that.

Breslin: Most of my tenants are asking for a non-disturbance clause.

Day: They should have the lender on the phone making him realize that we are all in this together. Why are we pretending that all the parties can't talk to each other?

Rabinowitz: In all the rent relief and termination discussions that have occurred, you have to get the lender involved.

Kampler: What's happening a lot of time is that if the landlord will not work with the tenant, the tenant is sometimes forced to file bankruptcy. Sometimes the landlord needs to realize that if the tenant fails, he will have greater vacancy, which may put him at risk.

Bernstein: In defense of the landlord, the lenders have not been equipped to respond. In some cases, like securitization, the lender's clause prevented the lender from being proactive. That has only recently been amended. In other cases, the denial that some of you may be feeling from the landlord is far more significant at the lender level. We haven't used a lot of debt, so we aren't stuck in this position. The level of dysfunction in the lending market is a critical issue.

SCB: David [Rabinowitz], have you found owners

starting to get more interested in selling?

Rabinowitz: You still have a disconnect between the prices. That's why I don't think you are seeing a lot of investment transactions. There's a lot of delaying and extending going on by the banks. At some point that will stop and there will be properties that are taken back. When the lenders get those properties, that's when you are going to have to reset pricing and you'll see some transactions happening.

Siegel: The owners who are selling are the ones who are in trouble right now. They either have a loan that's coming due in the next 6 to 12 months, or it is the lender approaching us saying that they are going to be taking the property back. We recently sold a property that had a \$15 million loan. It appraised for \$20 million 3 or 4 years ago. We sold it for a little over \$2 million.

SCB: There are a lot of funds building to buy distressed retail assets. Is there going to be a feeding frenzy? When?

Siegel: There is a lot of money out there. The problem is that these funds don't think the prices are right yet. The problem with the right price is that you could previously get a 5 or 6 cap rate here in New York. Now you can get a 7 or 8 cap. If you buy at an 8 cap, you look at the underlying real estate and that lease is coming due in a year or two, and the rent is 50 percent over-market. An 8 cap all of a sudden is a 3 or 4 cap.

Fleishaker: What I find fascinating on the leasing side is that when we are negotiating with the landlord, he will say, 'I'm not going to give you that rent. Two years I could have gotten 20 or 30 percent more.' Well, I'm not asking for reductions on rents I signed 2 years ago. You can't sign a lease based on past history, but where the market is today. The landlords do not want to lock-in for anything; and a sale is the ultimate lock-in. The landlords, even on long-term leases, still feel that the market is coming back. It is hard to make a deal when the attitude is that they will get a better rent in 2 years.

Day: If they are right, they are right to wait.

Rabinowitz: If a tenant goes for rent relief, the landlord should have the right to ask for a larger commitment in terms of lease length and have the right to adjust the term of the period for the rent relief.

Breslin: A lot of the landlords here in New York are beginning to forget percentage rent. They want to talk about the retailer making up the money from the rent relief on the back-end.

Fleishaker: Or they will give short-term relief because they need to keep the center occupied for the next 2 years.

Harding: Why should you have long-term rent relief when we are in a cycle? I've gotten so many letters that all start out the same: 'Dear Mr. Landlord, we have thoroughly reviewed this store...'

Breslin: You could be like one retailer here who just mailed out his rent checks on time for amounts that were discounted 25 percent across the board.

Bernstein: Eventually, this cycle will play out and we will get to normalized rent. It may take a few years. The main problem is going to be the lenders. There is \$500 billion coming due in the next few years. If it doesn't work its way through the system, we will have \$1 trillion in debt and someone will have to figure out what this debt is actually worth. A lot of it will be worked into the market. But all of this capital that is being raised is very small compared to the total amount of debt, even if you discount the \$1 trillion in half. \$500 billion in real estate needs to be re-leveraged and recapitalized over the next 2 to 5 years. We have to get mentally prepared for a lengthy re-leveraging period. The banks are nowhere near where they were a few years ago.

