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Perspectives

Zombie Malls – Part 1: Bringing Dead Shopping Venues Back to Life Through Multifamily Development – The Death of the Local Mall

Volume 48, Number 8 - February 26, 2024 • Written by: **Dr. Mark Gambill**

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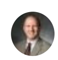
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Abstract:

As more retail activity goes online with Ecommerce and given the fact that the U.S. is over retailed, mall owners/developers are looking for ways to revitalize and monetize their real estate by adding multifamily to

create a mixed-use environment. One of the main drivers of this effort is parking reduction, as developers and retailers have come to the realization that most shopping centers are over parked. There are many things to consider when attempting to incorporate apartments in a shopping area, not the least of which are regulatory issues and private land controls of other tenants/users in the center.

A Brief History of Malls:

Regional shopping malls have been around since 1956 when the Southdale Center, the first fully enclosed shopping mall, opened in Edina, Minnesota, a suburb of Minneapolis. [i] [ii] This was one of the first attempts to locate a collection of stores in a climate-controlled environment. Prior to this, shopping was primarily an urban activity, as retailers were located mainly in the central business districts of cities.

With the increased ownership of automobiles, city residents, who heretofore had relied on proximate public transportation to travel to their jobs, were better able to move to the suburbs. The Interstate Highway System created arteries for suburban dwellers to commute to employment in the cities. [iii]

Even though there was exurbanization as people moved to the suburbs, one issue, however, was that the stores primarily remained in urban areas. This was not necessarily a problem for commuters to downtown locations, but urban planners quickly realized that bringing stores out to where consumers were now living was going to benefit not only consumers but also retailers.

According to Feinberg and Meoli, “Shopping malls didn’t just happen. They are not the result of wise planners deciding that suburban people, having no social life and stimulation, needed a place to go (Bombeck, 1985). The mall was originally conceived as a community center where people would converge for shopping, cultural activity, and social interaction (Gruen & Smith, 1960).” [iv] The Feinberg and Meoli article gives a good quick synopsis of mall development through the late 1980s.

Even more important than the arterial expressways created by the Federal Aid Highway Act of 1956 [v] were the “veins” of the Interstate Highway System, the beltways around the cities. As the populations grew in the suburbs, merchants, primarily department stores that had heretofore been located downtown, started their migration to the outlying areas of the cities. (For an excellent analysis of this phenomenon, see Steuteville’s article [vi]).

Developers followed the exurbanization of the citizens and began building shopping malls on the outer belts of cities. They would locate malls with a 10-mile or less separation. This led to today’s situation of an excessive inventory of bricks and mortar retail. Templeton [vii] states that the U.S. has 40% more retail space in square feet per capita than the next closest country, Canada. Templeton goes on to say, “On a year over year basis, brick and mortar retail sales have increased at a 3.8% pace and are about average going back to the beginning of 2002. Faster incremental growth in retail sales is occurring with the non-store (online, supplied) retailers, though the chart below (see Endnote) shows growth at 8.4% on a year-over-year basis. At the end of the day, there is simply too much retail square footage per capita, which means that some retailers will continue to face headwinds.” [viii]

Death of Malls:

Malls are graded by investors, retailers, lenders and other interested parties and many malls in the U.S. that grade low are considered dying. [ix] [x] Moore cites a CNBC report that there are approximately 380 C- and D-rated malls, which are considered the most at risk, as they do not generate sufficient sales to maintain their property values and have higher vacancy rates. [xi] (For a good summary of mall classifications, see Jordan Wathen’s article. [xii] See also Forbes article, Trends and Future Outlook for Malls. [xiii] Also, Forbes article, Malls are Dying. [xiv])

There are numerous factors involved in the death spiral of struggling malls and each mall is affected differently; however, there are two factors that have greatly impacted the C and D malls:

1. Effect of E Commerce – There are countless articles on the impact of

ecommerce on physical retail. Bain indicates that America’s vast swaths of retail space have become a burden in the age of e-commerce. [xv] “The suffering is mostly concentrated in brick-and-mortar retailers, particularly malls

