

## Chapter 4

# Office and Industrial Development

Office and industrial development share certain similarities and, in fact, overlap in their definitions. Some of the flex and hybrid types of properties could be categorized as either office or industrial space, and potential users of these kinds of space would not necessarily limit their search by category. The methodology of market analysis for office and industrial space requires an understanding of the local business climate: Which industries are expanding and by how much? Which nodes or locations are desirable for particular industries and types of business activities? What are the specific space needs (amount, type, and price) of new and expanding businesses? Determining the requirements of industrial-space users is more complex than for office users. Whereas office space is a fairly simple function of amount of space per employee, industrial users are more varied in their activities and space needs, and the analysis requires a greater understanding of the target businesses.

### Characteristics of Office Buildings

Office development runs the full gamut of building size, class, and location. About 20 percent of all employed Americans work in office buildings, mostly in service and information sectors.<sup>1</sup> Some office buildings are specifically targeted to distinct market niches: medical offices, banks, back-office functions (data processing, customer service, order taking, etc.). As for location, office buildings can be found in downtowns, suburban highway strips, office parks, and mixed-use developments. About 20 percent of all non-governmental office buildings are owner occupied. The balance is owned by real estate services compa-

nies (institutions, insurance companies, REITs, partnerships, family businesses, and individuals) and leased to tenants.

Office space can be categorized according to several factors, including the following:

- Class;
- Location;
- Size and flexibility;
- Use and ownership;
- Features and amenities.

### Class

Class is measured by evaluating a building's age, location, quality of finishes, building systems, amenities, lease rates, and tenant profile. Three classes of office space are usually defined. Class A, or investment grade, buildings are the most desirable; they feature high-grade finishes and amenities, which offer status to the businesses within. Class B and Class C buildings are often older properties that have not kept up with modern trends in design or features; however, older buildings can sometimes be renovated and repositioned as Class A properties. Most large, new buildings are Class A, but smaller, basic office structures with few amenities can be Class B from the outset. Definitions vary, but age, size, rent level, location, building materials, and amenities are all considerations.

### Location

Downtown central business districts (CBDs) are usually prime locations that are characterized by high-density office buildings and high rents. Major service

firms in fields such as law, accounting, and consulting as well as government tenants often prefer downtown locations. Located outside of the CBD, but still in the city, are often secondary office nodes that may center around hospitals, universities, or other business magnets. Suburban locations are more difficult to evaluate, and they appeal to a more diverse group of office users. Many of the mature suburban communities that ring large urban cores have their own concentrated "downtown" office cores that can even rival the CBD.

### Size and Flexibility

In size, office buildings range from less than 10,000 square feet to more than 1 million square feet. The twin towers of New York's World Trade Center comprise 12 million square feet. Office buildings generally fall into three size categories: high-rise (16 stories or more), mid-rise (four to 15 stories), and low-rise (one to three stories). Floor plate size is important for tenants that need large contiguous blocks of space. Floor space flexibility is becoming increasingly important as more tenants opt for open floor layouts and more efficient use of space. Office floor plates generally range from 18,000 square feet to 30,000 square feet.

### Use and Ownership

Buildings can be either single-tenant or multitenant structures. A single-tenant building may be owned by the tenant, in which case it is referred to as an owner/user building. A building constructed for a specific tenant is called "built-to-suit," while a building constructed for unknown tenants is a speculative or "spec" building.

### Features and Amenities

One of the most important characteristics is the availability and cost of parking, or in urban cores, the proximity of mass transit. The importance of some of a building's features is defined by the target market. If the targeted tenants are high-tech firms, the electrical power and telecommunications infrastructure may be most important. If the target tenants are high-profile law firms, the architecture and quality of finishes in public areas may be the key factors. Some tenants may require on-site health clubs, restaurants, and retail outlets.

According to a survey of office tenants conducted by the Building Owners and Managers Association and ULI, rents and pass-through charges are the most

important factor that tenants consider when signing or renewing leases. But the next most important factors were associated with the quality and productivity of the work environment: comfortable temperatures, indoor air quality, and acoustics and noise control. The next most important criteria relate to management responsiveness and maintenance. Today's tenants are less concerned with lavish lobbies and expensive exterior cladding.<sup>2</sup>

## Characteristics of Industrial/ Warehouse Buildings

The line between office and industrial space has blurred because so many businesses today require flexible space to accommodate a wider range of activities. Industrial development includes a continuum of real estate product types that range from research and development (R&D) space, which closely resembles office space, through unfinished warehouse space. Hybrid space mixes characteristics of office and industrial and does not fall neatly into one category of use. Most new industrial buildings are located in business parks, most of which are dominated by warehousing and distribution activities rather than production. Warehousing and distribution functions are characterized by relatively low ratios of employment to building square footage, an important factor to note when selecting market analysis methods.

Industrial space is classified in three broad categories: (1) manufacturing, (2) research and development, and (3) warehouse/distribution.<sup>3</sup> Most new factory buildings are designed and built to user specifications and are corporate owned. Laboratories, incubator space, and warehouse facilities may be single user or multitenant, speculative or built-to-suit. Although large retail store chains still tend to operate their own warehouses, multitenant bulk warehouses run by third-party logistics managers are increasingly common. Businesses that do not handle perishable items are moving to fewer but larger warehouse buildings.

Warehouse/distribution facilities are further distinguished by the percentage of space used for office functions (as opposed to package assembly, shipping, or storage). Small businesses often occupy flex space with a high degree of office finish (25 to 50 percent). Rents per square foot for high-finish industrial space are much higher than for bulk warehouses where less than 10 percent of the square footage is used for offices.

Because industrial space is low-rise and much of it is unfinished, warehouse buildings take less time to build than office structures do. As a result, smaller warehouse markets can quickly become imbalanced. Despite the relative ease of constructing bulk industrial space, the warehouse property market is less volatile than the office market. Rents and occupancy experience slow but steady increases during periods of economic expansion, and slight declines when recessions are underway.

Metropolitan areas often specialize in different types of industrial space. For example, San Jose, Boston, Austin, San Diego, Minneapolis, and northern New Jersey are well known as centers for high-tech research and laboratory space. Atlanta, Cincinnati, Columbus, Indianapolis, Kansas City, and Sacramento are warehousing meccas because of their location at the junction of two or more interstate highways. (See Case Study 4.3, Peachtree Industrial Park.) Port activity in Los Angeles, Oakland, Seattle, Miami, and Newark generates demand for warehouse space. Manufacturing space is concentrated in both large and small metropolitan areas in the Southeast and the Midwest.

Because of greater automation in warehousing activities, today's warehouse buildings are very different from those built in the past.

- Buildings with 100,000 square feet or more are common; a 300,000-square-foot warehouse is not unusual.
- "High cube" structures have ceilings at least 24 feet tall, with 32 feet desirable. Some facilities are as tall as 60 feet. High ceilings require more costly, sophisticated lighting systems.
- Technological capabilities are increasingly important; storage and distribution are now highly automated operations governed by the principles of just-in-time inventory control.
- Highly durable flat concrete floors are installed to accommodate taller stacking systems and heavier pallets.
- Warehouses have more truck docks, allowing simultaneous loading and unloading ("cross-docking"). At one time, the norm was one dock door per 10,000 square feet of warehouse space. New buildings now are providing one dock per 5,000 square feet.<sup>4</sup>
- Site plans provide for wider turning radii and longer parking bays to accommodate bigger trucks.
- Users may require both high docks and drive-in bays.

These new design standards suggest that much of the existing warehouse inventory is obsolete. The space

requirements previously listed, however, reflect the needs of large national and multinational firms. Local businesses, which often combine light assembly with distribution and storage functions in one facility, do not require (and do not want to pay for) state-of-the-art facilities. A flexible facility that can easily be expanded or reconfigured to accommodate tenant expansion will be preferable for both investors and users.

Manufacturing and laboratory space is usually designed to meet user specifications. The specialized nature of each facility poses problems when tenants move out or owners decide to shut down operations. Because of the high cost of retrofitting existing factory or high-tech buildings for new users, absorbing vacant manufacturing or R&D space takes longer than for warehouses.

## Analyzing Office and Industrial Space Markets

Office and industrial developers and investors use market analysis to identify and evaluate opportunities for developing new projects, to attract investors and financing institutions, to reposition existing projects to attract different segments of the market, or to define a sales price for an existing property. To be most effective in planning a new development, the market analysis needs to be reexamined continually and updated throughout the planning and construction phases. Its performance projections—rent levels, timing of absorption, and occupancy—change as planning and design decisions are made, new information is gathered, and changes occur in the market, such as the possibility of a new competitor. A large tenant might move into the market. Its removal of a significant amount of space from the market would require upward adjustments in the market study's projected absorption, occupancy, and rent levels. Or a major tenant in the market might downsize or vacate. The addition of available space could necessitate downward adjustments in the rent, absorption, and occupancy projections.

### From Macro to Micro Analysis

A commercial development often proceeds on the basis of a succession of analyses—from macroeconomic analysis (also called "market screening") to local market analysis to site analysis and project marketability analyses—serving to guide the developer in formulating and refining a development concept.

Many firms study office and industrial development, especially in the larger markets, and much information is available so that the analyst does not have to reinvent the wheel for every study.

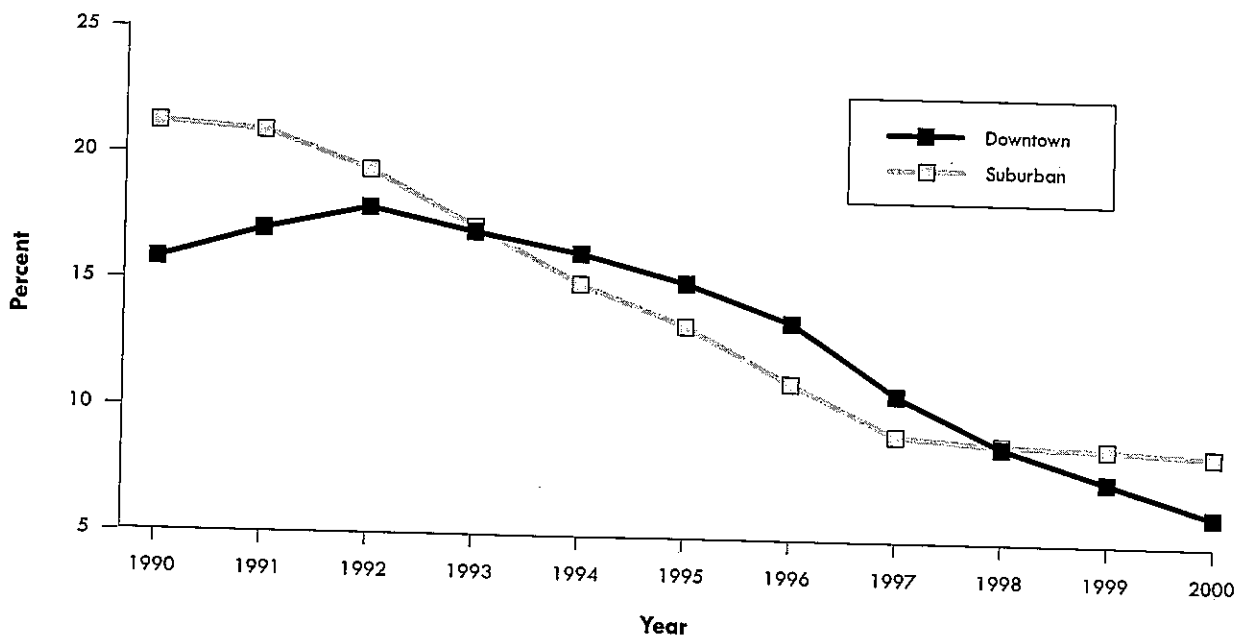
### Macroeconomic Analysis, or Market Screening

Market screening identifies potential development or investment opportunities by assessing the locational, economic, and market conditions of one or more large market areas. It generally focuses on broad elements such as the underlying economy of the market area and its prospects for growth, the growth potential of the office- or industrial space-using sectors of the economy, the availability and cost of labor, the development climate, and supply and demand factors in the regional office or industrial space market. What are the historical trends, by class and type of building, in net absorption, occupancy and vacancy rates, and rental rates? How much vacant space is currently on the market and how much space is planned or under construction? The following questions should be addressed:

- Who are the major employers in the submarket? Are they in industries that are expanding or contracting?
- What industries are expanding in the area?
- Are different types of tenants attracted to the smaller submarkets or office concentrations within the larger submarket?
- Is there interchangeability among submarkets and within submarkets?
- What types of tenants are attracted to the various areas and why? Is it back-office use, headquarters use, or small professional-tenant use?
- What size tenant is attracted to the various areas and why?
- What amenities are available to office buildings in the area? Are the amenities sufficient?
- What type of residential neighborhoods surround the area? Is executive housing nearby?
- Is the area able to draw support personnel from nearby areas? Is public transportation convenient to allow commuting by support personnel from other areas if not from nearby neighborhoods?

Figure 4-1

## Year-End Office Vacancy Rates in United States



Source: CB Richard Ellis.

### Local Analysis

Local analysis explores the dynamics of a single MSA. Typically, its purpose is to identify which submarkets, if any, indicate strong potential for new office or industrial space. It includes a description of the economic base of the metropolitan area, a review of development trends, and, usually, a detailed assessment of the strengths and weaknesses of submarkets—covering net absorption, occupancy, and rental rates by class of building, as well as demand by tenant size.

Within a metropolitan area, conditions can vary widely from one submarket to another. Analysts generally identify a submarket based on a major transportation node or a particular edge city or a district or neighborhood within a city. Industrial submarkets are often transportation based. For example, an airport might be the hub of an industrial submarket. Major highway corridors are often industrial submarkets as well.

### Market Area Definition

In an area with an ample supply of comparables, the market area is defined first on the basis of location, then narrowed to include only the most competitive buildings within the previously defined market area. Sometimes it is necessary to broaden the market area by either location or product so that enough competitive product is delineated. The exact extent of the market area for any particular office or industrial project depends on many factors, such as the following:

- Location of competitive buildings;
- Street and road patterns in the area surrounding the building;
- Proximity to mass transit where applicable;
- Commute times from residential areas;
- Proximity to other facilities relevant to target businesses, such as universities or other institutions;
- Jurisdictional boundaries;
- For industrial property, proximity to airports and/or rail lines or interstate highways;
- Land use patterns;
- Physical barriers to access;
- Psychological or perceptual barriers to access, like unappealing or purportedly unsafe areas that must be traversed to get to the building.

The analyst must determine what factors to consider in defining the market area. For example, an office building located at a mass-transit station might be more competitive with buildings located at other stations than with nearby buildings that are beyond

walking distance from the station. A definition of its market area would have to take that possibility into account. Urban and suburban locations tend to have quite dissimilar market areas. The market area for a downtown office building may encompass only a few blocks surrounding the building, whereas the market area for a suburban office project may encompass several suburban nodes, or edge cities, surrounding a central city.

Because shipping is usually a major function for industrial properties, industrial sites are more transportation driven than office sites. The market area for an industrial building might be the business parks surrounding an airport or an industrial strip along a rail yard. An R&D complex might depend on access to a university or other research center.

Identification of the market area for commercial real estate is less subjective than for residential or retail development. In many cases, generally accepted development corridors or nodes can be used as the market area for the study. These local submarkets are commonly used by brokerage companies and potential users, and data have already been organized by these submarkets.

### Site Selection

Site selection is a crucial step in the development of an office or industrial project. The project's location directly affects the rent and occupancy levels it can achieve. Even office buildings located relatively near each other can experience significant location-based differences in rent and occupancy levels. A building within walking distance of a mass-transit station, for example, may be able to obtain substantially higher rents than buildings only two or three blocks away. Buildings with highway visibility can command higher rents than those without it. Land prices can reflect these large differences in the locational value of sites. Developers choosing sites based on price alone can find themselves unable to compete in the market, even at lower rents.

All of a site's qualities will affect the office building's potential for attracting tenants. Developers should compare the location, access, and physical attributes of alternative sites to identify potential opportunities and obstacles to development. This comparison should include a review of the rent and occupancy characteristics of the buildings located around each site. It should also note any differences in zoning or allowable development potential.

Office buildings should be located in areas with a sense of place. The synergy of a mixed-use environ-

ment—office uses alongside support uses such as restaurants, shopping areas, and club facilities—generates higher rents and better leasing. Infill or redevelopment sites in established office locations can offer the advantage of established amenities, available utilities and other infrastructure, and favorable zoning.

Suburban office buildings should be located close to freeways or roads that feed into the regional traffic system. Good access to adjacent roads is critical. Parcels located on prime highways may have great visibility, but they may not be accessible from those highways. Access for parcels located on major highways or frontage roads may be limited to side streets or even rear streets. The location, number, and arrangement of curb cuts into the parking lot can affect significantly the ease of access to a suburban office building.

Busy streets with high traffic counts may be popular with retail developers, but office developers may shy away from areas of heavy traffic. A site's topography plays an important role in project feasibility. For example, hilly sites may require extensive grading, which increases construction costs, but they may also provide excellent opportunities for tuck-under parking, which requires less excavation on a hilly site. In the case of business parks or industrial buildings, it is also important to look at the size, dimensions, and shape of a land parcel. Other factors include utilities, future expansion capability, and adjacent uses. Public approvals for office and industrial projects often hinge on traffic loading during peak hours.

### **Demand Analysis for Office Development**

Good estimates of the total demand and demand for space with different characteristics are essential. Estimating future demand is an uncertain, often subjective, exercise and analysts should always keep in mind that short-term demand trends live up to their billing as short term. Developers with the ability to discern long-term trends are better able to put together developments that stand the test of time and retain their value.

Increases in demand come primarily from growth in office-using jobs. Unfortunately, employment data are not reported in most markets in a way that allows analysts to identify which or how many jobs are located in office environments, particularly at the submarket level. Nor are the data reported in a way that allows analysts to translate employment growth into a number of square feet of demand for office space. Still, analysts can glean important information from employment projections about the makeup and strength of the local

economic base, as well as a broad understanding of the market dynamics of office space demand.