SCB: Do you see owners of multiple properties becoming REITs to get away from their debt?

Bernstein: Certainly. Any company that is experiencing any capital issues is considering the public market. It is a lengthy and complicated process, and it is not an easy decision, so many will choose not to go that route. Some will join other public companies. Others will go public and do a great job. Yes, there are more companies considering going public than there are companies considering merging.

SCB: As a public company, are you considering acquisitions?

Bernstein: We are sitting on a lot of capital so we have been acquiring and we continue to do it as long as it makes sense. In January [2009], we bought a great asset. Since then, we haven't seen many good opportunities for us, other than buying back our own bonds and debt.

SCB: As owners, when you see retailers like discounters looking at your locations — ones they never could have dreamed of getting in the past — how do you feel about it as a long-term solution?

Bernstein: From my perspective, it is a case-by-case basis. There are some centers where we wouldn't consider it. The merchandising mix is too critical. In others, it won't make a difference. Some of the dollar stores are doing a terrific job. We have signed a handful of deals where it won't have any negative impact.

SCB: In Chicago, several landlords stated they'd rather have someone in the space and have the lights on than have empty space.

Zuckerbrot: Clearly, in any property where tenant mix is critical, we want to bring the tenant that is critical there, even if we have to have some financial inducement. Landlords are still making decisions based on preserving their assets. It is painful when they want to sign a 25- or 30-year lease.

Kampler: The domino effect of dark stores and a dark center is huge.

Zuckerbrot: The gym business has been a high growth business over the last year. I'm sure many of us have been involved with projects where there are leasing restrictions against gyms. At the end of the day, to the extent they are not concerned about the parking, some of these larger tenants are recognizing that they want the

balance of the property filled also, so they are working with us.

Harding: Some of the gyms that are filling in these days are smaller format. They don't make the impact that the larger gyms of 30,000 or 40,000 square feet do. We have gotten waivers from national tenants.

Breslin: They are legitimate, 20,000-square-foot users these days.

Kampler: The retail tenant before thought that the co-tenant clause was a hook, but they weren't quite sure what the goal of it was. The real goal, of course, is performance. It would make everyone more comfortable — the retailer, the lender and the invisible lender — if we really say what we are trying to achieve, which is if sales aren't a certain amount, then the retailer will go out. If all those co-tenancy clauses aren't compromised, the domino effect is just going to get worse. Sometimes when you look at those clauses, and you see the retailers named, you realize they are all gone.

Kushner: That is a lot harder for the landlord to control. You can, to some extent, control co-tenancy. You can't control sales. So if you give the retailer the ability to kick because they are not making a certain number, the response from the landlord is going to be, 'Can I kick if I don't like your number?' and the response will be no.

Kampler: Maybe the retailer should not be saying he will kick, but he has the option to go to a flat rent or percentage rent only structure to get through the period. With those co-tenancy provisions, you can only control them if their CEO hasn't filed for bankruptcy.

Rabinowitz: Maybe the focus should be on opening co-tenancy rather than changing the structure.

Kushner: If you are talking about a small specialty tenant. As far as I'm concerned, if I'm a box and I open up and I get my box and my parking, I don't care if the other tenants go out; it will create more parking for me. But if you are a small tenant and you succeed because you have a jewelry store and a menswear store and a supermarket in the center, you are going into that center and paying that rent because of that tenant mix. It used to be that a tenant would say, 'If these tenants go out, I want a rent reduction or a kick-out clause.' At the end of the day, what Nina [Kampler] is saying is don't hold me over a barrel just because the tenants went out. If you have established yourself as the best jeweler in the market and your co-tenants have gone out, but your sales haven't dropped 5 cents, then you shouldn't be entitled to any relief.

Harding: Then the retailer says, 'My sales haven't gone down because I've spent all this money on advertising.' That's the comeback to that one.

Fleishaker: As someone who has been a tenant almost all my life, there should be some sort of test where if Circuit City goes out of business and my sales go up, that shouldn't trigger an automatic penalty. You should have a lack of co-tenancy and a lack of sales to trigger it.

