

TOSS THE RETAIL DEVELOPMENT PLAYBOOK OUT THE WINDOW

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IF YOU THINK YOUR RETAIL LED DEVELOPMENT PROJECTS WILL MOVE ALONG JUST AS SOON AS THE FINANCIAL CRISIS SUBSIDES, THINK AGAIN. THE CONSUMER MARKET TRENDS THAT DEFINED MUCH OF THE PAST TWO DECADES ARE, LIKE 2008, ABOUT TO BE A THING OF THE PAST.

It was never really a question as to whether or not a financial day of reckoning, like what the U.S. is currently experiencing, was going to happen; rather, it was always a question of when it was going to happen, given the profligate spending and instant gratification culture that has come to be associated with American society. Compounding matters further, meaningful demographic shifts are underway across the country that, notwithstanding the current financial and housing crises, will influence the nature of retail development for decades to come.

LIFE, LIBERTY AND THE PURSUIT OF THINGS PURCHASED ON CREDIT

Consumerism in the U.S. has come to symbolize what it is to be an American. In large measure, our waking hours are spent earning money towards and shopping for goods and services that, ostensibly, improve our standard of living. Growth in shopping center space, nationally, defined as gross leasable area (GLA) in industry parlance, is perhaps the greatest testament to our consumer culture. According to the National Research Bureau (NRB), in 1986 there were slightly more than 3.5 billion square feet of shopping center space in the U.S. or approximately 14.8 square feet of shopping center space per capita. By 2005, NRB reported shopping center space in the U.S. had grown to 6.1 billion square feet or 20.5 square feet per capita – a 72% increase. However, during this same 20-year period, the U.S. population had only increased by 24%. How is it possible that such strong growth in retail square footage could have been supported by relatively modest population growth? In a word, debt. Consider these sobering government statistics:

- Real median household income in 1967 (real median income represents inflation adjusted money income where 50% of households earn more than this amount and 50% earn less) was \$38,771. During the same year, average household debt (the aggregate of a household's mortgages, auto loans, and credit card and other consumer loan debt) was nearly equal at \$38,409, representing an income-to-debt ratio of approximately one. In 2007, reported real median household income was \$50,233 and average household debt, during the same year was

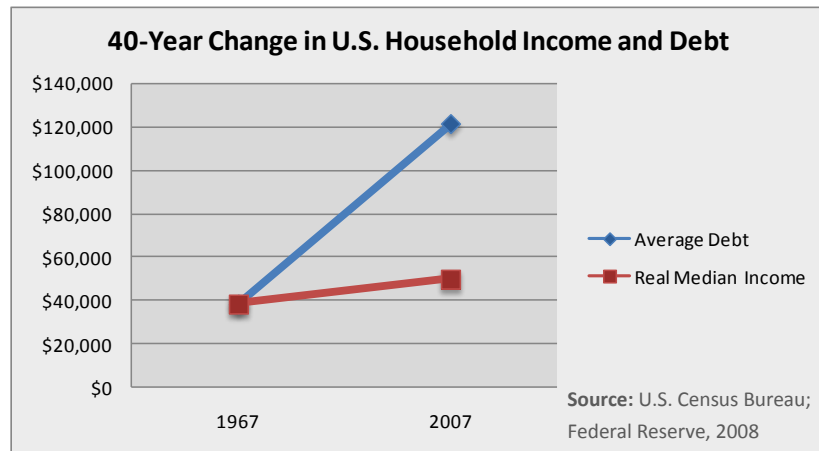


FIGURE 1

- \$121,650, representing an income-to-debt ratio of .41. In the 40 years between 1967 and 2007, real median household incomes rose by just under 30%, while average household debt increased by approximately 217% - a more than seven fold increase over the rise in real median household income.
- While real median household income increased by slightly more than 10% between 1987 and 2007, household expenditures on apparel, dining out and entertainment/electronics increased by 30%, 71% and 126%, respectively, over the same period.
- The average savings for a household in 1967 was \$5,978. By 2007, the average savings per household had declined to \$449.

Today, the majority of households are allocating an ever increasing portion of their take home pay to what the Federal Reserve refers to as a household's "financial obligations", which consist of all payments towards primary residential mortgages, consumer and auto loans, tenant occupied rental payments, home owners insurance and property tax payments. In short, consumers, who represent nearly 70-percent of U.S. Gross Domestic Product, are all but tapped out financially.

Going forward, a combination of tighter U.S. banking and credit industry regulations, stricter consumer underwriting standards and higher interest rates will likely crimp the breadth and depth of consumerism from recent years. While the decline in annual household purchases may be relatively small as a result of the above actions, in aggregate, the effect will certainly lead to a consolidation of retail space.