### **Space per Employee**

Market analysts often multiply the expected growth in office jobs by the estimated average square footage allocated per office employee to calculate the future demand for office space in the market area. The first step in this approach is to look at local employment patterns by industry or types of job. The U.S. Bureau of Labor Statistics (BLS) is a widely used source of data for this purpose. The BLS provides employment data for counties or metropolitan areas broken out by job categories based on standard industrial classification (SIC) codes.

All SIC-code job categories include some office-using jobs. Some, like finance, insurance, and real estate (FIRE) jobs, are strongly office based. But the BLS data do not distinguish between office jobs and nonoffice jobs. Some analysts use employment in one or two SIC codes, such as FIRE and business services, as a proxy for office employment. But this practice can produce widely inaccurate estimates of office demand. Analysts may do better by inferring from their own knowledge of the local economy the ratio of office to nonoffice jobs for each locally important job category. Analysts can gain an understanding of the makeup of a local economy by talking to major employers and other professionals who are knowledgeable about the local labor market.

Many state and local planning agencies estimate future employment levels. These estimates can be useful input in a demand analysis. The BLS data on employment growth by SIC codes do not include projections, but the U.S. Department of Commerce, through its Bureau of Economic Analysis (BEA), provides employment projections for metropolitan areas. The BEA forecasts form the basis of most state and local employment projections. A number of commercial forecasting firms offer employment projections as well. The appendix in this book lists some of these data providers.

After employment has been projected, the second step in the employment-forecast method of estimating the future demand for office space is to estimate the average amount of office space per employee. Analysts should be cautious and conservative in their assumptions in this regard. For many corporate office users, the amount of space allocated per employee is on a downward path. Many companies have cut back on space in order to reduce occupancy costs. An increasing number of companies are adopting open office space plans with fewer private offices. And

technological innovations have eliminated the need for some office jobs altogether, although they have expanded the need for space for equipment in certain instances.

Virtual office arrangements are another factor decreasing the need for office space. Various arrangements allow workers to spend less time in the traditional office, such as telecommuting, hoteling (through which the worker reserves office space only for times needed), and working on the road or at customer sites without an office at all.<sup>5</sup> At one time, the average space allocation per employee was 250 square feet, which included a proportionate share of public space, corridors, and restrooms. That figure is no longer valid, and many buildings now average less than 200 square feet per employee. The amount of

space varies significantly, however, by industry and location, and it is important to customize the figure to the specific market study.

For analysis of office space demand, the forecast of total regional demand is less important than the demand projected for the market area in which the project will compete. The analyst must clearly identify the relevant market area for a prospective project and construct as complete a picture as possible of employment trends, space requirements, and other demand factors for that market area.

The sources of demand for a proposed project generally can be segmented into two major categories: principal users and second-tier users. Principal users (a building's premium or marquee tenants) are generally large and growing firms. Potential premium

Table 4-1

### Private Sector Employers with Significant Office Employment: 1987 U.S. Standard Industrial Classification System (SIC) and 1997 North American Industrial Classification System

#### 1987 Standard Industrial Classifications

Code	Description
47	Transportation services
48	Communications
50	Wholesale Trade
60-65	Finance, Insurance & Real Estate
73	Business Services (1)
781-782	Motion Picture Production & Distribution
80	Health Services exc. 805 Nursing Facilities & 806 Hospitals
81	Legal Services
829	Schools & Educational Services n.e.c.
83	Social Services exc. 835 Day Care & 836 Residential Care
86	Membership Organizations
87	Engineering & Management Services (2)

#### 1997 North American Industrial Classifications

Code	Description
51	Information (3)
52	Finance & Insurance
531	Real Estate
5324	Commercial/Industrial Equip. Rental & Leasing
54	Professional, Scientific & Technical Services (4) exc. 5417 Scientific R & D Services
55	Management of Companies & Enterprises
561	Administrative & Support Services (5)
6114	Business Schools & Computer/Mgmt. Training
6116	Other Schools & Instruction
6117	Educational Support Services
621	Ambulatory Health Care Services (6)
6241	Individual & Family Services
6243	Vocational Rehabilitation Services
7113	Promoters of Entertainment Events
7114	Agents/Managers for Artists
813	Religious/Grantmaking/Professional Organizations

- (1) Includes advertising, credit/collection, mailing, business equipment rental, personnel supply, computer & data processing, building services.
- (2) Includes architectural, engineering, accounting, research, testing, management, & public relations.
- (3) Includes publishing, motion picture & sound recording, broadcasting, telecommunications, information & data processing.
- (4) Includes legal, accounting, payroll, architecture & engineering, design, computer, data processing, management consulting, personnel recruitment, marketing, environmental, advertising, public relations, marketing, photography, translators.
- (5) Includes employment agencies, call centers, business service centers, credit/collection, travel agents, investigators, security services, building services.
- (6) Offices of physicians & other health care practitioners, outpatient facilities, diagnostic labs outside of hospitals & nursing facilities.

tenants may be essentially landlocked in their current locations, unable to expand into contiguous space because tenants that cannot be relocated occupy adjacent floors. If contiguous building floors are essential to their operations, moving becomes their only option. Developers must ascertain the presence of large, high growth firms in their market area, and their space needs. Other potential premium tenants may be firms preferring a particular location, such as law firms, which often are drawn to buildings with good courthouse access. Complementary users (a building's second-tier tenants) generally are smaller tenants, such as public relations companies, business consultants, and others that are drawn to a location near their major clients or one that provides access to potential clients.

### Leasing Activity and Absorption

The analysis of net absorption trends in the market area can supplement and provide a cross-check for the broad-brush office-employment approach to calculating demand for office space. The absorption analysis should look at trends for different types of office space. Analysts must distinguish between net absorption and leasing activity. "Net absorption" is the change in occupied office space over a specified time period. "Leasing activity" is the amount of space that becomes leased or committed in a specified time period. Leasing activity does not account for space that has been vacated during the period, but net absorption does. A tenant moves out of 50,000 square feet of space in building X and moves into the same amount of space in nearby building Y: 50,000 square feet of space has been leased, but net absorption is zero.

Because both measures shed light on aspects of office space use, they are both relevant to the analysis. Most analysts argue that net absorption indicates the real strength or weakness of a market, whereas leasing activity indicates movement within a market area. By comparing trends in net absorption and leasing activity, analysts can reasonably describe the underlying strength and stability of an office market. For example, a market in which the rate of net absorption and the rate of leasing activity move in tandem over time is more stable than a market in which net absorption and leasing activity (or gross absorption) exhibit widely varying rates.

The market is said to be "churning" if it has a high rate of leasing activity and a low rate of net absorption. In a market characterized by churning, tenants are leaving space in one building and taking space in another, both within the market area. Although the market may seem to be growing, the amount of occu-

piated space increases little. Churning often occurs in overbuilt markets with falling rents. The availability of higher-quality space for lower rents, along with moving incentives offered by building owners, lures tenants away from their current locations.

Both office employment and net absorption are imperfect proxies for office space demand, and neither approach should be relied on alone in market analyses. When used together, however, the two approaches can provide a reasonable picture of trends in office space demand.

### Straight-Line Projections

A straight-line projection of either office employment or net absorption is a notoriously unreliable method of estimating office demand. A straight-line projection uses recent trends as the basis for estimating future trends, and thus ignores the all-but-certain appearance of the next stage in the economic cycle. Nor can an analysis relying on recent historical trends take sufficient account of the predictable industrywide and local employment changes that are likely to occur for any number of reasons.

The straight-line projections of office space demand performed by developers and investment institutions in the 1980s contributed to the steep crash of commercial real estate in the early 1990s. Market studies should look beyond actual absorption and employment trends, and consider when national and local business cycles are likely to move into new phases and what effect that phasing will have on the demand for office space in the market area.

The demand analysis must go beyond general projections of future demand to identify and assess the sources of demand for the proposed office building. This analysis should include the identification of both potential tenants and market niches that need space—typical space and other requirements. This look at the demand picture entails the following steps:

- Interviews of brokers and other real estate professionals, business organization specialists, and major employers for their perceptions of the need for additional facilities in the market and the features that would be desirable in a new building;
- A determination of leasing trends in competitive properties—including vacancy rates, lease rates, and tenant types—to understand current demand;
- A determination of the services and amenities sought by potential tenants or potential types of tenants;
- An assessment of absorption trends to differentiate between new demand and mere churning.



## Supply Analysis for Office Development

Measuring the competitive supply of office space is a less-subjective exercise than measuring demand. A supply analysis has essentially three components: existing space, likely future additions, and vacancy rates. Case study 4.1, an office building acquisition, illustrates the kinds of tables that need to be developed for office market studies.

The first step is to profile existing and proposed office space in the market area. The most basic feature of office space is its quality or class as measured by various characteristics including location, design, and amenities. Market studies should include an inventory of office space by class. It can be useful to categorize office space in the market by other property characteristics as well, such as size, style, location, lease rates and terms, ownership, tenancy (whether owner or renter occupied, whether in single-user or multiuser buildings), type and quality of building systems, and amenities included. A profile of buildings based on property characteristics not only delineates the competitive supply situation, but also provides important information about the local demand for office space and tenant preferences.

A field survey of competitive properties helps the analyst to verify published data and to gain personal insights. Building size, height, general quality, and tenant types are key factors to determine from the field survey. Some of the following building characteristics may be worth noting as well:

### Exterior Building Characteristics

- How many floors: low rise (1-3 floors), mid rise (4-15 floors), or high rise (16+ floors)? High-rise buildings tend to be more prestigious and may offer exceptional views. Is the property midblock or on a corner? Corner properties are preferable to midblock properties that may lack good views and lose the benefits of their height.
- Is access to the building and parking easy or difficult? Do turn signals assist accessibility? Tenants obviously prefer that access be as easy and convenient as possible.
- Does the building have visibility from the street or highway?
- Are surrounding uses compatible? It is preferable to be located in an office core with buildings of similar uses.
- Does the building have curb appeal? Is the building well landscaped and well maintained? The initial impression of a building can affect tenant

leasing decisions; thus, it is important that the building have a timeless quality so it will be appealing to tenants over the long term.

- What type of parking exists: surface, attached garage, or subterranean? Is parking free or, if not, what is the monthly rate? Is the parking lot at capacity or can it hold additional cars? Are cars parked in tandem? Is executive parking or valet parking available? How far do employees or visitors have to walk in the open air or is parking attached? Covered or subterranean parking is preferable to surface parking, especially in cold or wet climates.
- What type of exterior does the building have? Polished granite, glass, concrete, brick? Does the exterior have a timeless quality? How will it look in ten years when the building is being sold? The appearance of the building should fit the rent level. In addition, it is important to invest in buildings that will remain able to attract tenants and that will achieve increasing rent levels over time.

### Interior Public Space

- What is the number of elevators and elevator ratio (elevators per total square footage excluding the ground floor)? A preferred elevator ratio is one elevator per 30,000 to 40,000 square feet.
- What amenities does the building have? Some typical amenities are concierge service, a fitness center, a restaurant or deli, a conference room, dry cleaners, a card/sundry shop or other retail outlets, and banks. Smaller buildings do not have amenities in the building, but similar facilities should be located nearby. Ground-floor retail and specialty space in office buildings is often difficult to lease and should be minimized unless the market can support such amenities.
- Is the lobby a modern style or outdated? Has it been recently renovated? Is it well maintained? The image of the lobby must be appropriate for the type of tenants in the building. Today, many firms are sensitive to cost issues and therefore do not want to be in a building with an over-designed, expensive lobby.
- Are corridors modern looking? Are they wide or narrow? Spacious corridors are generally a minimum of six feet. How high are the ceilings? A preferred ceiling height is generally eight feet. Is tenant signage one consistent style?
- Are restrooms modern looking or outdated? Do they have stalls designed for the handicapped?
- Is the floor layout confusing or easy to navigate?

### Tenants and Leasing

- What types of tenants occupy the building? The analyst can get a sense of the occupants by scanning the building directory. Are tenants concentrated in a particular industry? Government and medical tenants are generally a detriment to a Class A office building. Are the tenants prestigious or upstarts with tenuous credit? It is preferable to have at least 40 percent of the building secured by tenants with strong credit, but this rule of thumb does not hold true during economic downturns. Unless an investor is interested in single-tenant buildings secured by a strong credit, long-term lease, no one tenant should occupy more than 30 percent of the square footage of a building. This criterion protects an investor from a downsizing or a large move out that would severely undermine the cash flow and viability of the investment.
- Are leases staggered so that not all of the leases roll over at the same time?
- Who is the leasing agent for the building? Be sure to note the telephone number. In addition, when the analyst is driving the market and conducting a field survey, he or she should note any vacant parcels of land that could be developed for office use, any broker signs on vacant land, or any developer signs indicating a site for future development. After the analyst returns to the office, he or she should call the brokers listing vacant land to find out its selling price and what the zoning will allow or call the developer to find out what is under construction or planned.

Tenant interviews are useful if it is possible to perform them. Tenants can provide greater insight into the issues of the building and metropolitan area. The following is a list of sample questions to ask for office building tenants:

- Why did you choose to locate in the subject building?
- What other buildings did you consider?
- Has the building met your expectations?
- Do you have any problems with the building?
- Is building management responsive?
- Does your firm need to be in this submarket? Why? What other submarkets could you locate in?
- Are you planning to renew your lease in the building when it expires? Why or why not?

Following the field survey, the analyst calls the leasing brokers for the most competitive buildings to obtain the following information:

- Current asking rents, lease terms, and any concessions being offered (such as months of free rent or higher-than-standard tenant improvement allowances that might indicate soft markets); annual escalations based on CPI or another index, if included; history of vacancies, absorption, and base rent increases over the last few years. Rents are usually expressed in terms of annual rent per square foot.
- Pass-through charges that are billed directly to tenants based on the amount of space leased, such as utilities and property taxes. Some office buildings rent space on a triple net basis, with all expenses passed through directly to tenants. Others include certain utilities and taxes in the base rent, and charge tenants only for actual increases above and beyond the initial year of the lease.
- Floor/area ratio (building space to lot area). Suburban floor/area ratios are much lower than in central business districts, where higher densities are permitted. Single-story office structures in suburban business parks typically have floor/area ratios of less than 1.0. Mid-rise buildings could have ratios of 2.0 or more.
- Parking spaces per thousand square feet of office space. As recently as the 1980s, a parking ratio of four spaces per 1,000 square feet was considered typical, but today office tenants look for more parking spaces because more workers are packed into less space. Parking availability is more important in the suburbs than in downtowns where workers may use public transportation or park in commercial lots or garages.
- Capacity of heating, ventilation, and air conditioning systems has become a very important consideration.
- Telecommunications capabilities.
- Total building size, usable versus rentable space, size of a typical floor. Usable space may be limited by columns or mechanical systems that are part of the rentable space.

The previous checklist of building characteristics is more extensive than what the analyst will usually consider. This list, however, is useful for examining an existing property under consideration for purchase, sale, lease, or repositioning.

### Sublet Space

Ascertaining the amount of space available for subleasing in a market area is an important element of the supply analysis. Such space is commonly referred to as "sublet" space. In the overbuilt markets of the

early 1990s, it was common for tenants to vacate space before the end of the lease period in order to secure less expensive or more desirable space. In many cases, large amounts of sublet space should have indicated to analysts that markets were not as strong as overall leasing data indicated.

Sublet space, even if it remains vacant, is not technically vacant. It is under lease and the tenant is still paying rent. It is, nevertheless, empty space that is available to be leased. Tenants that vacate before the end of their lease term generally attempt to sublease the vacated space. Often, space available for sublease is offered at a discount and thus is less expensive than other vacant space. The availability of large blocks of sublet space can impinge significantly on the viability of existing and proposed office projects in the market area. It is important, therefore, to include an estimate of sublet space in the analysis of the competition that a prospective project will face.

### **Vacancies**

Vacancy rate trends are another key item in the supply analysis. It is important to analyze movements in the market's overall vacancy as well as vacancy differentials within the overall market that indicate where and in what kinds of space vacancy rates are high or low, rising or falling. Are large blocks of space available for lease? Or is the supply of vacant space made up mostly of numerous, small chunks of space? How is vacant space distributed among classes of buildings? Are vacancies spread throughout the market area? Or are they concentrated in certain areas? The analyst should know whether space is leased and occupied or has a lease commitment. Often, a lender requires about 30 percent of a new office project (as much as 40 percent of an industrial project) to be preleased as a prerequisite for financing.

The analysis of vacancy trends also provides input for determining a potential project's "stabilized occupancy," which is the typical annual occupancy rate for the project after its startup period (and a key variable in assessing a project's feasibility). In the early and mid-1980s, office market analyses on proposed projects routinely projected stabilized occupancies ranging from 93 percent to 95 percent. As construction soared later in the decade and demand began to decline, however, the actual stabilized occupancies achieved by these new office buildings were well below their pro forma projections. Market studies for new developments today will have more conservative occupancy assumptions, even in markets where the overall vacancy rate is under 5 percent.

### **Demand Analysis for Industrial Space**

Like office space demand, the demand for industrial space is often projected by estimating future employment in appropriate sectors. This method often works for projecting R&D demand, which is strongly tied to space needs per worker. But the link between employment and the demand for manufacturing and warehousing space is not clear. Such space is more closely associated with products than persons. A more appropriate method for forecasting such demand is based on projecting the gross metropolitan product (GMP). GMP is a measure of the output of a local economy, and much of this output is the goods produced and stored in industrial facilities. A proportional relationship is derived between the change in occupied industrial space and the change in GMP.

Others have used a model that studies the path of goods movement,<sup>6</sup> which is particularly suited to assessing demand for warehouse and distribution space. Demand for such space shows little correlation with employment trends but is influenced by the movement of goods from the place of production to the place of consumption. Measuring the growth of goods production in weight rather than dollar value provides a way to gauge the need for this kind of space. An accurate market analysis for industrial space requires a good understanding of the distribution process.