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and department stores. One of the underlying causes is the amount of physical retail space in the US, which grew excessively even as more shopping began taking place online. American retail is in serious need of a diet, and 2017 is forcing it on one." [xvi] Bain quotes Urban Outfitters CEO Richard Haynes as he summed up the situation during an earnings call with analysts in March 2021:

"Retail square feet per capita in the United States is more than six times that of Europe or Japan. And this doesn't count digital commerce. Our industry, not unlike the housing industry, saw too much square footage capacity added in the 1990s and early 2000s. Thousands of new doors opened, and rents soared. This created a bubble, and like housing, that bubble has now burst. We are seeing the results, doors shuttering and rents retreating. This trend will continue for the foreseeable future and may even accelerate." [xvii].

2. Department Stores – Another critical element in the demise of many malls is

the increasing irrelevance of department stores. According to Green Street Advisors, [xviii] a leading real estate analysis firm, as cited by Thomas, over 50% of department stores in malls are predicted to close by 2021**.** [xix] As of the writing of this article, seventy-six full-line department stores have closed their doors completely. [xx] A review of the referenced list will reveal that some of the listed department stores became part of another company, as when Macy's bought numerous chains such as Foley's, Rich's, Burdines, May, etc. and rebranded them as Macy's, but the majority on that list have simply gone out of business. (See also Vox and the New York Times articles for excellent overviews of the death of department stores.) [xxi] [xxii]

When shopping center owners end up with a vacant department store box, they often repurpose it by turning it into an alternative use such as a call center or office building, entertainment use such as a theater or splitting it up into boxes for other retailers. Owners are also taking these dead department stores discussed herein, tearing them down and creating lifestyle wings such as General Growth Properties brought about at Augusta Mall in Augusta, Georgia. [xxiii] [xxiv] They are also redeveloping these properties or incorporating them into the multifamily projects discussed herein.

The Wall Street Journal, in an article from November 23, 2023, looked at the case of Berkshire Mall in Wyomissing, Pennsylvania and declared it and others like it as "Zombie Malls" [xxv]. "There are hundreds of zombie malls throughout the U.S. like the Berkshire Mall, more dead than alive. The older, low-end ones have lost at least half and, in some cases, more than 70% of their value." [xxvi] The Wyomissing Borough Manager said that the community would be better served if the Berkshire Mall was turned into something more valuable. "Ideally, a mixed-use property with housing and medical offices or educational space and maybe some retail and restaurants." [xxvii]

The gap between the best and the rest of the shopping malls is increasing. According to Macy's CEO Jeff Gennette, this year (2021, supplied), "we have witnessed a bifurcation of malls, and lower–tier malls continue to decline rapidly." [xxviii] Fung and Serkez state, "The rise of online retail and changing consumer preferences have hammered U.S. shopping malls since their heyday in the 1990s. Many of these former engines of commerce and centers of community life are now mere skeletons as they fight for their lives." [xxix]

In an article in the Los Angeles Times, Khouri indicates, "A recent report from Credit Suisse predicted the trend will result in 20% to 25% of America's malls closing in the next five years. To stave off that fate, some owners are redeveloping their properties into destinations to try to give shoppers a new reason to venture outside. There is an emphasis on experience and typically more restaurants and outdoor boutiques, as well as community spaces that can hold concerts and other events. Housing is also key. 'You don't have to reach out to your customer base, because they live right there' said Cynthia Murphy, who oversees mall leasing nationwide for commercial real estate brokerage CBRE Group." [xxx]

Saving the Local Mall:

Because many malls are dying, the owner/developers can use what the author calls "extension strategies" to breathe life into malls that are on life support and can take various forms. One of the primary extension strategies being utilized is the addition of multifamily complexes to mall sites. According to the Los Angeles Times, acres of prime real estate are opening for redevelopment as America's malls struggle to compete with Amazon and other online giants, offering developers a rare shot to remake swaths of land in the country's built-out metropolises.