LEAVING GAP FOR AARP

As if an over leveraged consumer weren't bad enough for existing and prospective retail projects, the rapid aging of the baby boom generation (those born between 1946 and 1964) portends a more structural change for consumerism over the next 20-years. According to the U.S. Census Bureau's latest population projections, the 25 to 54 age group (the prime shopping demographic for non-convenience oriented retail centers) will increase by approximately 10.6 million persons or eight percent between 2009 and 2029. In contrast, the 55 to 84 age group (individuals in

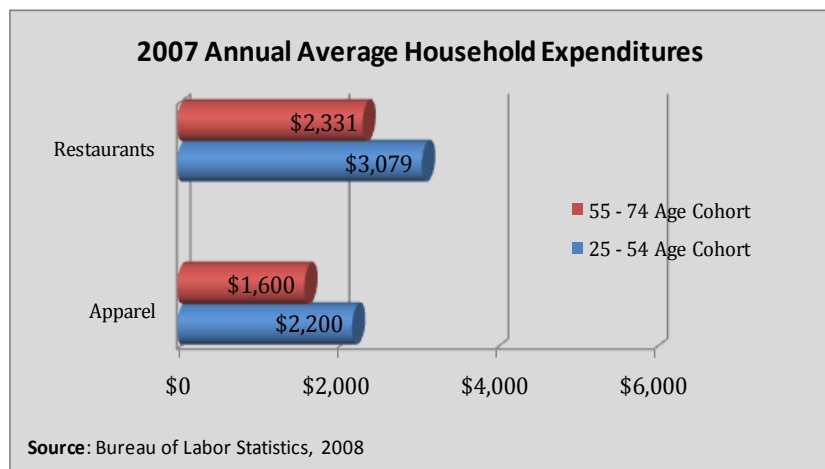


FIGURE 2

or preparing for retirement)

is projected to increase by

nearly 34 million persons or 49-percent over the same 20-year period. For retailers who have grown accustomed to year-over-year increases in sales revenues and profits, this is particularly bad news.

As consumers begin reaching retirement age and beyond their tendency is to pull back on discretionary purchases such as apparel, home furnishings, electronics equipment and dining out – the core offerings at most retail centers. Figure 2 illustrates the significant differences in age related household expenditures. Annually, households headed by persons between 25 and 54-years of age spend approximately \$700 and \$600 more per year on apparel items and restaurants, respectively, than do households headed by persons 55 to 74-years of age. Or put another way, and based on retail industry averages, a community of 10,000

households headed by 25 to 54-year olds would support, on average, about 20,000 and 10,000 square feet more of retail clothing and chain restaurant space, respectively, than could a similar number of households headed by persons 55 to 74-years of age. Given the current dive in financial markets and associated retirement accounts, the discretionary spending retrenchment among those 55 and older will likely accelerate, further pressuring the viability of retail projects.

Existing and planned retail developments most likely to be impacted will be traditional malls, outlet and lifestyle centers, as these shopping center formats are highly dependent on discretionary spending (think clothing, electronics and prepared food). Retail stores such as GAP, Ann Taylor, Limited, Pottery Barn and Williams-Sonoma, which rode the consumerism wave of the relatively affluent baby boom generation will struggle as boomers open their wallets less frequently and shift a greater share of their discretionary income to healthcare related goods and services, travel and savings.

LOOKING AHEAD

In light of the coming economic and demographic structural shifts identified above, developers, public officials and investors will want to closely evaluate their respective real estate markets and demographic trends in advance of committing to their next retail led development project. Here are a few metrics, some unorthodox, development and planning organizations should track:

Market Area Retail Square Footage Per Capita – Understanding both the rate at which this metric has changed over the past decade as well as a retail market area's relative standing against adjacent market areas provides important context for development decisions.

Projected Change in Age Cohorts – As illustrated in this article, age matters, where retailing is concerned. Particular emphasis should be paid to the projected change in the number and percent of households headed by persons between 25 and 44 years of age – retailing's target demographic.

Household Discretionary Income – Discretionary income is what remains after deducting payments for taxes (federal, state, and local), food, shelter and basic clothing expenditures. As taxes, shelter and food costs have risen, discretionary consumer expenditures have been reduced.

Percentage of Households Overburdened by Housing Costs – A government statistic representing those households in a given geography paying 35-percent or more of their income towards housing costs (mortgage, rent, and utilities). This measure serves as a proxy for the percentage of households most likely to be overleveraged and particularly constrained where discretionary purchases are concerned.

Industry Trends – Tracking changes in industry employment and projected growth trends provides an early warning indicator for the scale and quality of retail development likely to succeed.

In the future, the planning for retail development will look substantially different from that of the last quarter century; organizations that pay close attention to the coming economic and demographic shifts within their market areas will be in a better position to achieve success than those which cling to past formulas and rules of thumb. ■

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4ward Planning is a land-use economics consulting firm focused on assisting local governments and private developers improve their development project's impacts on social, environmental, fiscal and economic systems.