The growth of e-commerce is having an effect on warehousing and distribution needs. The demand for industrial space may actually increase, as fewer retail outlets distribute goods, but purchases are handled directly from distribution facilities. The design of new distribution facilities will have to take into account automated shipping and tracking functions and new methods of inventory control.<sup>7</sup>

### **Supply Analysis for Industrial Space**

When the inventory for the supply analysis is compiled, properties should be categorized by type and configuration. Elements such as ceiling height, office buildout, column spacing, building depth, the number of docks and ground-level doors, and other functional components help to define the property's market. Site considerations, such as parking and the size of the truck apron, might also be important factors. Attention should be directed to those components that might give the property an advantage in the market. Air conditioning and oversized parking lots are examples of physical components that might garner a premium in market rents.

When an existing project is analyzed, a rent roll or, at minimum, a leasing summary should be reviewed. This procedure identifies tenants at the subject property and rental rates, lease terms, and other relevant factors. As with office space, most industrial property rents are quoted on an annual basis. A review of the subject property's physical characteristics reveals to the analyst how to analyze the competitive submarket. For example, should the analyst look at large, single-tenant warehouse properties with minimal office space, high ceilings, and lots of dock doors, or should the analyst look at multitenant warehouse facilities with oversized office buildout and ground-level doors? Only by understanding the subject property can the analyst answer such questions and properly analyze industrial space in the competitive submarket. Information on rents, tenants, and leases can help the analyst to position the property when current submarket conditions are studied later in the analysis. In the case of a project that is not yet built, the analyst's job, most likely, will be to recommend the characteristics that are most desirable for the market by examining comparable properties.

In addition to visiting the subject property, the purpose for touring the submarket is to examine competing industrial properties and to acquire a sense of the area's characteristics. Major points of access, transportation corridors, quality of industrial space in the area, general appearance, activity levels, and other spatial considerations should be reviewed during the site visit. It is also useful to schedule building tours with brokers and property managers active in the submarket. Such individuals are among the best sources for revealing the strengths and weaknesses of a submarket, as well as its subtleties.

### Sources of Data

The U.S. Census Bureau's *County Business Patterns* includes economic data for counties, including the number of employees and business establishments by SIC code. These data can serve as a proxy for identifying the types and sizes of tenants in a county.

Most metropolitan areas have at least one real estate brokerage firm that maintains a database of office buildings or an office building guide. Some local governments or economic development authorities maintain such information. Obtaining such a list should be the first step in identifying competitive buildings. Usually, existing data are available on rents and occupancy on a building-by-building basis. Detailed data on construction activity, both underway and planned, may be available from a brokerage or

from one of the public agencies. Office inventories are usually compiled based on net rentable area; however, some landlords may quote lease rates based on gross or usable space.

For larger markets, national research firms (such as Torto Wheaton Research and National Real Estate Index) provide historic and current market data for submarkets and property class for a fee. These reports are usually updated at least twice annually. Analysts must supplement published information with field visits to competitive properties and interviews with leasing staff.

The inventory of competitive office supply must include planned projects that may come online and compete with the project under consideration. Such data are more difficult to obtain and are less reliable than are surveys of existing buildings. Some local economic development agencies and planning offices compile lists of proposed projects and track their progress through the approval and development pipeline. Officials in these agencies are likely to know about proposed projects and should be able to provide some details. Market analysts can confirm and expand on information from public agencies by questioning brokers and the executives of construction or development firms about building plans.

National and local commercial brokerages collect and publish data on the industrial market. Industrial data is, however, less comprehensive than office market inventories. Coverage can be inconsistent across metropolitan areas or among sources, or the analyst may need to pay a substantial fee to obtain the detail needed.

- CB Richard Ellis's *Industrial Vacancy Index of the U.S.* (published quarterly) covers only facilities with more than 100,000 square feet (although information on smaller buildings is often included in market reports prepared by its local affiliates).<sup>8</sup>
- Grubb & Ellis's coverage is defined locally; in some markets, buildings as small as 5,000 square feet are included, while in others the minimum size is 25,000 square feet. Although Grubb & Ellis's national industrial vacancy reports include multi-tenant, single-tenant, and owner-occupied space, other firms cover just investment properties.
- The National Real Estate Index's rent, price, and cap rate statistics are for Class A warehouse properties only.
- Torto Wheaton Research's *TWR Industrial Outlook* covers all three types of industrial properties, providing semiannual updates of rent, space availability, and construction activity both metrowide

and for subareas. It also includes two-year forecasts.

- The Society of Industrial and Office Realtors publishes an annual overview of industrial property market conditions in both large and small metropolitan areas. This reference provides a breakdown of the percentage of industrial space that is manufacturing, warehouse, or high tech, with average rent information for each type. Recent absorption, operating expenses, and market trends are also highlighted.<sup>9</sup>

Office absorption is highly correlated with office employment. A subscription to Economy.com, WEFA, or McGraw Hill's DRI can provide historical and projected data on office employment by metropolitan area. However, if a subscription to one of the forecasting groups is too expensive, office employment can be approximated using the FIRE and 37.7 percent of Services categories from the BLS's *Employment and Earnings* publication. (See appendix for further information on data sources.)

Industrial brokers usually provide information on industrial availability, not vacancy. Because so much industrial space is corporate owned, vacant space is not always on the market. Available space is a better measure of full or partial buildings that could be acquired or leased. Manufacturing space tends to have the lowest availability among the three types of industrial buildings and shows little movement from year to year. In contrast, R&D space occupancy is the most volatile of industrial types.

Few market data sources provide industrial space information by subtypes. Most secondary market data are lumped into a single category labeled "industrial." Data portrayed in this fashion explain little about actual market trends and the performance of individual industrial property subtypes. Analyses based on such generalizations often result in flawed conclusions. Analysts often must make the best of imperfect data, but it is worth the time and trouble to identify a data source that characterizes the industrial market in the proper way.

### **The Integration of Demand and Supply Analyses**

A comparison of the current rate of net absorption of office or industrial space with the existing (and planned) supply of space gives a fairly clear picture of the overall balance between demand and supply in the market. For example, if annual net absorption in

the area has been averaging 50,000 square feet and 50,000 to 75,000 square feet of space is available, demand and supply are in balance. If, however, 100,000 square feet of space is available, the market has a two-year supply of office space; if the market contains 500,000 square feet of available space, it has a ten-year supply. This simple comparison of current demand and supply represents an expedient way of gauging the market's short-term supply/demand balance, but such a snapshot should never be relied on to predict future trends. To produce a study of real value, the market analyst must look for factors that could affect absorption of office or industrial space in the future and interpret current market conditions accordingly.

After the demand analysis has identified relevant industries in the market area and generated historical trend data for them, the market analyst must search out relevant clues by which he or she can extrapolate the future. Which local industries are poised to grow? To contract? What new office-using employers might locate in the area? Is the local government taking steps to attract certain types of industries? Are policy changes or program initiatives being considered at the federal or state level that will affect the growth of office employment or industrial-space users in the market area? Do tax or other cost differentials affect decisions in the market?

No easy and fast rules for understanding the market exist at this level. Analysts usually piece together the information they have obtained in interviews with local and regional government officials, civic leaders, employers, trade association representatives, and real estate professionals to arrive at their reasoned insights on the future of the area's commercial real estate market. In the end, a site-specific market analysis is only as good as its interpretation of the facts it so painstakingly gathers.

The main tasks in the integration of the demand and supply analyses are to determine how successfully the proposed project will compete in the market area and, specifically, to estimate what share of the competitive market it can be expected to capture. The marketability analysis and the market-share analysis are covered in the following sections.

### **Marketability Analysis**

Several of the preliminary steps involved in determining a proposed building's market competitiveness have been described earlier in this chapter. A market analysis is conducted to identify a site (or to assess the development potential of a specific site) and a

target market. As part of the market study, the specific market area in which the project will compete for tenants should be defined precisely and a detailed inventory of the market area's existing and proposed buildings should be compiled. The inventory can be used to identify competitive projects.

Developers need to compare their prospective project with the buildings with which it will compete. The proposed building's advantages and disadvantages relative to the features offered by competitive buildings are evaluated in order to arrive at an achievable rent. The assessment of how the proposed building stacks up against the competition is really a matter of judgment by the development team, but the team's opinion should be based on the findings of the market analysis.

By looking at the competitive advantages and disadvantages of the proposed property, developers can arrive at an adjustment factor—negative or positive—that weighs the position of the proposed property relative to each competitive building. For each competitive building, the adjustment factor is applied to the rent charged in order to determine an indicated rent for the proposed project. The typical (or, in some cases, average) indicated rent of all of the competitive properties is then assumed to be the rent that the proposed project can expect to achieve, the rent that competitive analysis indicates is achievable. Case study 4.3 shows how marketability can be improved by repositioning an existing R&D facility.

### **Market Share and Absorption**

The analysis usually includes an estimate of the proposed development's capture rate, or market share, so that absorption can be projected. It has already projected how much office or industrial space can be supported in the market area overall. Now the analyst must estimate the amount of the market that the prospective office project is likely to capture. Expressed as a percentage, this figure is estimated by comparing the subject project with competitive projects in terms of amount of space, location, price, amenities, special features, and strength of management. It is important to be realistic. A proxy for a building's fair-share capture rate is the share of competitive supply that it represents. This share-of-current-supply method is a good first cut at estimating a building's capture rate. A building may absorb more or less than its share depending on its competitiveness. Perhaps a location and amenities that make the building superior to the competition, or lower rents

that make it more competitive, will enable the proposed project to capture extra market share.

Another approach to fine-tuning the estimate of the capture rate for a proposed office project is to analyze how well the building meets the location, size, and other preferences of potential tenants. At this point, it is very important that target tenants and their space needs and preferences have been identified. If the project, as proposed, does not conform to the building characteristics sought by its target market; it should be redesigned to maximize its potential market share.

After a project's capture rate has been estimated, the analyst can calculate how long absorption will take. The basis for this estimate is demand projections and the lease-up experience of similar projects. Rental rates and terms should be estimated. The basis for these estimates is the rents achieved by the most comparable projects in the market area, adjusted for the proposed project's particular competitive position. Finally, stabilized occupancy, which is the typical annual occupancy rate for the project after its startup period, should be projected, based on local market conditions and the experience of similar buildings in the area. The analyst should clearly state whether absorption means leasing or occupancy pace. These various elements of the project—lease-up period, rental rates, and stabilized occupancy—together with operating expenses constitute the basic ingredients for the cash flow analysis that must be performed as part of the financial feasibility analysis.

### **Overview of Case Studies**

Three case studies are included in this chapter. Case study 4.1 is an analysis of a Class A office building nearing completion in a desirable office corridor in suburban Chicago. The consultant has been hired by an investor who wants to purchase a building that will bring a stable cash flow over a ten- or 15-year period. The purpose of the market analysis is to familiarize the investor with the market and the subject property and to help determine if the subject suits the investor's needs.

Case study 4.2 analyzes a multitenant warehouse property in the Valwood submarket of Dallas. This case study uses the annual changes in GMP and population to model warehouse-space demand in the metro area, then applies a capture rate to the submarket. The case study also projects rent ranges for the submarket.

Case study 4.3 examines the Peachtree Industrial Park, a complex of four buildings in suburban Atlanta. The owner is selling the property and needs to determine a fair market value and identify how to reposition the property to improve its value and to better attract potential investors.

## Notes

<sup>1</sup> Jo Allen Gause et al., *Office Development Handbook*, 2d ed. (Washington, D.C.: ULI—the Urban Land Institute, 1998).

<sup>2</sup> Building Owners and Managers Association (BOMA) International and ULI—the Urban Land Institute, *What Office Tenants Want: 1999 BOMA/ULI Office Tenant Survey Report* (Washington, D.C.: BOMA International and ULI—the Urban Land Institute, 1999).

<sup>3</sup> According to the Society of Industrial and Office Realtors (SIOR), roughly 59 percent of the nation's industrial inventory is warehouse space, 33 percent is manufacturing, and 8 percent is high tech. Torto Wheaton Research, which covers a smaller number of markets in greater detail, estimates that half of the nation's industrial space is warehousing, 32 per-

cent is manufacturing, 8 percent is R&D, and the balance is specialized facilities.

<sup>4</sup> Marvin F. Christensen, Bill Wisener, and Darrel J. Campos, "Attributes of Tomorrow's Warehouse Structures," *Real Estate Review*, vol. 27, no. 3 (Fall 1997): pp. 51-57.

<sup>5</sup> Thomas Davenport and Keri Pearlson, "Two Cheers for the Virtual Office," *Sloan Management Review*, vol. 39, no. 4 (Summer 1998): p. 51.

<sup>6</sup> Glenn R. Mueller and Steven P. Laposa, "The Path of Goods Movement," *Real Estate Finance*, vol. 10, no. 2 (Summer 1994): pp. 42-50.

<sup>7</sup> John McMahan, "The Impact of E-Commerce on Real Estate," *Real Estate Issues*, vol. 24, no. 4 (Winter 1999): pp. 1-11.

<sup>8</sup> In the aggregate, the *Index* covers more than 5 billion square feet of industrial space. The largest market, Los Angeles, has 2,800 buildings, or nearly 5 percent of all the space in the United States in structures with at least 100,000 square feet.

<sup>9</sup> See Society of Industrial and Office Realtors and Landauer Associates, Inc., *Comparative Statistics of Industrial and Office Real Estate Markets*, published annually, Washington, D.C. Local brokers provide the information; more than 100 market areas are covered.

# Retail Development

**T**he retail market analyst must understand the real estate as well as the retailing business and its customers. Retail real estate includes both shopping centers and freestanding stores. The ULI definition of a shopping center is “a group of commercial establishments planned, developed, owned, and managed as a unit.”<sup>1</sup> Store space, whether in malls, strip centers, or on Main Street, is most commonly tabulated as gross leasable area (GLA)—the total floor area that a tenant occupies exclusively, including any space used for storage or offices.<sup>2</sup>

The U.S. Census Bureau and the International Council of Shopping Centers (ICSC) classify stores in two main groups: GAFO and convenience. GAFO is an acronym for stores selling general merchandise (discount and conventional department stores), apparel and accessories (including shoes), furniture and home furnishings (including electronics), and “other” (specialty shops selling books, toys, luggage, jewelry, or sporting goods). Convenience stores include supermarkets and other food stores (such as bakeries or butcher shops) and drugstores. Home improvement, hardware, and building supply stores are often classified with convenience stores.

Although much of America's store space is now found in shopping centers, freestanding retailing (in individual buildings or street-front business districts) provides additional competition. Well-capitalized retail chains are often able to build their own stores—and attract customers—without being in a shopping center. Although they can benefit from being close to other shopping attractions, freestanding stores usually enjoy lower rents. Freestanding retailers do not have to pay for common area maintenance, mall

marketing, and management. Also, some chains want exclusive control over store siting, design, and parking, which is not always possible in a multi-tenant shopping center. Traditional neighborhood business districts, sometimes called “town centers” are enjoying a revival. Compact, pedestrian-oriented environments attract both local residents and visitors, especially in upscale neighborhoods.

Available data on retail space and sales trends focus on large malls, but it is important to remember that more than 70 percent of shopping center space is found in centers with less than 400,000 square feet such as small convenience centers, as well as neighborhood and community strips. (See Figure 5-1.) In 1999, only 730 centers had more than 800,000 square feet and only 14 new centers of this size opened around the country in 1999. Many reasons exist for the relatively small number of big malls.

- They require many years of advance planning, including a lengthy (and often acrimonious) public approval process.
- They are more difficult to finance than smaller centers.
- They are rarely finished within two years of ground breaking. General economic conditions, as well as the financial stability of key tenants, can change dramatically during that time frame.
- Most markets are already served by regional malls and cannot support additional major malls.

On the other hand, small centers are comparatively easy to plan, finance, and build. More often than not, market analysts are asked to evaluate proposed new



neighborhood and community centers or to determine whether expansion or renovation, or both, of an existing center makes sense in light of the market's demographics and competition.

## Types of Shopping Centers

ULI and the ICSC describe seven key types of shopping centers. Each consists of "anchor tenants" (bigger stores that draw shoppers) and "in-line" or

"mall shop" space (small tenants, usually a mix of national, regional, and local stores and service businesses).

1. *Neighborhood centers* sell convenience goods (food, drugs, cards, and sundries) and provide personal services (dry cleaning, hair and nail care, travel agent, and video rental) that meet the day-to-day living needs of the immediate area. Takeout food and small sit-down restaurants are also common in neighborhood centers. They tend to be smaller than 100,000 square feet in size, but can range from 30,000 to 150,000 square feet. Usually anchored by a supermarket, larger neighborhood centers serve a two- to three-mile radius and need ten to 15 acres of land, including parking.

2. *Community centers* also provide for daily necessities, but add more apparel and specialty store space. Key tenants are usually a supermarket and a discount department store. Home improvement stores, hardware, lawn and garden, gift items, banks, and larger eating establishments are also featured in community centers. A typical community center is 150,000 square feet, but may range in size from 100,000 to more than 300,000 square feet and occupy 30 or more acres. Trade areas range from three to six miles.

