LET'S TALK BUSINESS

Ideas for Expanding Retail and Services in Your Community

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Shopping Center Site Selection

Why Real Estate Developers Often Choose "Edge" Locations

by
Bill Ryan and Matt Kures*

Developers who build shopping centers make economic decisions after careful market analysis. Their decisions are based on a center's potential capture of consumer spending in the trade area as well as the market requirements of prospective retail tenants. The developer must be knowledgeable of retail including consumer trends and new retail formats (warehouse clubs, power centers, outlet malls, etc.).

The most important element in determining economic viability is location. Location is critical as it determines who will be the tenants and what type of investment return will be generated by the retail center. By understanding the economics of location, community planners can work effectively with developers to explore smart retail growth alternatives including downtown redevelopment.

Developers as Rational Decision Makers

Real estate developers are not "demons," as some would like to say. Instead, they are rational decision-makers. They understand that certain factors are important in the market acceptance and success of a shopping center. A center must be big enough and have an appropriate tenant mix to draw the traffic necessary to make it successful. It must accommodate traffic circulation and make it relatively easy and secure for customers to get into the parking lot, and from there into the stores. The center and its signage must be clearly visible and easily accessible from the highway. Further, the appearance of the retail center must be inviting and stores should have strong individual but complementary identity.

However, many real estate developers have been at odds with sprawl critics for the following reasons:

- Time - A developer's perspective is normally short-term. Developers and retailers have one to five year financial obligations. The community perspective is typically much longer.
- Residents - To a retail developer, community residents are considered customers. To a community, they are citizens.
- Auto versus Pedestrian - Often retail development focuses on accommodating cars. Sprawl critics focus on pedestrians, bikeways, and transit alternatives.
- Lot Lines - Developers focus on land within their lot lines. Community focuses on the whole area or region where the parcel is just a small piece.

Why Developers Choose "Edge" Locations?

Over the past 50 years, constructing shopping centers on the edge of town has been an attractive scenario for many developers. Edge locations allow developers to design centers around customer and retail preferences and then replicate their successful design in other communities. According to the Vermont Forum on Sprawl, developers choose edge locations over downtown or infill sites for the following reasons:

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Land Costs Tend to be Lower - Purchase costs per square foot are typically higher in downtown areas. Also, more than one property may need to be assembled for a downtown project, adding time and costs. In outlying areas, greater available space usually means a simpler land purchase.

Title Problems are Less Likely to Crop Up - Because they have a history of use, downtown properties often present complex title issues.

Permitting is Less Complex and Time-Consuming - Proposed downtown projects often require a complexity of permits, and may pose conflicts between permit and code requirements, as well as historic preservation guidelines. Developers prefer a more predictable permitting process.

Zoning May be Less Restrictive - Redeveloping a downtown building often involves a change of use, which triggers additional review under local zoning. Big buildings on small downtown lots often cannot meet zoning requirements for setbacks or parking. Seeking a variance or zoning change is costly and time-consuming.

Site Preparation is Simpler - Downtown construction often involves demolition of existing structures, while preparing a suburban lot may mean little more than clearing trees. The chances are considerably higher downtown that a project will encounter environmental hazards, unstable ground conditions, deteriorated infrastructure, or other complications - often unforeseen.

Construction is Simpler - Downtown building projects often bring complex challenges: scheduling issues, neighbor relations, crane and staging needs, planned utility outages, even employee parking. In many communities, it will cost 25-50% more to build downtown compared to an edge location.

Suburban Buildings Can be Bigger – Not only can they be bigger, but they can also more easily meet the standardized requirements of national merchandisers. The bigger a new building, the lower its square-foot costs for leasing. In smaller, downtown spaces, economies of scale are hard to obtain, and zoning may limit building heights. Also, corporate retailers tend to seek uniform prototype rectangles with ample floor space. These are easier to build on new, spacious suburban sites.

Parking is Ample - Providing enough parking downtown for employees and customers can be a major zoning, convenience, and cost issue. Suburban lots are likely to provide more parking.

While many good investment opportunities exist for downtown real estate development, there are many real and perceived barriers facing developers. Few equity investors are interested in downtown, as they fear that nobody will want to rent space there. When they are willing to invest, financial institutions are often reluctant to lend money. Sometimes buildings are owned by trusts or absentee landlords who refuse to sell or develop. Many owners may not care if their downtown buildings are underutilized in the first place or believe they are in such bad shape that they could never be rehabilitated.

"Show Me the Numbers"

Developers typically choose edge locations over downtown or infill sites because their perceived risks are lower and their anticipated returns are greater. Accordingly, before smart retail growth alternatives become truly viable options, investors must understand their market and economic potential.

When a project is completed, its value must be greater than the cost of creating it. Cost is the total dollars it takes to bring a project from concept to finished building. Value is what the property is worth to someone else once the project is completed. Developers usually favor edge locations because they anticipate that their total value will be greater than their total cost. They do not believe that downtown or infill sites simply can generate this favorable value-cost relationship.

For smart retail growth to occur, communities need to establish a tool-kit to help demonstrate the market potential and economic value of downtown or infill sites. Unfortunately, many smart growth strategies take more time to implement. This additional time translates into lower return and higher risk. Through income tax, financing, cost-reduction, and operating incentives, the gap between value and cost can be eliminated, making smart retail growth alternatives possible.

Sources:
Vermont Forum on Sprawl, http://www.vtsprawl.org/

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Evaluating The Downtown Real Estate Opportunity, National Main Street Center

* Bill Ryan is a community business development specialist with the UW-Extension Center for Community Economic Development. Matt Kures, also with the Center is a graduate student in GIS and cartography at the UW-Madison. Newsletter production by Alice Justice, program assistant with the UWEX, Center for Community Economic Development.