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‘Retail Is Where the Action Is’

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For decades the Midwest's fortunes have been driven largely by the industrial sector, particularly the auto industry. But in recent years, it's middle-American names like Wal-Mart, Target and Kohl's that have bolstered the region's real estate economy. While most property sectors have languished — office vacancies remain stuck at 20% or higher in some markets — retail development in many Midwestern cities has forged ahead.

The investment in retail, particularly in power centers, has been broad-based across the region, and in many cases involves the redevelopment of office and distribution sites. Case in point: Continental Real Estate Cos., based in Columbus, Ohio, has acquired the regional headquarters of Lucent Technologies Inc. and plans to put a 250,000 sq. ft. retail center on the site. Nearby, Continental is erecting a 180,000 sq. ft. grocery-anchored shopping center and another center, this one spanning 400,000 sq. ft., anchored by Wal-Mart, T.J. Maxx and Staples.

“The big-box retailers — Target, Kohl's and Wal-Mart — are all expanding aggressively around here,” explains David Kass, president of Continental. “We do all kinds of development. But office space in Columbus is more than 20% vacant, and industrial is very tough right now. Retail is where the action is.”

Up in Minneapolis, Tom Palmquist, vice president of retail development at Ryan Cos., is quick to agree. In October, the firm opened a 225,000 sq. ft. Target-anchored center in suburban Champlin. Ryan Cos. has five more projects under way in suburban Chicago. In fact, more than a half-dozen big retailers, including Staples and Pittsburgh-based Dick's Sporting Goods, are lined up ready to debut in metro Chicago.

“We're looking for retail sites in Milwaukee, too,” Palmquist says. “Lowe's is just entering the Twin Cities market for the first time, and we hope to build some of their stores here for them. Sears also is looking to do deals.”

Retail Leads The Pack

Third-quarter data supports the idea that retail is firming up in many places. In Chicago, the shopping center vacancy rate has declined to 9.2% from 11.1% at year-end 2002, according to CB Richard Ellis. In Cincinnati, the retail vacancy has decreased from 12.8% to 11.2% — the first decline in four years, CB reports.

Meanwhile, in Minneapolis/St. Paul, retail vacancies registered a meager 5.5%. Average asking rents are $18.33 per sq. ft., up from under $17.50 per sq. ft. a year ago. Some 18 retail developments totaling 2.7 million sq. ft. are now under construction in the Twin Cities. That's high by historical standards.

“Among institutional and private investors, retail has been the favorite product category in the Midwest over the past two years,” says Todd Caruso, a managing director with CB Richard Ellis in Chicago.

Gary Linder, owner of retail brokerage Linder Co. in Indianapolis, notes that lifestyle centers are cropping up in Westfield and Plainfield, Ind. New market research has led key retailers to attract customers within a smaller radius, Linder explains. “That's driving new development,” he says. “These retailers have also figured out how to get their stores into second- and third-tier markets like Fort Wayne. That's led to a lot of retail activity.”

But has the pendulum in favor of retail swung too far? Kerry Vandell, director of the center for urban land economics at the University of Wisconsin, worries that the ongoing binge in shopping center construction is “a sugar high that isn't sustainable over the long term.” Shuttered factories aren't likely to reopen anytime soon, he predicts, and job creation has remained sluggish. “As the U.S. economy recovers, the Midwest may be a step behind,” Vandell says, adding that “cities like Minneapolis and Chicago with diverse economies will fare better than much of the rest of the Midwest, including Detroit, which is still heavily dependent on autos.”

Other Sectors Still Lagging

Meanwhile, Midwestern office markets continue to struggle. Detroit's vacancy rate in the third quarter climbed to 20.2%, up from 17.3% a year ago. In Columbus the vacancy rate stands at 23.3%, up from 19.9%. With so much sublease space available, few predict a quick recovery.

Much of the activity in industrial has centered on small users requiring less than 100,000 sq. ft. In the Chicago suburb of Bartlett, a former limestone quarry of 670 acres was turned into a corporate park three years ago and suffered a stubborn drought of demand. But in the past six months the owner, Elmhurst-Chicago Stone Co., has closed on nearly a dozen deals involving small tenants.

“A lot of people who were watching the economy are making decisions on new manufacturing and industrial space,” says Brice Soltys, a vice president with Triumph Development Corp., which has developed part of the quarry for clients. “It's mostly smaller, expanding companies. There aren't many big 400,000 sq. ft. industrial boxes being built around here now.”