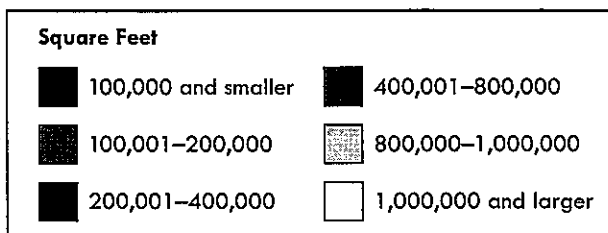
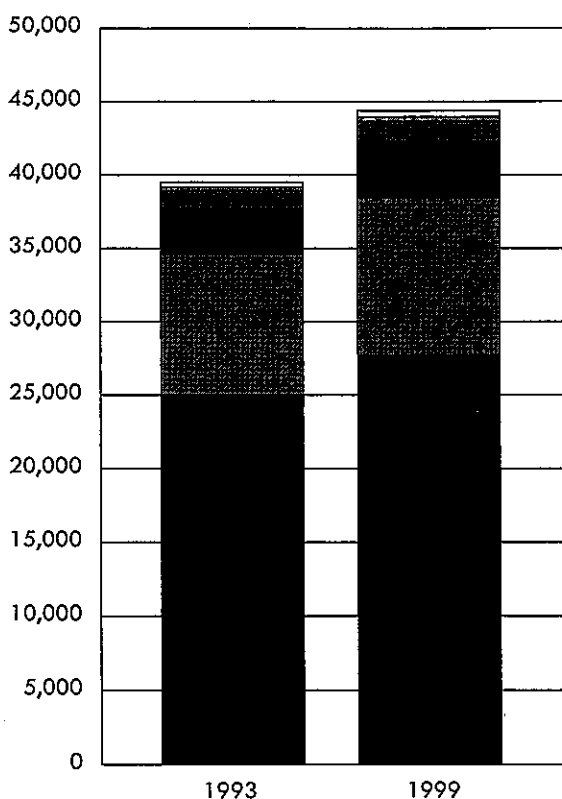
3. *Power centers*, developed in large numbers between the mid-1980s and late 1990s, are also known as super-community centers. They range in size from 250,000 to more than 1 million square feet, and offer at least three "big-box" or "category-killer" stores, each having at least 25,000 square feet of space. Such stores offer in-depth merchandise selection at attractive prices. Less than 20 percent of power center space consists of small stores; some have no in-line space at all. These open-air centers prefer locations near large malls and draw shoppers from a radius of five miles or more.

4. *Regional centers* focus on general merchandise, apparel, furniture, and home furnishings. They are usually enclosed, with two or three department stores. They may have movie theaters, a food court, and restaurants. Typical size is 400,000 to 800,000 square feet. Regional centers draw 80 percent of their sales from within ten miles.

5. *Super-regional malls* have at least 800,000 square feet of GLA, three or more department stores, and a range of entertainment offerings. A typical size is 1 million square feet, but the largest malls are closer to 2 million square feet. Each department store has at least 100,000 square feet of space. Many super regionals need more than 100 acres of

Figure 5-1

### Number of Shopping Centers by Size, 1993 and 1999



Source: National Research Bureau Shopping Center Database and Statistical Model.

land. In densely populated areas, their trade areas can be as small as five miles, but in typical suburban locations, they draw from ten miles or more.

6. *Outlet centers* are collections of discount stores directly operated by manufacturers. They sell out-of-season items and production overruns. Many outlet centers also include discount stores or close-out operators. Most are single story, open-air strips, but some use renovated older buildings. They are usually less than 400,000 square feet with no traditional anchor tenants.

Originally, factory outlets were limited to tourist destinations and highway locations far from regional malls. (Full-line department stores did not want vendors to sell directly to their customers at lower prices, and vendors were willing to comply.) Outlet stores are now locating at the fringe of large metropolitan areas. Some apparel manufacturers now produce goods especially for their outlet stores.

7. *Value-oriented hybrid malls* combining large discount and off-price anchors with smaller factory outlet stores and themed entertainment are a special case. The largest such center, Sawgrass Mills in suburban Fort Lauderdale, Florida, opened in 1990 and now contains more than 2 million square feet of space. Since 1990, however, the trend has been away from such large centers, and newer ones are closer to the 1 million-square-foot range. A good value-oriented hybrid mall can draw shoppers from as far away as 60 miles, but its primary trade area is typically within a half-hour's drive.

## Store Mix in Shopping Centers

In a regional or super-regional mall, the full-line department stores are referred to as the anchors. Anchors might also be entertainment centers or large specialty stores. Most regional or super-regional malls have three or more anchor tenants. The anchor chains often design and build their own buildings, executing a ground lease with the mall owner. Some anchor stores own their land and a portion of the parking lot. The arrangements could be different for each anchor in a given center. (Over time, the percentage of department stores that own their buildings has increased.) As a result, it is important to understand whether sales statistics include the department stores. Some mall managers report sales for an entire center. Others report sales only for space owned by the mall, covering only in-line or mall shops.

A combination of operating economics and shifting consumer preferences dictates a shopping center's desired tenant mix. In newer super-regional malls, anchor tenants account for 50 to 70 percent of total GLA. Although mall shops pay higher rents per square foot than anchor tenants do, leasing agents find it increasingly difficult to find successful credit tenants for smaller store spaces. And as independent department store chains continue to be acquired by the largest operators (notably Federated, May Company, and Dillard's), older regional malls may find themselves with empty anchor space. Today, it is not at all unusual to find discount department stores or big-box category killers taking over vacant anchor space in enclosed malls.

ICSC statistics indicate that family apparel stores (such as Old Navy and the Gap), family shoe stores, and furniture and home furnishings stores (such as Crate and Barrel and Pottery Barn) are occupying an increasing share of mall shop space. At the same time, the proportion of space devoted to women's ready-to-wear and men's and boys' shops is declining. Among non-GAFO tenant types, entertainment—in the form of theme restaurants and ever larger multiscreen movie theaters—has become more important, whereas drugstores are moving out of regional malls. (In fact, the pharmacy chains' newest prototypes are freestanding buildings located on strip-center outlots where they may feature drive-up prescription windows that cater to time-pressed customers.)

## Retail Market Analysis

With the emergence of new types of shopping centers and retail tenants, the market study is not as simple as it once was. What was once primarily a quantitative study of retail space needs has now become heavily qualitative, relying on the kinds of survey techniques described in chapter 2. In all situations, however, the developer must be sure the market can absorb the increase in retail space that is being proposed. Success may require providing a new shopping center type, a more up-to-date merchandising mix, a more current design concept, or stronger tenants.

Measuring a project's market potential is the first exploratory step in determining the feasibility of a shopping center. The developer's first aim is to match the location, size, and composition of the center to the needs of the trade area. To do so, the developer usually tries to obtain an accurate economic analysis of the trade area, based on a market survey, from

which he or she can derive a tentative plan for a shopping center.

A shopping center cannot generate new business or create new buying power; it can only (1) attract customers from existing businesses within or beyond the trade area that are not meeting market expectations because they are obsolete or poor quality; (2) fulfill a demand that has not been met within the market area; or (3) capture the increase in purchasing power that results from population, household, employment, or income growth. New retail space can cause a redistribution of business outlets and consumer patronage, but it cannot create new consumers. A new center can, however, alter consumers' shopping habits. Each new center must be justified by gauging the purchasing power available to it in light of the nature of its competitors.

The following key elements are typically part of a comprehensive market study for a shopping center. The extent to which all of these elements are examined depends on the resources available, the complexity of the proposed center, and the level of sophistication desired. Although household expenditure data and sales figures for competitors should form the core of the analysis, those statistics are the most difficult to obtain, and the analyst will need to rely on a combination of available data and estimates based on experience.

Demand analysis includes the following elements:

- An economic base analysis for the metropolitan area showing general characteristics of the market, including overall economic trends, employment trends, projections of economic activity, and growth patterns;
- Delineations for primary, secondary, and peripheral trade areas and accessibility patterns;
- Population, household, and employment growth trends and projections for each trade area, as well as household characteristics such as household type (families, singles, etc.), lifestyle data, and ages, including trends and projections;
- Income characteristics for each trade area, including household, family, and per capita totals, and disposable income trends, purchasing power, and future projections (today, three year, and five year);
- Demographic data for any sources of patronage other than the resident population in the trade areas: tourists, workers, and convention and business travelers;
- Expenditure patterns and trends by type of goods and services in the trade areas.

Supply analysis includes the following elements:

- Location, characteristics, and sales figures of competitive retail centers, by type of center, in the trade areas;
- Retail space availability, absorption, and sales trends by retail categories in the trade areas;
- Characteristics and status of proposed and planned retail developments in the trade areas, as well as availability of other vacant, zoned sites that could likely become competitive retail development;
- Estimated market share (capture rate) and sales per square foot, and recommended characteristics, anchors, and sizing of the center or centers, depending on the scenarios being considered.

In addition, a retail analyst may investigate other indicators of future market-area growth potential, such as land availability and costs for housing, sales tax revenue growth, and bond programs for road and utility infrastructure.

Defining the trade area for retail development is based on road and transit access (or sometimes pedestrian access) and is limited by distance, travel time, and the location of similar competitors. A demographic study of the supporting population's income and composition will decide the type of retail outlets in demand in the trade area. The demographics and other characteristics of the trade area's population will strongly influence the tenant composition. Income levels play a major role in shoppers' choices. Do major segments of the population consist of families or singles, blue-collar or professional workers, college-educated young people, aging baby boomers, or retirees? Do households own their homes or rent? Accurately analyzing population traits and any changes in the composition of the population is of paramount importance in evaluating the feasibility of any retail location. The number, composition, density, growth rate, income, expenditures, buying habits, and lifestyles of the population can be translated into market potential. Much of this information can be extracted from census data (including metropolitan area supplements), sales tax reports, consumer expenditure data compiled by the Bureau of Labor Statistics, statistics gathered by the jurisdiction's planning and economic development offices, and—usually the easiest and most cost-effective—market area data purchased from vendors like Claritas or CACI. Much must be interpolated and evaluated, however, and many assumptions must be made.

## The Importance of Key Tenants

Seasoned developers know the trade area characteristics that suit the type of center they want to build. But until developers know what key tenants are obtainable, they can only surmise the type or size of center that may be feasible. For example, if the top-volume supermarket chain operating in the area is not represented in the vicinity of the proposed center, and that chain is interested in striking a deal with the developer, then a certain pattern of success can be projected with some confidence. In contrast, if the major volume-producing chains have already established stores in the vicinity, leaving only poorer producers available for the proposed site, the size of the center, its success, and other factors will be evaluated differently. Only someone well versed in leasing will be able to resolve the selection of key tenants. For a regional shopping center proposal, the strength of the key tenants interested in the site selected determines the size, character, and success of the center and even the price that can be paid for the land.

In retail development, the anchor tenants are essentially the customers; they are comparable to the homebuyers in a residential development. Just as the residential analyst identifies segments of potential homebuyers, it is often up to the retail market analyst to identify potential retail tenants. What anchor tenants are not already represented in the market area? Which ones are looking to expand in the area? Which ones would be appropriate for the proposed center and suitable for the target market? The experienced retail analyst is familiar with the expansion plans of national and regional chains and understands what they look for in trade area demographics, which other tenants they like to be near, and what space requirements they have. Several trade publications provide useful information. For example, each listing in the *Directory of Leading Chain Stores* gives the number of new outlets planned for the year, the standard store size, types of locations preferred, and estimated sales figures.

A developer must be equipped with hard data to interest prospective tenants, to identify the site, to sketch the proposed plan, to satisfy the community, to obtain zoning approval, and to secure financing. The end result is matching the location, size, and composition of the center to the demands of the trade area. However, the market study is analogous to the chicken and egg conundrum. A potential key tenant will not be interested in a center until a market analysis has been completed, but a thorough analysis cannot be made until the kind of key tenant that the trade area will attract is known. As a consequence, two

types of analyses must occur simultaneously: one is to interest potential key tenants in anchoring a prospective center; the second is to determine the number and types of customers who may be brought to the center. The customer draw influences the volume of business that can be expected by other major and supplementary tenants.

Obtaining commitments from major tenants is fundamental to determining project type and size, estimating project costs, and framing leasing arrangements with other tenants. Such commitments are key to the economic feasibility of a project. Without key tenants, no shopping center—neither a small neighborhood center nor a regional center—can materialize. Although specialty centers often do not have traditional anchor tenants, tenancing is still crucial because a cluster or group of tenants probably will function as the anchor tenant.



Dove Whitcomb/RTKL

**Citrus Park Town Center in Tampa, Florida, includes 1.1 million square feet.**

Pursuing and choosing appropriate anchor tenants requires a clear understanding not only of the type of store that will benefit the center but also of locations that such tenants seek and will accept. A good location for one type of retailer may not be a good location for another. For example, a power center located on a commercial strip is appropriate for a destination-type tenant such as a home improvement warehouse. A specialty department store, in contrast, needs to be in a regional center, surrounded by other specialty stores. Each center's ambience, character, and level of finish is also quite different. Upscale retailers want to be located in a well-lit, attractive mall of high-quality design and finishes. Home improvement stores are more concerned with ease of entrance, egress, loading, and overall vehicle access and convenience. Perhaps most important, the location and type of center will have a strong impact on a

retailer's drawing power, sales, and rent structure. Anchor tenants have a very clear understanding of the types of locations and shopping center concepts that will meet their requirements, and a well-conceived market study makes these distinctions and requirements clear.

When a retailer considers a new market, reevaluates existing stores, or analyzes new or existing markets, two questions arise: How many stores of this genre can the market support? What is the minimum number of stores needed to gain a foothold in the market? Often, the first retailer in a market will capture enough of the market potential to thwart additional competition until sufficient growth allows a second store, either the first retailer's or a competitor's. Additionally, many major retailers are public companies, which find that embarking on an aggressive expansion program is the only way to maintain the corporate objectives of continued expansion and earnings growth. Last, a retailer's distribution center may be underused or an investment in some new technology may require spreading the cost to all the existing stores in the chain; the more stores, the lower the cost per store, even though some stores may be marginal performers.

Big-box tenants, which provide the anchors in power centers and community centers, are a special case. Their corporate goal is to drive out competition altogether—hence the name “category killer.” It is not uncommon for these stores to be built in such profusion that they saturate a market and eliminate the competition, which leaves large vacancies in the least-competitive centers. Having won the competition, the winning big-box chain may then close some of its own stores that had been built solely to establish market dominance. As a result, when developing a power center, choosing the strongest anchors as tenants is particularly important. (See ULI's *Developing Power Centers* for a detailed description of tenants in power centers.)<sup>3</sup>

## Trade Areas and Market Segments

The character of a prospective trade area and the nature of the competition within it will shape the character of a shopping center, including its type, quality, and tone. The trade area traditionally is the geographic area that provides the vast majority of the steady customers necessary to support a shopping center. The delineation of trade areas is more complex than in the past because of the variety and volume of shopping centers already present in most markets. It is further complicated by the existence of multiple consumer markets that are attracted to a

center by their affinity for the type of goods sold and the environment in which they are sold, rather than because the center is located within a prescribed distance of their home or workplace. Trade area boundaries are determined by a variety of factors, including shopping center type, accessibility, physical barriers, location of competing facilities, and driving time and distance limitations. Defining a trade area is never as simple as drawing concentric circles around a potential site although potential retailers often want to know the statistics in terms of “rings” to screen potential locations.

Because new shopping centers do not create buying power, they must attract existing customers from their trade areas and capture a portion of new buying power as those areas grow. Hence, the extent of the area from which a new center can be expected to draw most of its customers, whether they are residents, workers, tourists, or business travelers, must first be established. Within a shopping center's trade area, customers closest to the site patronize the center most frequently, with customer influence diminishing gradually as the distance increases. Trade areas are usually divided into two or three categories or zones of influence. The following general guidelines should be modified depending on the type of center and other factors:

- The primary trade area is the geographical area from which the center will derive its largest share of repeat sales. This area typically extends to 1.5 miles for a neighborhood center, three to five miles for a community center, and eight to 12 miles for a regional mall. Driving time within the primary trade area ranges correspondingly from five minutes to 30 minutes, and 70 to 80 percent of the center's regular customers are drawn from this area. In denser areas like older suburbs or urban areas, the distances can shrink by as much as 50 percent. Some newer specialty centers, such as entertainment centers and off-price megamalls, have much larger trade areas and may draw from an entire metropolitan area. Some outlet malls actually derive the majority of their patronage from tourists passing through or from day-trippers.
- The secondary trade area generates from 15 to 20 percent of the total sales of the average shopping center. The extent of the secondary trade area is heavily influenced by the existence of similar centers nearby and, as a result, the extent of secondary trade areas varies widely depending on center type and size, as well as on the competition. For the largest centers, the secondary trade area

may extend three to seven miles beyond the primary trade area.

- The tertiary or fringe trade area forms the broadest area from which customers may be drawn. A small but sometimes significant share of a center's customers may be drawn from tourists and other travelers who do not live in the market at all. This is particularly true for large specialty centers, downtown centers, factory outlet centers, and entertainment centers. Although customers in the tertiary trade area must travel greater distances, they may be attracted to a center because it is more accessible or it provides special merchandise, greater parking, more stores, better value, or higher-quality goods or it has a more attractive ambience than closer centers. For the largest centers, driving time from the tertiary market area to the site can be an hour or more, extending 15 miles beyond the primary trade area in major metropolitan markets. In smaller markets, or rural areas, it may extend as far as 50 miles or more.

Geographic distance and travel time must be differentiated. The competitive relationships among retail areas largely control the movement of shoppers in an urban area, and this situation can vary widely. Distance alone is therefore not a reliable criterion for establishing the extent of a trade area. In addition, a shopping center's trade area may extend farther in one direction than in another. Natural barriers, such as lakes, rivers, hills, parks, and other open space or undevelopable land, as well as constructed barriers or psychological barriers such as railroads, freeways, and large institutional uses, can act as boundaries to the trade area.

The size of a trade area also depends on a site's accessibility from streets, highways, and transit stops, where relevant. Travel times should be set by actual trial runs over key access routes, with the runs made during peak and off-peak times and under weather conditions typical of the area. Driving times, traffic lights, roadside hazards, and barriers are all factors in measuring accessibility. Any proposed changes in existing routes must also be considered.

If a factory outlet or off-price megamall is being considered, the market analyst generally should survey a larger trade area than if a traditional center of the same size were being considered. Similarly, if a downtown entertainment center is proposed, the market analysis should reflect the fact that the center will draw from far beyond the primary trade area. An entertainment center will draw heavily from metropolitan area residents, downtown workers, business

travelers, and tourists. Further, the market analysis for such a center should also take into account the drawing power of other downtown anchors and attractions, such as museums, sports facilities, and historic sites; the overall character of the downtown environment (in terms of appearance and safety); and how well the proposed center meshes with this environment, because all these factors can directly affect the center's potential to succeed or fail. The tradeoff is that a large trade area usually means smaller capture rates.