[xxxi] In particular, real estate experts say that the demise of retail centers provides one of the best chances to add needed housing in California's urban regions, where a shortage has left nearly 30% of renters in the state paying more than half their income on housing. [xxxii]

Danziger states, "Mall properties have great access, great visibility, lots of space and utilities on site. They have good access to mass transit. They're ripe and ready for redevelopment and repurposing," quoting CRTKL associate principal and architect Sarah Holstedt. [xxxiii]

As a counterargument to resigning underperforming malls to the proverbial scrap pile, Brown and Lubelcyzk state, "Shopping malls can reclaim their status as the pillars of modern retail if their leaders re-imagine how they engage consumers. Many observers of brick-and-mortar retail feel that shopping centers are crumbling at their foundations. However, we believe that today's world offers malls an opportunity to turn a new page. With swift and aggressive innovation and a customer focus, shopping centers can transform into "consumer engagement spaces": mixed-use offerings designed to meet the needs of new and future generations of shoppers." [xxxiv] [xxxv]

Monetizing Mall Real Estate: Harvesting Value

Besides an effort to bring dead malls back to life, another factor in the move by some mall owners to add multifamily to their shopping centers is an effort to monetize the real estate. "Monetize" refers to the process of turning a nonrevenue generating item into cash. In many cases, monetization looks to novel methods of creating income from new sources. [xxxvi] Investopedia states, "Indeed, finding novel ways to turn otherwise neutral or costly business operations into profit centers is a goal of today's entrepreneurs and is sought after by investors." [xxxvii]

The easiest way of monetizing a real estate property is selling it. [xxxviii] The National Real Estate Investor asks the question, "Does a retailer (or mall owner, supplied) need all the owned square footage or could it reduce its current footprint and sell or lease the excess real estate area?" [xxxix] Mall owners are selling multifamily tracts to apartment developers or developing multifamily projects themselves.

The Urban Land Institute (ULI) found, "In many communities, malls often occupy the largest remaining land parcels under single ownership. Although the value of these sites has increased, often dramatically, most of the land is still underutilized because it is in the form of parking lots. When market conditions are right, these "land banks" provide valuable opportunities to intensify development by adding land uses and development types that most suburban communities need but often lack. Possible projects include a new town center, housing forms designed to serve new demographics, mixed-use environments, hotels, civic and cultural facilities, public gathering places, and pedestrian precincts." [xl]

ULI goes on to state, "Use mixes that unlock the value of the land can go beyond retail and entertainment. If residential uses—both rental and for-sale—are introduced to the redeveloped site, the land may become more valuable. The residential component provides a customer base for retail, and the convenience of retail close to home will attract people. To maximize real estate value and market potential, be creative in unlocking the value of the land under obsolete shopping centers and parking lots, who are looking for a unique place to live. Most successful retail is linked to successful residential development." [xli]

Multi Housing News quotes Yaromir Steiner, founder & CEO of Steiner + Associates, Columbus, Ohio-based developer and New Urbanism pioneer, "Every mall presents a unique circumstance. If a mall is in a potentially attractive location for residential development—and the retail is underperforming or defunct—the greatest value is in the site rather than in the buildings. There are projects around the country where the mall could not exist, so essentially the mall was progressively demolished and became a residential neighborhood. Several hundred multifamily units can be added initially on five or ten acres, a step that can be conducted in an economically feasible, minimally disruptive manner. The residential component can be added in phases as the mall is progressively vacated and eventually demolished."

Adding multifamily to a shopping center can also increase the value of the shopping center itself. Steiner states, "We have seen value adds or increased rents in the range of 20 percent when the residential can be located in a place where they can take advantage of the amenities such as restaurants, bars and health clubs provided by the regional retail destination."

Conclusion:

The United States is over-retailed and many malls are dying particularly in the C and D categories, partly because of e-commerce, but mainly through the demise of department stores. In Part I, the article looked at this phenomenon and causes for the glut of retail real estate. As mall owners deal with this issue, they are turning to "extension strategies" to not only preserve value and reinvigorate these assets, but also to monetize the real estate and maximize its worth.

In Part II of this article, one solution to the decline of malls will be explored, reducing required parking and adding multifamily to the center. This can not only preserve the asset, but it can also make the center more valuable. As more and more centers lose anchors and become subject to market forces leading to their decline, strategies for making changes to drive these malls to greater viability.

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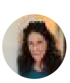

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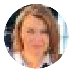

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