Kampler: We need to get smarter as an industry. What is good for the landlord is good for the tenant and vice-versa. Too much rent isn't working and not as much synergy between tenants isn't working. I'm not a tenant that wants to take every last dollar from my landlord, and the landlord that isn't working with the tenant who is hyperventilating, isn't helping. When the tenant starts doing stores again in 2011, we'll remember who the jerk was who didn't help them survive. These landlords will be blacklisted because retailers talk. The landlord needs to say, 'We are all in this together to make money. We might make a little less money than we would have, but life is still good and we'd rather you be here than anywhere else.'

Kushner: Did people get religion during this cycle?

Fleishaker: We live in a world of cycles. Right now, the big box retailers who have great balance sheets are looking forward to stepping on the necks of the landlords. And the landlords who are getting their necks stepped on are waiting for the cycle to turn so they can step on the neck. No retailer offers \$16 per square foot when the asking price is \$12.

Montesano: As of last September, we were getting crushed. Every developer had the best product at the highest price. We sat and we watched. You're absolutely right, Aaron [Fleishaker], we live in a world of cycles. The last 12 months, we are on the other side of the table. The shoe is on the other foot.

SCB: Does rent reduction impact the owner in that he has to cover his loan covenants? Is there a point of no return?

Kampler: They won't lose their property. The landlord will need to have a conversation with the lender. Does the lender want that property back? No.

Kushner: From the landlord's point of view, you have to look at whether the retailer is really struggling. If they are, can they get through it? If not, the landlord's probably are more willing to help because they'd rather have someone they know in the center.

Fleishaker: But they are not helping out of the goodness of their own hearts. If they had five guys lined up to take the space they would say, 'Pay the rent or get out.'

Zuckerbrot: It is about being an operator today. I had a retailer in multiple properties. In one property, they were expanding and I got a letter saying they wanted to reduce the rent. In another one, they were really hurting and we had to deal with it. You can't blanket everything.

Fleishaker: Some retailers are out of line with the interests of the landlords. They are picking them off one at a time with a BB gun trying to make the cheapest deals they can. There is no alignment of interests. Supply and demand is the most simple law of economics. In the old days, when the sporting goods stores were all duking it out for the same space, the rents went straight up. When there was a vacancy and Modell's was the only one that would take an urban location with no one else competing, the rents went down.

Rabinowitz: I'm curious to hear what people's thoughts are on green development? Are you willing to pay more rent for it?

Breslin: The laws are changing to require more green methods. It will be a serious industry.

Fleishaker: All our research shows that employees want to work for a green company; the customers want to shop in a green store. As a retailer, if you are not thinking green, you are missing the boat. Our stores are not 100 percent green, but every method we can employ, whether it's in lighting, refrigeration, etc., we are doing it. We are encouraging our landlords to go green as well.

Montesano: At Costco, everything down to the simplest thing is focused on this. If you buy cashews that are more square because they can get more cans of cashews on a pallet and more cans of cashews into a tractor-trailer, allowing them to move more product more efficiently. It makes total business sense from every level of the business — from lighting to distribution to transportation — to go green. Costco was an innovator of using natural light in their stores 25 years ago. If you go into one of their suburban style stores, 80 percent of the lights are off, because they are using sunlight to light the stores. In Manahawkin, New Jersey, we did a huge solar panel installation on the store. It is more expensive short-term, but a good retailer is going to get the payback in 5 to 7 years.



Madison Retail Group

Madison Retail Group is a leading provider of retail leasing and tenant representation services in major metropolitan markets throughout the United States. Based in Washington, D.C. and New York, our clients include storefront owners, retail chains, institutional landlords and real estate developers.

Our property portfolio includes over 2 million square feet and we represent more than 50 leading retail and restaurant brands. Our Washington, D.C. office services the entire Washington/Baltimore region. The New York office is a licensed real estate broker and services Manhattan and other major urban markets throughout the country.

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