Using geographic information system (GIS) imagery and readily available software programs, a map of the trade area can be plotted easily on the basis of geographic coordinates. Such a map puts into perspective the current and proposed access routes, the population density of developed areas, any commercial locations and competitive facilities, and the topography and land use features. The availability of GIS technology allows an analyst to easily test different scenarios, trade area sizes and configurations, and assumptions to determine the optimum type and size of shopping center to be developed. Many major retailers have been using GIS as a tool for site-selection strategies. GIS enables retailers to examine sites objectively and quickly. Variables that can be weighed include census and traffic counts, household income, and competitors' locations.

## Purchasing Power

The income level within the trade area is critical to the success of a proposed center in terms of total dollars available but, more importantly, in relation to disposable income by retail categories. Disposable income estimates for households in the trade area can be derived by applying a factor of consumer expenditures to household income figures, or estimates can be purchased from one of the private data providers. The percentage of income spent on retail purchases varies by income, as does that share of income that is disposable. The Bureau of Labor Statistics indicates how much households (BLS uses the term "consumer units") spend by income group for each major category of goods and services: food, food services, general merchandise, clothing and accessories, shoes, home furnishings, home appliances, building materials, hobbies, gifts, jewelry, liquor, drugs, automotive parts and accessories, and a range of personal services. Potential consumer expenditures in each of these categories can be estimated from the per household purchasing power available in the trade area.

The key factor for determining demand for retail is the total number of people multiplied by the aver-

age per capita expenditure within each retail category, which yields the total sales potential of an area. A comparison of the total potential retail sales and the total actual sales in existing retail areas shows whether excess purchasing power is available that either is not being spent or is being spent in surrounding trade areas. Purchasing power that leaves the local market area is often called "leakage." In either case, such a situation clearly indicates unmet potential for new retail development. Even without excess potential, there may still be an opportunity for new retail activity if some of the existing retail stock is not meeting the demands of the market. Given the rapidly changing demands of consumers, and the large stock of older retail space in many regions, obsolete space is increasingly common. Estimating the amount of uncaptured trade potential, the expenditure potential that can be drawn from obsolete space to the proposed center, and the variation in expenditure patterns by different income groups will help to determine the size, type, and development concept of the proposed center.

In growing trade areas, it is not uncommon for centers to be built that exceed the size needed to meet current demand. Such centers depend on the continued growth of population and purchasing power for success. In such cases, the area's future purchasing power must be carefully estimated and factored into the area's total available purchasing power. The full sales potential of centers that rely heavily on future trade area growth may not be reached for a decade as the market matures around them. Thus, the market study must take into account the center's anticipated underperformance in the early years to reap the benefits when the center and its market reach maturity. Developers of new communities in isolated fringe areas may have to construct some convenience retail facilities before the size of the market fully justifies them in order to be able to market the community. Potential homebuyers need to see that basic goods and services are available before deciding to move into a new community.

The risk increases if a center is located too far on the leading edge of growth or is too aggressive in its projections of purchasing power. National economic trends and cycles can slow or stop growth for years, rendering carefully made projections inaccurate. Given the increasingly competitive nature of the shopping center industry, entry into the market more often requires riskier and earlier decisions, and developers must secure a site that will benefit from future trade area growth and beat the competition to the market.

### **Inner-City Communities**

Many developers and retailers perceive that doing business in inner-city neighborhoods is risky and unprofitable. Yet, the untapped market potential of these communities is vast. Lower incomes are offset by high population densities, yielding greater aggregate buying power in a concentrated area than in most suburban neighborhoods. Further, studies suggest that retail spending rates are proportionally higher for inner-city residents than for suburbanites. And because few competitors exist, capture rates are likely to be considerably higher for retailers that do enter inner-city markets. The traditional ways of collecting and measuring retail market data tend to underestimate the potential of these communities for several reasons.

- Most data are based on the U.S. Census and Consumer Expenditure Survey data. These sources tend to undercount low-income households and their spending power. For example, such statistics do not include the unreported income (for babysitting, home repairs, and other informal business activity) that makes up a large portion of household revenues.
- Because retailing is so minimal in inner-city neighborhoods, little data is available on sales. Also, the lack of existing retail options leads to considerable purchasing power leaking into wealthier areas with better retail facilities. Statistics do not accurately measure this phenomenon.
- Purchasing patterns differ among the various ethnic communities. These specialized niche markets are just beginning to be studied, understood, and targeted by retailers.

In 1998, a national study of inner-city shoppers found that inner-city shoppers actually spend more on certain goods than their suburban counterparts.<sup>4</sup> Many companies that have developed outlets in inner-city locations have found success. For example, McDonald's estimates that their volume in inner-city Los Angeles exceeds their national average by over 25 percent.<sup>5</sup> One key to success is to understand the market niche and its buying patterns. A representative of Home Depot, which has opened stores in inner-city Chicago, New York, Los Angeles, and Denver sums it up: "We don't sell riding lawn mowers at inner-city locations."

### **Forecasting Sales**

A new shopping center will not attract all the business in its trade area (primary, secondary, and peripheral),

but it will draw on three sources: patrons from existing stores in its trade area; customers seeking goods and services currently not offered in the trade area; and, in the future, new residents, workers, tourists, and business travelers. The portion of spendable income that is unsatisfied by what is currently offered reveals the extent of potential sales that are leaking to other communities.

The increasing complexity of shopping centers combined with a multiplicity of overlapping trade areas requires that the analyst use multiple methods to estimate potential sales. Thus, the analyst can project the range of anticipated sales at the proposed center, and the developer can plan for different scenarios using expected, lower-than-expected, and higher-than-expected sales. Several ways of estimating sales are presented in the following paragraphs.

A number of computer programs exist that can help forecast sales volume for individual retail stores. In some cases, they rely on an analog model in which market share for a new addition is compared with existing stores having roughly similar site and trade area characteristics. Using a regression model to project new-store sales, existing-store sales can be adjusted by factors expected to influence sales at a specific new location. Other, simpler methods bracketing estimated potential sales volume can also be used. First, a retailer may compare sales per square foot of other stores in its chain and assume a similar productivity per square foot for a new store, adjusted for variations in trade area characteristics. Second, a retailer may estimate the volume achieved by its competitors in the trade area and then redistribute those sales based on its entry into the market. Third, a retailer may estimate market share on the basis of market shares achieved in other comparable locations.

Several methodologies historically have been used to determine the viability of retail facilities. The choice of which model to apply rests partly in the underlying motivation of the potential consumer. If the trip purpose will be shopping—that is, to acquire needed goods and services—some variation of a gravity model may be useful. If the purpose is recreational shopping combined with entertainment activities—for example, to see a movie, to enjoy lunch or dinner out, or generally to be entertained—a comparable project/per capita analysis is more appropriate.

### **The Gravity Model**

The gravity model combines store sizes and geographic-distance relationships. Reilly's Law of Retail Gravitation, formulated in 1929 by William J. Reilly at the University of Texas, states generally that

when two cities (or retail centers) compete for retail trade, the breaking point for the attraction of such trade will be more or less in direct proportion to the population of the two cities and in inverse proportion to the square of the distance from the immediate area of each city. In effect, this law states that people will travel to the largest shopping center most easily reached, assuming the centers offer the same types of goods and services, except in the case of neighborhood centers, where customers are most interested in convenience, not size.

### **Experience-Based Models**

The gravity model has major weaknesses, because where people shop is determined by far more complex factors than the location and size of a center. Store quality, image, ambience, prices, and customer service are some of the many factors that draw customers independent of size and distance. Increasingly, the synergistic effects of the center's multiple stores, services, and entertainment attractions are what draw shoppers, because most people do not make a separate trip for each need. This phenomenon is the "bundling effect," and the gravity model does not lend itself very well to analyzing that effect. Estimating the bundling effect is very difficult, except through past experience with similar retailing concepts. For such analysis, one must rely on a sophisticated understanding of how consumers behave, how strongly various types of anchors attract customers, and which mix of retailing concepts and specific tenants have the strongest and most long-lived appeal. A better methodology is one that bases projections on experience at comparable retail centers.

The projection of potential sales volume at a new shopping center presupposes a clear understanding of other shopping centers against which it will compete—both existing and planned. They include suburban shopping centers within and beyond the trade area, retail facilities in the central business district(s), and street-front retailers throughout the trade area, the last of which might exercise a strong though varying influence on shoppers throughout a metropolitan area.

In the past, clear tenant distinctions existed among shopping center types, but since the 1980s shopping center types have become less distinct from one another and tenants that used to be found only in regional malls are increasingly found in other types of centers and vice versa. For example, urban street retail is thriving again in some locales and drawing major chain retailers that once considered only regional mall locations. In addition, new types of



hybrid shopping centers and others filling newly identified niches are emerging—even in markets that by traditional measures are saturated with retail space. Older centers are being repositioned as home-furnishing centers with tenants that feature furniture, linens, shades and blinds, lighting, and so on. Sales at these centers will depend on some existing centers' inability to meet the changing demands of today's consumers or retailers, with the result that some of their business will be cannibalized by emerging centers. Case study 5.3 is an example of experience-based modeling used to determine the potential of a new entertainment retail center.

## Location Decisions

Location is of paramount importance in the success of all shopping center types. The site must qualify by virtue of its trade area characteristics, the income level of the households in the area, competition, highway access, and visual exposure. Location and access are interrelated but separate aspects. The site must be easy to reach and its roads must have the extra capacity to avoid congestion during periods of high traffic volumes. The site must be easy to enter and safe to leave for customers and employees, or it must be able to be modified to make it so. Ideally, the site also should represent an impregnable economic position. Its superior access, greater convenience, better merchant array, and improved services should make it impractical for another similar project to be developed nearby.

Recommended distances between shopping centers cannot be precisely established either for centers of the same type or for centers of different types. After all, it is not mere distance between centers, but population density, customer convenience, accessibility, and diversity of merchandise that count. For example, multiple convenience and neighborhood centers can operate successfully within the trade area of a regional center or even be located next to or across the road from it. Likewise, power centers and other types of community centers often are developed across from or next to regional centers to tap the already established shopping patterns of the regional center's customers. Such coexistence is possible because the two types of centers offer distinct ranges of merchandise. Shoppers at a neighborhood center want convenience in buying everyday goods and services, whereas customers of the regional center are primarily comparative shoppers who are looking for and comparing general merchandise in terms of price, quality, size, color, and style.

## Sources of Data

The trade area's population and projected growth are key determinants of a proposed shopping center's viability. Secondly, the composition of the population according to age, income levels, and family and household sizes is helpful in refining the center's characteristics. The U.S. Census of Population and Housing (taken each decade) and the Census of Retail Trade (conducted every five years as part of the economic censuses) offer basic statistics. (See appendix for specific reference works and sources.) Projections for the trade area's population are often based on estimates for metropolitan area zones made by various planning agencies. It is important to understand the underlying assumptions in the population projections because they often vary depending on source and methodology. The market analyst can use them to create an independent assessment of the market's growth potential.

Because the retail development industry has become much more complex and retail centers are being targeted to increasingly specific market segments and niches, the need for timely, accurate, and sophisticated demographic data has increased significantly, and firms specializing in demographics and psychographics have become an important source of data. Many of those firms offer sophisticated analyses, including the use of a statistical technique known as "cluster analysis." These demographic groups are based on lifestyle and psychographic information (as well as basic age, sex, and income data) in recognition of the fact that people with different lifestyles shop differently.

Statistics on the physical characteristics and market performance of shopping centers are more widely available than for freestanding space or street-front retailing.

- Every two years, ULI's *Dollars & Cents of Shopping Centers*<sup>®</sup> provides information on sales performance by size and type of center (and for individual store types), based on surveys of more than 1,000 U.S. shopping centers. From time to time, ULI also prepares reports on specialty centers such as high-end fashion malls or downtown retailing in mixed-used projects.
- The ICSC reports monthly mall shop sales for regional and super-regional centers. It also publishes annual summaries and special reports on sales trends, tenant mix, and other aspects of regional mall operations.
- Shopping center directories (national and regional) are published by Chicago-based National Research

Bureau (NRB) and are available on CD-ROM and in paper copy. Centers are listed by state, metropolitan area/county, and municipality in alphabetical order. Descriptive information includes center size and type; anchors and smaller tenants; year built/renovated/expanded; and contact names for owners, managers, and leasing agents.

- NRB also publishes national and regional statistics on the number of shopping centers, average size, and sales per square foot in six size categories. It also reports the number of new-center openings each year.
- Commercial brokers, local chambers of commerce, newspapers, and business journals often prepare lists of the larger shopping centers.
- Retail tenant directories provide information on retail tenants and their needs.
- The summer issue of *Stores* magazine shows sales figures for all major chain retailers.

Although the NRB's shopping center directory is updated every year, tenant mix changes frequently and new competition is always being added. Any shopping center lists or directories should always be checked in the field. Follow-up telephone contacts with center managers or leasing agents will be necessary to learn about future expansion or renovation plans and anticipated changes in tenancy, as well as rent levels and common area maintenance charges.

In addition to those private sector sources, the U.S. Census Bureau publishes monthly and annual statistics on retail sales nationally and for a selected number of large metropolitan areas on a yearly basis. These estimates are based on store sampling and do not distinguish between freestanding stores and mall tenants. Sales are tabulated by SIC (Standard Industrial Classification) code.<sup>6</sup> Additional retail sales and establishment information can be found in publications from the Census of Retail Trade, conducted every five years. State information on sales-tax receipts for municipalities is often used as a proxy for retail sales and can be compared on an annual basis.

## Shaping the Character of the Center

After the trade area has been drawn and the potential retail sales have been projected, the character of the proposed center begins to take shape. Developers typically specialize in certain center types, and the most successful of them develop long-term relationships with favored anchors and other key tenants. The advantages for developers are that they understand

how these tenants do business, what kind of deals they are looking for, what their location and business requirements are, and under what circumstances they will perform well. These tenants are somewhat predictable partners, and their presence lessens the risks of development. Developers are also able to leverage key tenants' demand for the best locations in the center with locations that are not as good, making it easier to fill secondary space. Retailers also benefit from long-term relationships with shopping center developers. Their investors demand expansion and sales growth, and long-term relationships with key developers create a continuous source of new locations, as well as the opportunity to strike more favorable deals on rents and other charges.

The shaping of a shopping center's character usually begins with a determination of the key anchor tenants. Table 5-1 lists typical anchors by type of center. Retail analysts prepare lists of probable tenants, including anchors and key tenants, while the market analysis is being conducted. Increasingly, developers strive for a mix of local and national tenants. National tenants, also called "credit tenants," provide the strong credit ratings needed to finance a shopping center, while local tenants provide the offerings that give the center its special character. In most areas, some local merchants are stronger than others, and the local standing of a merchant should be taken into consideration. For example, a majority of customers might prefer one supermarket chain over another. Popular, established merchants are likely to draw more patrons to a new center, thereby strengthening its appeal.

Identified market segments in a trade area, combined with national shopping center trends, often suggest a special character for the proposed center that would allow it to depart from the traditional neighborhood, community, or regional center tenant mix and to include special tenant categories that could be supported because of the presence, or absence, of such segments in the market. For example, in a market with a large number of young single professionals demand for food-service tenants will likely be greater, because busy adults without children tend to eat out more often. Additional market analysis could quantify those potentials.

In any market study, assumptions should be conservatively made, clearly understood, and based on realizable goals. They are critical to the validity of the study because the primary purpose of a market survey is not to convince prospective tenants that the trade area needs and can support a proposed center, but to find out whether the area can support a new shopping center of the type being considered. Key

Table 5-1

## Typical Shopping Center Anchors by Type of Center

Convenience	Neighborhood	Community	Regional/Super Regional
Minimart	Supermarket	Junior department store	Full-line department store
Restaurant	Drugstore	Discount department store	Fashion department store
Beauty parlor	Discount department store	Supermarket	Megaplex cinema
Dry cleaners	Restaurant	Off-price superstore	Entertainment center
Fast-food outlet	Furniture store	Variety store	Food court
Medical/dental office	Hardware store	Family apparel store	Large-format specialty store
	Automotive store	Furniture store	Large-format off-price store
	Liquor/wine store	Sporting goods store	
	Video rental outlet	Drugstore	
	Bank	Office supply store	
		Cinema	

Source: *Dollars & Cents of Shopping Centers*®: 2000 (Washington, D.C.: ULI—the Urban Land Institute).

tenants will conduct their own market studies because their criteria and assumptions will likely be different from the developer's in some respects.

## Overview of Case Studies

This chapter features four case studies, each illustrating a different type of retailing and different methods of analysis. La Cantera, case study 5.1, is a value retail center to be built by a major national retail developer in suburban San Antonio. The concept capitalizes on a unique tenant mix and its location within a larger entertainment complex to draw customers from a very wide trade area.

Case study 5.2, the Granby Street District in downtown Norfolk, Virginia, is an urban redevelopment project that is part of the revitalization of what was once a thriving downtown. Similar to downtowns throughout the country, Norfolk's retail core declined during the 1960s and the 1970s as suburban shopping centers seized much of its customer base. Beginning in the 1980s, revitalizations like Granby Street's captured the imagination of local governments and developers throughout the nation, and the trend continues today. The market analyst faces difficulties identifying and quantifying market potential for these pioneering projects because of untested markets and a lack of comparables.

The Lake at Riverdale, case study 5.3, is a retail/entertainment complex that features a cinema as an anchor. The market analysis uses a combination of several methodologies, including psychographic analysis and focus groups to fine-tune the concept. For comparables, the analyst found it necessary to go

well beyond the boundaries of the market area and to draw from a national list of successful projects.

Case study 5.4, Wilanow Town Center, in Warsaw, Poland, depicts an emerging retail market that is replacing the old state-owned shopping facilities. In researching markets outside the United States, analysts often face a lack of data and must rely more heavily on interviews and other primary research for documentation. Projects in emerging locations, such as inner-city neighborhoods, often present similar situations and the analyst must invent creative approaches to the market analysis.

## Notes

<sup>1</sup> ULI—the Urban Land Institute, *The Dollars & Cents of Shopping Centers*®: 2000 (Washington, D.C.: ULI—the Urban Land Institute, 2000), p. 3.

<sup>2</sup> GLA is measured from the centerline of joint partitions and outside wall faces.

<sup>3</sup> W. Paul O'Mara, et al., *Developing Power Centers* (Washington, D.C.: ULI—the Urban Land Institute, 1996).

<sup>4</sup> PricewaterhouseCoopers LLP and the Initiative for a Competitive Inner City, *The Inner-City Shopper: A Strategic Perspective*, 1998.

<sup>5</sup> "Retail Rebounds in Inner-City L.A.," *Chain Store Age*, vol. 76, no. 9, p. 196.

<sup>6</sup> See U.S. Bureau of the Census, Current Business Reports, in *Annual Benchmark Report for Retail Trade*. The old SIC system will soon be replaced by the NAICS (North American Industry Classification System). Shifting classifications will complicate comparability with earlier years' sales statistics. Although most retailers will still be classified in Sectors 44 and 45 (Retail Trade), restaurants (formerly Eating and Drinking Places) will now be grouped in Sector 72 (Accommodations and Food Services).

## A Value-Retailing Center: La Cantera (1992)

Mark E. Kissel

In the highly competitive environment of retailing, retailers and developers alike struggle with the inherent conflict between following the path of proven success or blazing a new direction that may deliver big returns. In shopping center development, the right location and the right demographics may not guarantee a successful project. Developers must be cognizant of how their project will compare to competitive projects—directly or indirectly. Project layout, architecture, an unusual combination of tenants, and complementary uses, particularly entertainment, are all elements of a project's design that can be used to differentiate a center from competitive centers.

The proposed project, La Cantera, was designed to be a unique destination differentiated from competitive shopping centers by its value-oriented tenant base coupled with one-of-a-kind tenants and a location adjacent to a major theme park—entertainment complex. Thus, the development strategy was, to some degree, to draw shopper sales from other San Antonio centers, to attract the San Antonio tourist, and to generate “cross-shopping” business with the adjacent entertainment complex.

### Location and Site

The La Cantera site is located at the intersection of Loop 1604 and I-10, at the far northwest corner of San Antonio's city limits, 15 miles northwest of the central business district (CBD). The shopping center site is one component of a larger entertainment complex. The recently developed theme park—Fiesta Texas, which features amusement rides, musical entertainment, and various food services—is adjacent to the La Cantera site. In addition to the existing theme park, several other large-scale projects are proposed as follows:

- Between one and three Branson, Missouri-style, celebrity theaters;
- A multiplex theater with eight to 12 screens, plus the possible inclusion of a specialized film format;
- Several hotels to serve different market segments, including a 500-room hotel/conference center adjacent to an 18-hole golf course, a 350-room hotel to serve Fiesta Texas, and a 150-room budget hotel;

- A variety of dining experiences, including themed dinner theaters, specialty restaurants, a fine-dining format, entertainment clubs, and a microbrewery;
- A cable television and radio network that would air musical events at Fiesta Texas, offering increased exposure and revenue through broadcasting rights.

### Market Area

San Antonio ranked 30th among the 281 metropolitan areas in the 1990 census, with a population of 1.3 million. Most noteworthy are its population growth rate, exceeding that of the state of Texas (1.99 percent versus 1.79 percent), and its large Hispanic population. San Antonio is home to about 684,000 Hispanic residents, making it one of the largest Hispanic markets in the United States, both in actual and relative (53 percent) terms.

San Antonio's economy experienced a boom-to-bust cycle during the 1980s. The low of the cycle hit bottom in 1988, and the economy has since rebounded. San Antonio's unemployment rate has declined because several high-technology firms and back-office operations of national corporations have entered the job market. Unemployment rates have declined from the 7.0 to 7.9 percent range that prevailed during 1986 to 1989 to the 6.0 to 6.9 percent range that has existed since 1990. Employment in the early 1990s in San Antonio is dominated by the service, government, retail, and finance, insurance, and real estate (FIRE) sectors.

The area within a ten-mile radius of the site demonstrates the quality of growth in the northwest quadrant of San Antonio. The 1992 population of 415,200 has grown at the rate of 3 percent per year with a median household income of \$34,000. In contrast, at a distance of 20 miles or more from the site, the demographics tend to reflect the metropolitan area at large, with a population growth rate of approximately 1.7 percent and a median household income of \$29,000. The household income within a ten-mile radius—reflecting the income characteristics of the northwest quadrant—is 21 percent higher than the household income for the overall market. These income demographics enhance the marketability of the La Cantera site. Furthermore, the northwest quadrant of the San Antonio

market is home to three important employment generators: South Texas Medical Center, a health care and education center with 17,900 employees; USAA, a worldwide insurance and financial services corporation with 9,600 employees; and the University of Texas at San Antonio, with an enrollment of 16,800 students and 1,200 full-time employees and 2,300 part-time employees.

For most shopping centers, the consideration of radius-based geography above a 20-mile radius is not relevant to the dynamics of a typical regional mall trade area. Most traditional regional shopping centers capture a large proportion of their patrons from within a 20-mile radius. A shopping center with a distinctive tenant base and physical design, however, functions differently from a traditional regional mall because such a center attracts a large proportion of its patrons from within a 40-mile radius. Because the proposed center at La Cantera could potentially attract patrons from an area broader than the three-county area of the (MSA), this analysis used a six-county region, consisting of 1.35 million people. (See Table 5.1-1.)

Tourism is a key economic activity in San Antonio and would add to the customer base of the proposed shopping center. At present, San Antonio accommodates approximately 5.3 million overnight visitors annually. The continued success of the tourism industry depends on extending the stay of overnight visitors and converting day-trip visitors into overnight visitors. The second critical element of success is complementarity. As long as the entertainment venues complement each other's activities, a tourist conceivably can plan to visit every venue. If the complementarity of the venues turns into direct competition, each of the competing attractions will suffer. Carefully nurturing the existing attractions by continual facility renewal, and understanding the long-term synergy of all the venues, creates the successful entertainment mix.

The level of tourism activity and the mix of the entertainment venues factor into what is termed the "inflow" part of the trade area and sales analysis. In essence, inflow customers reside outside of the trade area, and for a variety of reasons—from attending a convention to taking leisure tours of historical sights—pass through the trade area and, thus, have a higher than usual probability of shopping at the proposed retail center.

### Retail Market History

The suburbanization of San Antonio produced long-lasting effects in the retail community. The department store business consolidated from three local stores to two out-of-town stores, Dillard's and Foley's. Mall activity in the 1980s included expansions by North Star and Ingram Park, and the development of Rolling Oaks. North Star ultimately became the region's premier mall as well as the largest shopping center, at 1.2 million square feet. Central Park, North Star's neighbor and at one time near equal, was never able to keep pace with North Star's expansion and, hence, quickly became an outdated and underperforming shopping center.

Other retail development in the 1980s consisted of value centers, power centers, outlet centers, and urban centers. Discount and value stores paved the way for the development of value and power centers. What launched value retailing into a position challenging the department store business was not the national chains, but two local retailers, 50-OFF and Solo Serve. Although both stores relied on an off-price merchandising strategy, they served different customers. 50-OFF targeted low- to moderate-income customers, while Solo Serve catered to moderate-income customers with more of a fashion orientation. The two chains complemented each other's business and greatly expanded their store bases during the 1980s, capturing a surprising share of retail expenditures. In fact, entry into the San Antonio market by national off-price stores has been somewhat limited because of these two chains.

With respect to value-oriented retail development, Walzem Plaza represents one of the best examples of a 1980s value center. This center opened in 1981 and today incorporates a mix of national and local value tenants, including Service Merchandise, Solo Serve, Office Depot, and Weiner's. Westlakes Mercado, due west of the San Antonio CBD, opened in 1983 with Montgomery Ward and Target as anchor stores plus a number of off-price and value-oriented small tenants.

Exchange Place, near Ingram Park, evolved into a power center with value and category-dominant tenants such as Circuit City, Ross Dress for Less, and Pier 1 Imports. Adjacent to North Star, The Pavilions at North Star opened

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Table 5.1-1  
**Radius Demographics, La Cantera Site: Loop 1604 and I-10**

Demographic Attributes	5-Mile Radius	10-Mile Radius	20-Mile Radius	30-Mile Radius	40-Mile Radius
<b>Population</b>					
1990	72,454	388,421	1,168,916	1,272,829	1,373,935
1992	80,152	415,224	1,208,450	1,318,301	1,424,347
1997	99,415	482,245	1,308,432	1,433,097	1,551,471
<b>Annual Growth (%)</b>					
1990-1992	5.18	3.39	1.68	1.77	1.82
1992-1997	4.40	3.04	1.60	1.68	1.72
<b>Households</b>					
1990	29,339	151,329	405,057	441,119	475,849
1992	32,656	162,882	422,836	461,213	497,831
1997	40,950	191,766	467,283	511,449	552,785
<b>Annual Growth (%)</b>					
1990-1992	5.50	3.75	2.17	2.25	2.28
1992-1997	4.63	3.32	2.02	2.09	2.12
<b>Average Household Size</b>					
1980	2.45	2.54	2.81	2.82	2.82
1990	2.44	2.52	2.79	2.79	2.80
1992	2.41	2.49	2.74	2.74	2.75
<b>Annual Growth (%)</b>					
1990-1992	(0.20)	(0.39)	(0.36)	(0.53)	(0.36)
1992-1997	(0.25)	(0.24)	(0.36)	(0.36)	(0.36)
<b>Median Household Income</b>					
1990 (\$)	\$35,753	\$30,885	\$26,149	\$26,150	\$25,967
1992 (\$)	38,554	33,554	28,848	28,826	28,632
1997 (\$)	44,108	38,872	34,255	34,221	34,030
<b>Annual Growth (%)</b>					
1990-1992	3.84	4.23	5.03	4.99	5.01
1992-1997	2.73	2.99	3.50	3.49	3.51
<b>Households with Income &gt;\$35,000</b>					
1990: # of Households	14,899	66,067	144,626	157,116	167,889
% of Households	50.78	43.66	35.71	35.62	35.28
1992: # of Households	17,824	77,768	168,693	183,635	196,484
% of Households	54.58	47.74	39.90	39.82	39.47
1997: # of Households	25,272	107,242	227,484	248,646	266,815
% of Households	61.71	55.92	48.68	48.62	48.27
<b>Annual Growth (%)</b>					
1990-1992	9.38	8.49	8.00	8.11	8.18
1992-1997	7.23	6.64	6.16	6.25	6.31

Sources: Urban Decision Systems; Kissel Consulting.

in 1990 with a similar roster of tenants. In the northwestern suburbs, Trammell Crow developed Bandera Festival, a 188,000-square-foot value/convenience center anchored by Kmart and Solo Serve.

One of the more interesting developments was completed by locally based H.E. Butt, the dominant grocery chain in San Antonio. Within a half mile of Exchange Place, H.E. Butt developed a power center, called the Market Place, featuring an expanded format of its own grocery store, H.E.B., Office Depot, and value retailers such as Clothestime. Like the Pavilions and Bandera Festival before it, the design of the Market Place was a cut above the typical San Antonio open-air center. H.E. Butt designed the building to resemble an ore mine by using a corrugated metal facade. Although the design may be somewhat provocative, H.E. Butt created a fresh new look for an open-air shopping center that represented a distinctive departure from the usual, mediocre design of many San Antonio community shopping centers.

Outlet retailing came to the San Antonio area with the construction of the Mill Store Plaza in New Braunfels, Texas, in 1986. Anchored by Westpoint Pepperell, this 245,000-square-foot manufacturers' outlet mall captured tourist and intercity traffic traveling between San Antonio and Austin. With a distance of only 22 miles separating Mill Store Plaza from the junction of Loop 410 and I-35, San Antonio shoppers found Mill Store Plaza's location convenient, particularly for big-expenditure shopping trips.

With so much attention on suburban development between 1960 and 1980, the San Antonio CBD was largely a forgotten place until the early 1980s, when the DeBartolo Corporation embarked on a highly creative downtown project. The result, Rivercenter, connected an existing Dillard's department store, the Alamo, and the River Walk—the developed riverfront of the San Antonio River—with a three-level retail complex of boutiques, restaurants, and tourist attractions, plus a Lord & Taylor department store (which Foley's later assumed) and a Marriott hotel. By successfully linking the established urban amenities through a fun and upbeat retail environment, Rivercenter became a major attraction for tourists and residents alike. This development activity is summarized in Table 5.1-2.

By the end of the 1980s, the retail market had experienced significant growth, more than 3.1 million new square feet of major retail development. The decade did not pass, however, without several major changes in the market. As value retailing grew, conventional retailing contracted, primarily caused by the expense of corporate mergers and a long-term shift by consumers to stores offering value. By the close of the 1980s, retailing names such as Joske's, Frost Brothers, Wolfe & Marx, Rhodes, and Liberty House had all disappeared from the San Antonio retail landscape.

The largest retail development of the 1990s occurred not in San Antonio proper, but in San Marcos, Texas, approximately 18 miles northeast of the Mill Store Plaza in New Braunfels. Adjacent to I-35, the Prime Group built 310,000 square feet of outlet space in two phases. The tenant mix at this project, San Marcos Factory Shops, is an impressive collection of upscale manufacturers' outlet stores, such as Donna Karan, Mondri, First Choice, and Coach, and mid-scale tenants such as VF Outlet, Corning/Revere, Bass, and Springmaid/Wamsutta.

Most recently, a prominent manufacturers' outlet developer, Tanger Factory Outlet Centers of Greensboro, North Carolina, received approvals to construct approximately 100,000 square feet of outlet space adjacent to San Marcos Factory Shops.

### **Current Retail Assessment**

The value-retailing trend continues unabated in San Antonio, while department stores search for new merchandising strategies. Table 5.1-3 summarizes the impressive growth of value retailing in San Antonio to date and reinforces two prevailing themes of San Antonio value retailing.

- A compact growth period. The only value stores in operation before 1980 were Kmart and Solo Serve. Most important, their rapid growth demonstrated unabashed customer acceptance.
- A reputable representation of local retailers. Because of their larger store size, national retailers control about 80 percent of the value-retailing space in San

## A Value-Retailing Center: La Cantera (continued)

Table 5.1-2

### Growth in Major Shopping Center Space, San Antonio, TX, Market, 1960-1992<sup>1</sup>

Period	Major Shopping Centers <sup>2</sup>	Square Feet	Square Feet for Period	% of Market
1960-1969	North Star	670,000		
	Northwest	270,000		
	Crossroads	732,000		
	McCreless	468,000		
	Central Park	672,000	2,812,000	31.6
1970-1979	South Park	620,000		
	Windsor Park	1,061,000		
	Ingram Park	978,000	2,659,000	29.9
1980-1989	North Star Expansion	597,000		
	Ingram Park Expansion	148,000		
	Walzem Plaza	246,000		
	Westlakes Mercado	440,000		
	New Braunfels	245,000		
	Rivercenter	779,000		
	Rolling Oaks	650,000	3,105,000	34.9
1990-1992	San Marcos	310,000	310,000	3.5
<b>Total</b>		<b>8,886,000</b>		<b>100.0</b>

<sup>1</sup>Definition expanded to include shopping centers in New Braunfels and San Marcos, TX.

<sup>2</sup>"Major" refers to malls with approximately 250,000 square feet or more.

Sources: National Research Bureau; San Antonio Express-News; Kissel Consulting.

Antonio. The store size of a typical Kmart, Target, or Wal-Mart averages 85,000 to 95,000 square feet. On a store-unit basis, however, local retailers operate about 45 percent of the locations. Even though local retailers clearly trail behind the national retailers in sales (by virtue of the amount of selling space), their market presence is highly unusual in comparison to other major metropolitan markets.

One of the objectives of a retail analysis is to identify retail or shopper demand. Demand can be demonstrated directly by showing that it indeed exceeds retail supply. In

other words, the dollar or expenditure value of the retail goods and services that the trade-area population can potentially purchase is greater than the dollar or expenditure value of retail sales that occur within the trade area. This is the fundamental relationship of retail demand and supply within a store or shopping center trade area. Retail demand can also be demonstrated indirectly by showing that demand from *outside of the trade area*—in the form of sales from other stores or shopping centers (that is, the "transfer" effect)—or from *outside the market* (for example, tourist dollars) will augment trade-area demand and, thus, support the proposed shopping center.



Table 5.1-3

**San Antonio Value Retailers**

Type of Value Retailer/ Market Niche	Market Store	Estimated Total Scope	Units	Square Feet
<b>Off Price</b>				
Middle to Upper	Stein Mart	Regional	2	60,000
	Solo Serve	Regional	11	253,000
	Tuesday Morning	National	3	30,000
Middle	Marshalls	National	3	75,000
	Ross Dress for Less	National	3	75,000
	Burlington Coat	National	1	65,000
Lower to Middle	50-OFF	Regional	9	180,000
	MacFrugal <sup>1</sup>	National	4	60,000
<b>Discount</b>				
Middle	Weiner's	Regional	12	180,000
	Target	National	6	570,000
Broad	Kmart	National	11	990,000
	Wal-Mart	National	5	500,000
<b>Wholesale Membership</b>				
Broad	SAM's Club	National	3	360,000
<b>Total</b>			<b>73</b>	<b>3,398,000</b>

<sup>1</sup>Pic N Save changed the name of its four San Antonio units to MacFrugal in fall 1992.  
Sources: Solo Serve; 50-OFF; Kissel Consulting.

In the case of San Antonio, the developer had correctly identified a market niche for the kind of shopping center that was proposed. From a retail analysis perspective, the niche was predicated on an indirect demonstration of demand. In short, the project concept of combining a distinctive collection of tenants—value-oriented and “one-of-kind” stores—with proximity to a major entertainment complex creates a retail destination that arguably would attract residents of the metropolitan market, tourists, and visitors to the entertainment complex. Hence, the retail demand demonstrated by the trade area would be supplemented by the retail demand of tourists and theme-park patrons.

The proposed shopping center synthesizes several evolving trends in San Antonio shopping center development with national development trends that have yet to arrive in San Antonio. The fusion of those trends creates a

shopping center development product termed the “unique destination center.” This term defines the shopping center product envisioned by the developer. The unique destination center includes the following elements:

- Merchandising clarity. The shopping center consists of retailers that present a powerful selection of merchandise and/or merchandise at exceptional value. These two attributes, selection and value, draw shoppers to a destination almost regardless of distance. An integral part of selection and value is brand names. In other words, a store sells a stunning selection of brands within a particular product category and/or desirable brands are offered at unbelievably low prices. The only shopping centers in the greater San Antonio area to offer this kind of clarity are the outlet centers. Within San Antonio, only individual stores offer clear

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## A Value-Retailing Center: La Cantera *(continued)*

selection (like Circuit City) and/or value (like Solo Serve).

- **Identity.** Merchandising clarity certainly helps to establish identity. However, if merchandising clarity is duplicated, a shopping center's sense of identity or distinction diminishes. Both uniqueness and merchandising clarity define a shopping center's identity. Within San Antonio, only the outlet centers and Rivercenter come close to a truly unique identity. Nonetheless, two outlet centers with a handful of merchants duplicated in both centers now exist. The opening of the San Marcos center did split the outlet market: New Braunfels now tends to target lower- to middle-income shoppers while San Marcos tends to target middle- to upper-income shoppers. Neither of these centers, though, presents one-of-a-kind or retail outlet tenants.
- **Architectural appeal.** Shopping centers are places; they represent points or areas of commerce. When a place has aesthetic appeal, it generates enthusiasm for visitation. Regardless of whether a place is a restored colonial village or a contemporary shopping center, the design of the place stimulates interest from the market. In the case of the unique destination center, the design does not take precedence over the quality of the retail experience but rather enhances the experience by providing an attractive environment for the shopper.
- **Location.** When a center is unique, can there be a right location within an entire metropolitan area? The right location is one where several major interstate highways intersect or where a popular and well-known destination is adjacent to an interstate. In either case, a location close to the metropolitan area is preferable because it keeps driving to a minimum for the largest number of consumers.

A unique destination center—that is, a shopping center with merchandising clarity, identity, aesthetic appeal, and a good location—does not exist today in San Antonio. The opportunity for such a center exists at the La Cantera complex. With value retailing now established and maturing in San Antonio, a unique destination center would synthe-

size the existing value-retailing and development trends with new retail formats not presently in the market, at a celebrated location.

The advantages of the La Cantera site are twofold. The first advantage relates to the adjacent theme park. The proposed location is well recognized throughout the market because of the Fiesta Texas theme park. The second advantage is that the site is at the edge of the metropolitan area. This location turns out to be an advantage, given the desirability of leasing to outlet tenants. Manufacturers' outlets are one tenant constituency of the unique destination center that actually prefers locations at the periphery of a metropolitan area as opposed to suburban or urban sites.

The La Cantera location has one disadvantage. With respect to the entire San Antonio market, a location at Loop 1604 can be perceived as inconvenient from the perspective of the northeast, southeast, and southwest quadrants of the market. To counter such a perception, La Cantera must be positioned from the outset as convenient to I-10. In addition, La Cantera must be known as San Antonio's value center, unlike New Braunfels and San Marcos, which require a much farther drive.

Powerful selection and value can overcome any locational disadvantages. For La Cantera to succeed, it needs an innovative and distinctive mix of retailers in a fun environment. These qualities are key to a unique destination center that will firmly position La Cantera as San Antonio's distinctive shopping venue.

### **Sales Potential**

A sales forecast for the La Cantera site is based on the following assumptions:

- First and foremost, leasing will focus on merchandising La Cantera with tenants that offer all of the qualities of a unique destination center. Value and selection are clear. Merchants are distinctive and readily identifiable. The notion of clarity of offerings and uniqueness of value is critical to draw patrons from beyond the local area and to establish loyalty among the local patrons.

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## A Value-Retailing Center: La Canterra (continued)

- La Canterra will lure five to seven high-profile tenants from San Marcos Factory Shops. Not only must La Canterra cannibalize San Marcos Factory Shops' tenant base, but also it must create ambivalence among available tenants about where to locate their store. In other words, the possibility of a third choice (in terms of location) vis-à-vis San Marcos Factory Shops and Tanger's recently announced project creates a better opportunity for La Canterra now. If the leasing of La Canterra begins *after* San Marcos and Tanger have split the available tenants, then La Canterra will lose a significant strategic edge. Hence, the leasing of La Canterra must begin posthaste.
- Leasing will achieve an occupancy rate of at least 80 percent for opening in fall 1994.
- Access to I-10, the primary traffic carrier, and Loop 1604 will be smooth and easy to understand.
- A major *bilingual* marketing campaign of print (including major newspapers in San Antonio and Austin), broadcast, and outdoor advertising will create region-wide awareness.
- No new competing centers, traditional or outlet, will open in Bexar County during the sales projection year of 1994–1995.
- The national and local economies will maintain their present level of growth or will improve.
- Fiesta Texas will steadily increase its attendance levels; Sea World will reverse its downward trend and experience a modest rise in attendance.

Sales for La Canterra are estimated for the 1994–1995 period by analyzing the market's expenditures. Rather than undertake a detailed sales and trade area analysis, the client requested a more generalized method. An expenditure analysis meets the stated objective. The analysis follows a five-step process:

1. Accept a radius definition as an adequate representation of the trade area. The client did not want drive times used to define the trade area.
2. Estimate total expenditures for the trade area. From the expenditure estimate, derive retail expenditures for department store-type merchandise (DSTM) alter-

natively referred to as general merchandise, apparel, furniture, and other merchandise (also known as GAFO). Table 5.1-4 summarizes steps 1 and 2.

3. Apply three different scenarios—low, medium, and high—of estimated market shares against the retail expenditures. Also apply three different scenarios—low, medium, and high—of the ratio of market sales to inflow trade.
4. Calculate the "equilibrium level" of square footage for each of the three sales scenarios. The equilibrium level is based on a sales productivity benchmark for a regional shopping center as published in the Urban Land Institute's *Dollars & Cents of Shopping Centers*®.
5. Enter the square footage of the proposed project and account for the space allocated for food service (which is not considered a DSTM expenditure). The last row produces three different estimates of sales productivity based on the project's size, food sales, ratio of inflow to market sales, and market penetration. Table 5.1-5 summarizes steps 3, 4, and 5.

In the case of La Canterra, inflow business is projected to provide 15 percent of the center's sales, which reflects the "mid" sales scenario. Given La Canterra's access to I-10 and Loop 1604, the center will successfully attract patrons from beyond a 40-mile radius. The percentage of sales from the primary trade area, a 20-mile radius, is similar to a Mills-brand shopping center (a shopping center whose tenant base is a hybrid of different kinds of value retailers) and is thus quite different from traditional regional shopping centers.

Table 5.1-5 illustrates the supply/demand analysis process. For opening year 1994–1995, the forecasted sales productivity of \$269 per square foot, +10 percent/–15 percent, yields total sales of \$107.6 million. The disproportionate range, +10 percent versus –15 percent, indicates the possible effect of Tanger's project on La Canterra. Ultimately, the tenants, not the mall itself, provide customers with the benefits of shopping. Because tenants play the key role in the success of a shopping center, if La Canterra cannot secure quality tenants because of prior commitments to San Marcos' Phase III or Tanger, then La

## A Value-Retailing Center: La Cantera (continued)

Table 5.1-4  
Expenditure Overview, La Cantera Site

Expenditure Components	5-Mile Radius	10-Mile Radius	20-Mile Radius	30-Mile Radius	40-Mile Radius
<b>Average Household Income</b>					
1990	\$48,220	\$40,184	\$33,997	\$33,811	\$33,487
1992	\$52,599	\$43,613	\$37,098	\$36,871	\$36,509
1997	\$63,259	\$52,133	\$44,660	\$44,371	\$43,922
Estimated 1995 Income	\$58,758	\$48,542	\$41,466	\$41,203	\$40,791
<b>Annual Growth (%)</b>					
1990-1992	4.44	4.18	4.46	4.43	4.41
1992-1997	3.76	3.63	3.78	3.77	3.77
<b>Households</b>					
1990	29,339	151,329	405,057	441,119	475,849
1992	32,656	162,882	422,836	461,213	497,831
1997	40,950	191,766	467,283	511,449	552,785
Estimated 1995	37,406	179,644	448,969	490,729	530,111
<b>Annual Growth (%)</b>					
1990-1992	5.50	3.75	2.17	2.25	2.28
1992-1997	4.63	3.32	2.02	2.09	2.12
<b>TOTAL 1995</b>					
<b>Income Potential (\$x000)</b>	\$2,197,870	\$8,720,195	\$18,616,936	\$20,219,737	\$21,623,987
<b>1995 Expenditure Potential (\$x000), by Radius</b>	\$373,638	\$1,482,433	\$3,164,879	\$3,437,355	\$3,676,078
<b>By Geographic Band</b>	<b>5-Mile Radius</b>	<b>5-10 Mile Band</b>	<b>10-20 Mile Band</b>	<b>20-30 Mile Band</b>	<b>30-40 Mile Band</b>
<b>1995 Expenditure Potential (\$x000), by Area</b>	\$373,638	\$1,108,795	\$1,682,446	\$272,476	\$238,722

Sources: Urban Decision Systems; U.S. Bureau of Labor Statistics Consumer Expenditure Survey; Kissel Consulting.

Cantera will have difficulty positioning itself as the destination of value and selection.

The sales forecast of \$269 per square foot demonstrates bona fide market potential for a unique destination center in San Antonio.

### Recommendations

The prospects for retail success at the La Cantera site look very positive. The five following factors support this conclusion:

- In terms of demographics, the northwest corridor demonstrates strong population growth and relatively high household incomes.
- Since the 1988 economic low, the economy turned upward as evidenced by a stabilization in retail occupancy rates and the ability of the market to attract new businesses from outside the market area.
- Between 1980 and 1990, the San Antonio MSA's employment base increased by 28 percent, an addition of 146,000 jobs, easily outpacing the nation's growth rate of 22 percent.

## A Value-Retailing Center: La Cantera (continued)

Table 5.1-5

### Sales Analysis Overview, La Cantera Site

Market Area	Retail Sales Potential (000)	Capture Rates (%)			Project Sales Range (000)			Sales Distribution (%)		
		Low	Mid	High	Low	Mid	High	Low	Mid	High
Primary Trade Area <sup>1</sup>	\$3,164,879	1.85	2.50	3.15	\$58,550	\$79,122	\$99,694	80.00	72.50	65.00
Extended Trade Area <sup>2</sup>	511,199	1.00	1.75	2.25	5,112	8,946	11,502	10.00	12.50	15.00
Total Trade Area	3,676,078	1.73	2.40	3.02	63,662	88,068	111,196	90.00	85.00	80.00
Inflow Trade					12,186	24,487	39,301	10.00	15.00	20.00
Total GAFO Sales (\$000)					70,736	103,609	138,995			
Benchmark Productivity (from ULI) <sup>3</sup>					\$207	\$207	\$207			
Supportable GLA (sq. ft.)					341,719	500,528	671,471			
Proposed GLA (sq. ft.) for GAFO Goods					396,000	396,000	396,000			
Proposed sq. ft. vs. Supportable sq. ft. <sup>4</sup>					1.16	0.79	0.59			
Sales per sq. ft.					\$179	\$262	\$351			
Food GLA (sq. ft.)					4,000	4,000	4,000			
Food & Service Sales (\$000)					\$1,400	\$1,560	\$1,700			
Total Mall GLA (sq. ft.)					400,000	400,000	400,000			
Total Mall Sales (\$000)					\$74,736	\$107,609	\$142,995			
Total Project Sales per sq. ft.					\$187	\$269	\$357			

GLA = gross leasable area; GAFO = general merchandise, apparel, furniture, and other merchandise

<sup>1</sup> Based on a 20-mile radius.

<sup>2</sup> Based on a 20- to 40-mile band.

<sup>3</sup> ULI 1990 median productivity for a regional shopping center (average size of 518,000 sq. ft.) adjusted to 1995.

<sup>4</sup> A value greater than 1.00 indicates excess space; a value less than 1.00 indicates a shortage of space.

Sources: Urban Decision Systems; U.S. Bureau of Labor Statistics Consumer Expenditure Survey; Kissel Consulting.

- The strength of biomedical, high-technology, tourism, and financial services industries offsets, if not exceeds, the weakness in manufacturing in the local economy.
- Together with the economic upturn, increased work in the biomedical and high-tech community, prudent management of tourism venues, and continued disposition of Resolution Trust Corporation-controlled real estate will further enhance growth.

Given the favorable demographic and economic conditions for retail development in the northwest corridor,

this analysis projects strong potential for a unique destination center at the La Cantera site. Assuming the development of 400,000 square feet of retail space (of which 396,000 square feet is for department store-type merchandise and 4,000 square feet for food establishments) and an opening year (1994-1995) sales productivity of \$269 per square foot, total annual mall sales should yield \$107.6 million.

Considering the market, economic, access, and competitive issues relating to the La Cantera site, this analysis concludes that the client should proceed with the devel-

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## A Value-Retailing Center: La Cantera *(continued)*

opment of a unique destination center at the subject site, based on three compelling factors:

1. The site's proximity to Fiesta Texas ideally positions La Cantera adjacent to a proven traffic generator at a location well known throughout the metropolitan area.
2. The northwest quadrant represents the best mix of demographic quality and economic development within the San Antonio market.
3. Well-merchandised and well-packaged value retailing simply does not exist in San Antonio. Within the market, Solo Serve stands alone as the only formidable off-price competitor. The stores of a unique destination center can answer Solo Serve's challenge through more sophisticated merchandising and a better selection of branded merchandise. San Marcos Factory Shops has established a successful, well-packaged retail complex more than 45 miles outside of San Antonio. A unique destination center at La Cantera, however, can accomplish the same

success at a closer-in location with a more diverse tenant base. As noted previously, La Cantera's leasing program must begin immediately to avoid the prospect of narrowing tenant availability caused by Tanger's project approval and San Marcos' planned expansion.

In summary, the San Antonio market presents an attractive opportunity for developing a value-oriented shopping center. A shopping center project based solely on the proposition of offering a roster of off-price tenants, however, is not the optimal market strategy. This type of product already exists in San Antonio. A tenant base that combines different kinds of value tenants including one-of-a-kind stores at a distinctive location creates the product differentiation that can distinguish La Cantera from competing shopping centers. Thus, the product strategy that best establishes a clear identity for La Cantera is to create a unique destination center, a shopping venue characterized by personality, entertaining fun, and great value that draws customers from within and outside the market area.

## Street Retail: Granby Street District, Downtown Norfolk (1998)

*H. Blount Hunter*

The Granby Street district of downtown Norfolk, Virginia, is a main-street retail zone that is being rejuvenated within the city's central business district (CBD). Granby Street was once Norfolk's primary retail corridor, with several department stores and numerous specialty shops. As occurred in many cities throughout the country, suburban development during the 1960s and 1970s drained Granby Street of its retail vitality.

During the 1980s and into the 1990s, Norfolk's downtown waterfront was restored to prominence as a site for entertainment and dining with the development of the Waterside Festival Marketplace and adjacent Town Point Park. The office core grew and prospered, and city planners wisely added several regional-scale cultural and recreational venues to enhance the mixed-use appeal of downtown. New hotels and a conference center were developed along with other tourist attractions and facilities.

In March 1999, MacArthur Center, a 1 million-square-foot enclosed shopping center anchored by Nordstrom and Dillard's department stores is scheduled to open adjacent to the Granby Street district. This upscale specialty center will draw millions of shoppers to the general vicinity of the Granby Street district for specialty apparel and other comparison goods not readily available in traditional malls in the suburbs.

In preparation for the opening of MacArthur Center, Norfolk's Department of Development commissioned a comprehensive retail and restaurant market assessment for the Granby Street district. Their goals were the following:

1. Quantify the special retail and restaurant sales potential associated with current patrons of downtown Norfolk.
2. Develop a merchandising strategy for the Granby Street district that is compatible with the adjacent regional center and the existing waterfront festival marketplace.
3. Provide usable, fact-based leasing data for the public and private sector.

### Fundamental Considerations

Whether located in a CBD or another type of urban setting, street retailing offers a significant growth opportunity

for local and national retailers, restaurateurs, and service providers. Across the nation, merchants are capitalizing on the extraordinary level of activity occurring in and around vibrant and revitalizing urban areas.

Initiating street retail activity often requires greater effort than is necessary for traditional suburban retail centers for the following reasons:

- Retail thrives in high-traffic areas. Street retailing functions best in areas that are crossroads locations for a broad mix of destination uses by a wide variety of consumer segments. Only limited retail development can be expected in single-purpose downtown areas inhabited solely by daytime employees. In such instances, street retailing will be confined to restaurants and to convenience-oriented shops and services with minor representation of comparison goods.
- Even in busy urban areas, retailers are often unable to perceive the full extent of consumer potential represented by all users of a downtown area. Although the daytime workforce is readily visible, other downtown patrons go unnoticed. It is ironic that the daytime workforce is often the only customer segment that is considered by prospective merchants, yet this segment typically generates less than 25 percent of sales in robust urban retail areas.
- Street retail areas suffer from the lack of a strategic merchandising plan with centralized execution. Unlike suburban retail centers, which are controlled by single developers, street retail areas are usually held by multiple property owners, which results in fragmented merchandising and leasing efforts.
- Unlike retail development of suburban greenfields, real estate in urban areas must often undergo remedial environmental action in order to compensate for private sector neglect of buildings and municipal neglect of infrastructure and streetscape. Retail activity will be slow to occur in the absence of environmental enhancement, which may be perceived as highly speculative by both public officials and private investors.

Developing an appropriate knowledge base for stimulating street retailing requires a systematic approach that includes the following steps:

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## Street Retail: Granby Street District, Downtown Norfolk *(continued)*

- Quantify current users and create profiles of trip motivations, demographic characteristics, and economic effects using primary and secondary consumer research.
- Quantify aggregate retail and restaurant expenditure potential associated with the current level of use through primary and secondary research as well as experience from other, similar cases.
- Translate aggregate expenditure potential into an estimate of supportable square footage, assuming a range of sales productivities that allows for economically viable retail and restaurant operations.
- Compare the estimate of supportable square footage to existing total space inventory and prevailing level of vacancy.
- Generate a merchandising plan based on user profiles and the existing retailers and restaurants. Identify high-impact leasing opportunities, that is, those with the potential to significantly redefine the image and usage patterns of the district.

### Establishing a Trade Area and User Profile

The most fundamental question posed by prospective tenants of any retail site is, "What is the trade area for this shopping center?" Suburban shopping center developers have become adept at defining residential trade areas based on sales generated by individual zip codes in areas contiguous to the shopping center. However, promoters of street retail areas and downtown districts often fail to answer this question adequately.

Without an accurate trade area definition, many prospective tenants of street retail erroneously assume that the trade area of an urban retail district consists primarily of its daytime-worker population supplemented only by the residents within a narrow radius of one to three miles. This assumption significantly underassesses the drawing power of a downtown area and can result in an unrealistically low measure of the economic vitality and the level of consumer expenditure potential available to merchants in an urban environment.

Trade areas are not necessarily defined in geographic terms. A trade area can be defined geographically, using

zip codes or counties, if telephone research was designed and conducted with an accurate representation of the distribution of local population by zip code or county within the MSA.

A more accurate means of addressing the level of consumer expenditure potential that is available to an urban retail district is to establish an annual estimate of visits, or "person trips," that flow into the downtown area by tracking its actual users and then generating economic and demographic profiles of those users. Total estimated person trips into the study area is an effective means of portraying the drawing power of a downtown. These data can be used to generate a geographic trade area for downtown retail as well as to create the following user profiles:

- Net reach, or percentage of a cohort that travels to the subject area, and frequency of use among key demographic groups;
- Share of annual usage related to nonwork versus work trip motivations;
- Comparative profiles of frequent users versus infrequent users.

Downtown users tend to fall into three relatively mutually exclusive market segments. These segments form the basis for estimating the annual number of person trips as well as expenditure potential as follows:

1. Residents of the entire MSA who visit downtown for discretionary purposes (i.e., nonwork trips);
2. Office workers and other employees who come downtown for work purposes;
3. Visitors from outside the MSA, including tourists, business travelers, convention delegates, and day visitors, who visit for a variety of reasons.

Collectively, these three market segments form the universe of potential customers for street retail. The size of each market segment is easily discernible using statistics available from local government agencies in most communities. Each segment's level of interaction with downtown can be quantified using a combination of primary and secondary data sources.



1. The population of adult residents of the overall MSA is available as updated census data from most local planning agencies. The analyst should make certain that the geographic basis used to represent the local resident market area is consistent throughout the analysis.
2. A count of office workers and other employees is generally available through the municipal economic development agency, state employment commission, or local chamber of commerce. Periodic employment counts are available from the U.S. Census Bureau.
3. The annual count of overnight visitors can be gleaned from statistics compiled by metropolitan convention and visitors' bureaus or state tourism agencies. Another estimate of visitor count can be constructed using hotel room counts combined with occupancy data. The day-trip component of total annual visitation is elusive and is typically estimated by applying a multiplier to the hotel-based visitor count.

The annual average frequency of downtown visits by members of each market segment must be measured in order to construct a comprehensive estimate of annual downtown usage. "Reach" and "frequency" of use by local residents from the MSA can be determined by proprietary consumer research. "Reach" represents the share of each customer segment that has visited downtown Norfolk at least once for nonwork purposes in the past six months. "Frequency" equals the average number of nonwork downtown trips by members of each segment. Frequency includes nonusers and users. Aggregate estimates of person trips generated by daytime employees and visitors are generated by standard usage estimates.

1. Random telephone interviewing within the MSA is used to measure the reach and frequency of downtown visits by local adults. Alternative sources of usage information are Scarborough- or Belden-type media/shopper studies or community-based omnibus polls, which are generally available through newspapers in larger communities. The results of the consumer research conducted among residents of the communities in the Norfolk MSA are shown in Table 5.2-1.

Table 5.2-1

**Downtown Norfolk's Penetration of Key Customer Segments and Average Annual Frequency of Nonwork Visits**

	Reach or Penetration (%)	Average Frequency (Visits)
<b>Age Group</b>		
18 to 24	38	7.4
25 to 29	35	11.8
30 to 39	43	11.2
40 to 49	37	10.8
50 to 59	41	12.2
60 to 69	25	3.4
70 and up	23	5.6
<b>Household Income</b>		
Under \$25,000	21	5.6
\$25,000 to \$34,999	29	6.6
\$35,000 to \$49,999	36	8.6
\$50,000 to \$74,999	42	8.4
\$75,000 to \$99,999	49	13.4
\$100,000 and up	75	30.2
<b>City of Residence</b>		
Norfolk	50	24
Portsmouth	34	8.4
Virginia Beach	40	8.2
Chesapeake	47	10.6
Suffolk	18	12.4
Southside Average	41	12.4
Newport News	23	4.2
Hampton/Poquoson	32	4.2
Williamsburg/James City Co.	14	2.2
York County/Yorktown	35	9.2
Peninsula Average	27	4.6
<b>MSA Average</b>	<b>35</b>	<b>9.2</b>

Source: H. Blount Hunter Retail & Real Estate Research Co.

2. Office workers and other employees are assumed to make approximately 200 trips annually into a downtown area when vacations, holidays, and sick leave are factored out. Generating the economic impact and demographic profiles of this market segment requires sampling by means of primary consumer research.

## Street Retail: Granby Street District, Downtown Norfolk *(continued)*

3. Downtown visitation by out-of-town visitors is best measured by convention and visitors' bureaus or state tourism agencies by means of exit-intercept research at hotels, airports, and follow-up research. It is reasonable to equate downtown visitation with usage rate for the most-visited attraction or venue located within the downtown area. Most tourist studies incorporate spending assessments and demographic profiles of out-of-town visitors.

For Norfolk's Granby Street district, the size of each market segment is presented in Table 5.2-2. The adult population of the Norfolk MSA is 1.2 million persons. Random telephone interviews within the MSA, with calls allocated in proportion to the population of each munici-

pality, indicate the average frequency of nonwork visits to the downtown is 9.2 trips per year, equating to 11.04 million person trips. In addition, the tourism sector contributes 2.86 million person trips per year based on visitor research conducted by regional and state tourist development authorities. Downtown workers, who number about 36,000, account for 7.2 million trips annually, assuming an average of 200 work days per year.

An interim result of the analysis is a fact-based estimate of actual usage, stated as person trips, of the downtown area over the course of a year. The analyst estimates that downtown Norfolk draws 21.1 million person trips annually from a combined market of local residents, tourists, and downtown workers and students. A full two-thirds of these trips are not work related.

Table 5.2-2

### Estimated Annual Person Trips to Downtown Norfolk

	Segment Size	Current Annual Usage Frequency	Projected Annual Person Trips
<b>Nonwork Trips</b>			
Local Residents (adults 18+)	1,200,000	9.2	11,040,000
Tourists/Day-Trip Visitors/ Business Travelers/ Meeting & Convention Delegates	11,000,000	0.26	2,860,000
<b>Work Trips</b>			
White-Collar Workers/Students/ Other Employees within 1 Mile	36,000	200	7,200,000
<b>Total Trips</b>			<b>21,100,000</b>
<b>Nonwork Trips</b>	13,900,000	66%	
<b>Work Trips</b>	7,200,000	34%	
<b>Total Trips</b>	21,100,000	100%	

Source: H. Blount Retail & Real Estate Research Co.

### Assessing Retail and Restaurant Demand

Assessing retail and restaurant demand requires objective expenditure data and subjective evaluations of the probable capture rate, or share of expenditures, that can be expected by retailers and restaurateurs in the study area. The basis for objective evaluation is existing behavior patterns and industry benchmark data, and the analyst's experience from similar retail districts provides the basis for subjective judgments.

At this stage of analysis, two questions are critical:

1. What share of all downtown person trips is the subject street retail district likely to capture?
2. What will be the average expenditure of each patron, once drawn to the street retail district?

Dual assessments of retail and restaurant demand are typically prepared. The first reflects potential and probable sales, assuming capture of current downtown users. This analysis is followed by future potential and probable sales goals, assuming a projected increase in downtown users. This case study focuses exclusively on the initial assessment of demand based on current downtown users (i.e., existing annual person trips).

Analogous experience provides a starting point for projecting the share of downtown person trips by each

## Street Retail: Granby Street District, Downtown Norfolk *(continued)*

market segment that can be captured by the street retail district. Influencing factors include the following:

- The overall size of the downtown area and the magnitude, or critical mass, of the subject street retail district;
- The connectivity of the street retail district with key activity generators within the downtown area; such as employment centers;
- The predominant time of usage of downtown facilities compared to retail and restaurant hours of operation;
- The proximity of the street retail district to key visitor attractions and facilities such as hotels and convention centers;
- The existing or planned anchors within the street retail district.

The expertise of the analyst is critical in applying analogous experience to this stage of assessment. Any inclination toward unrealistic capture rates will yield an overly optimistic assessment of market demand. Expressions of

aggressive capture may have a place, however, in the supplemental calculation of future potential.

Average expenditure (per capita spending) is also subject to analogous experience. The content of the retail mix determines the amount of expenditure assumed in the assessment of sales potential. Average expenditure per capita should be stipulated for each market segment.

Most rejuvenating street retail districts face modest initial average expenditures by customers because comparison-shopping goods will be minimally represented in favor of impulse-oriented specialty items. As the merchandise content of a street retail district evolves, projections of potential sales can reflect increasing average expenditures.

Table 5.2-3 represents the conversion of estimated downtown trips into expenditures. For the Granby Street district, the analyst determined that consumer expenditure assumptions should reflect a mix of casual restaurants and specialty shops to supplement other comparison-goods merchandise available elsewhere in the downtown area. From the calculations previously described, the analyst

Table 5.2-3

### Annual Retail/Food Expenditure Potential Analysis by Market Segment

	Market Segment Count	Person Trip Count	Annual Utilization Rate	Per Visit Per Capita Spending Factor	Total Sales Potential
<b>Residents</b>					
Norfolk MSA Residents over Age 18	1,200,000	1,680,000	1.40	\$30	\$32,400,000
<b>Tourists/Convention Delegates</b>					
Overnight Hotel Guests (net persons)	6,400,000	640,000	0.10	20	12,800,000
Overnight Non-Hotel Guests (net persons)	2,600,000	260,000	0.10	20	5,200,000
Day-Trip Tourists	2,000,000	100,000	0.05	20	2,000,000
Subtotal	11,000,000	1,000,000			\$20,000,000
<b>Office Workers/Daytime Employees</b>					
White-Collar Workers in Downtown Norfolk	25,000	6,500,000	26.00	25	16,250,000
Other Employees within 1 Mile of Downtown	11,000	110,000	10.00	25	2,750,000
Subtotal	36,000	6,610,000			\$19,000,000
<b>Total Annual Sales Potential</b>					<b>\$71,400,000</b>

Source: H. Blount Hunter Retail & Real Estate Research Co.

determined that Norfolk MSA residents account for 1.68 million annual person trips to the Granby Street district. At a per capita spending factor of \$30 per trip, this market segment will account for \$32.4 million in annual sales.

The 11 million visitors displayed in Table 5.2-2 are broken down into three sectors in Table 5.2-3. Overnight hotel guests comprise 640,000 person trips, with a per-visit spending factor of \$20, equating to annual sales potential of \$12.8 million. Non-hotel guests and day-trip tourists comprise the remaining potential from tourists, for a total annual sales potential from the tourism market segment of \$20 million.

Office workers and other daytime employees are the smallest sector, and despite accounting for the greatest number of person trips, still generate the smallest share of sales potential, estimated at \$19 million. The total annual sales potential for downtown Norfolk is thus estimated at \$71.4 million.

In Table 5.2-3, Annual Utilization Rate refers to the estimated average number of person trips generated, by market segment. It is derived by dividing the person-trip count by market-segment population count and reflects the analyst's experience in evaluating the performance of strong urban areas of varying sizes across the country. Similarly, the Per Visit Per Capita Spending Factor reflects the analyst's experience with main-street retail districts, as well as retail/restaurant developments within numerous downtown settings. These spending factors vary according to the specific circumstances of the study area and are influenced by factors such as the presence of department stores and the extent to which the study area is expected to become a destination for comparison-goods shopping (apparel and other mall-type goods).

### **Determining Supportable Square Footage**

From the calculations shown in Table 5.2-3, aggregate annual sales potential for the Granby Street retail district is determined to be \$71,400,000. Sales potential must be translated into supportable square footage of retail space. This extrapolation can be accomplished by creating a matrix that incorporates the aggregate sales potential and a range of sales productivities (sales per square foot) rang-

ing from \$150 to \$300, the range of productivity that is generally considered both acceptable and realistic.

The range of sales productivities used in the matrix must reflect the retail dynamics of the local market. If a base of retailing exists in the study area, the analyst should use current productivity as a guideline when establishing a productivity target for new businesses. Because the Granby Street district is essentially void of contemporary specialty retailing, the analyst did not have a preestablished sales productivity base to use as the basis for new tenants. Instead, he relied on reasonable productivity within the Norfolk MSA as the basis for setting a goal of \$250 per square foot for future sales productivity. This assumption affects the projected amount of supportable square footage, as well as rent economics. The temptation to increase the projected amount of supportable square footage by selecting a low level of productivity conflicts with rent economics if assumed sales productivity translates into unrealistic rent-to-sales ratios.

In some circumstances, the existing volume of retail and restaurant sales in the study area may be learned through tax records or from the business improvement district (BID) or management organization. When existing sales are known, the amount of supportable square footage can be based on net incremental sales (the difference between projected sales and current sales). The resulting amount of net supportable square footage can be compared to the existing vacancies to determine how much of the current supply of retail space can be filled, and whether a demand for new construction is indicated.

In the Granby Street district, projected demand will support 285,600 square feet of retail space at \$250 per square foot sales productivity. In Table 5.2-4, a range of sales volumes, representing a conservative level of 15 percent below projected sales and an aggressive level of 15 percent above projected sales, have been cross-indexed against a range of sales productivities to determine supportable square footages. The range of sales productivities corresponds to reasonable sales levels for retail and restaurant investment in a variety of retail settings, as well as the range of sales productivities currently generated by retail centers and districts within the Norfolk MSA.

Table 5.2-4

**Supply and Demand Analysis Sales Productivity Matrix (Supportable Square Footage Assuming Three Sales Volumes and Five Levels of Sales Productivity)**

Sales Volume	\$150 per Sq. Ft.	\$200 per Sq. Ft.	\$250 per Sq. Ft.	\$300 per Sq. Ft.	\$350 per Sq. Ft.
\$60,000,000	400,000	300,000	240,000	200,000	171,429
\$71,400,000	476,000	357,000	285,600	238,000	204,000
\$82,000,000	546,667	410,000	328,000	273,333	234,286

Source: H. Blount Hunter Retail & Real Estate Research Co.

**Creating a Merchandising Strategy**

A comprehensive merchandising strategy precedes the leasing effort. Promulgation of a broad merchandising strategy is an important element of creating a strategic vision and plan for a street retail district. Consensus must be reached among key stakeholders, including property owners, the directors of the BID or management organization (if present), and the host municipality.

Optimally, the merchandising plan for a street retail district will respond to the retail and restaurant interests of current and potential users of the downtown area in a way that simultaneously contributes to the district's extended drawing power and enjoys maximum insulation from competition from other retail and restaurant clusters. A "void analysis," which is often recommended by retail analysts for determining underserved retail merchandise categories, is arguably applicable because its greatest usefulness applies to assessing demand for comparison goods with predictable annual household spending based on data from the U.S. Census Bureau's Consumer Expenditure Survey. However, this analytical process is only appropriate for suburban retail development or for an urban study area that has overwhelming majority support from a nearby residential market. For most urban street retail districts, comparison-goods retailing will be secondary to specialty retailing where consumer spending is not well documented by any published government data.

The foundations for a merchandise strategy are drawn from

1. Prevailing themes in the larger downtown environment such as local history, maritime heritage, significant architecture, content of visitor attraction and cultural venues, and programmatic elements of marketing and/or special event organizations within the downtown area;
2. Demographic and psychographic characteristics of current and potential users;
3. Existing strong signature businesses in or near the street retail district;
4. Untapped niches in the competitive retail and restaurant landscape of the metropolitan area.

For the Granby Street district, key merchandising themes that emerged included history, maritime heritage, performing and visual arts and culture, entertainment, and casual and fine dining.

**The Next Steps**

Armed with a fact-based set of user profiles, realistic sales projections, and a comprehensive merchandising strategy that illustrates key themes, private sector and municipal stakeholders can proceed with leasing and development actions, as well as marketing and promotional activities.

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## Street Retail: Granby Street District, Downtown Norfolk *(continued)*

1. High-impact leasing and development opportunities should be identified for priority effort. These opportunities should have the potential to contribute to major image transformations for the street retail district. These kinds of tenants may be considered as being comparable to the anchors of a regional shopping center in terms of their potential for positioning the district and generating destination traffic.
2. Marketing and promotional activities can be organized in support of generating targeted traffic concentrated specifically within the street retail district. Strategies and tactics may be designed around the dual goals of increasing spending by current users and generating new person trips by nonusers. For example, a BID could undertake activities such as concerts or "Taste of the Town" dining promotions as a means of bringing people into the heart of the study area.
3. Periodic reevaluations of market conditions should be undertaken to measure progress and to refine future goals.

### Results

After completing the market analysis, promoters of the street retail district—like their suburban retail center counterparts—are able to answer the following ten questions most critical to retailers, restaurateurs, and site selectors:

1. Who are the customers?
2. How many customers are there over the course of a year?
3. Where do they come from?
4. What motivates them to come to this area?
5. How often do they come to this area?
6. Who are the best customers?
7. What do they do when they are here?
8. How much do they actually spend?
9. How much are they capable of spending?
10. How large a critical mass of retail and restaurant space can be supported given current levels of usage?

The Granby Street market study provides significant leasing data for the Downtown Norfolk Council, the retail development staff of Norfolk's Department of Development, real estate brokers, and property owners. The study identifies the penetration and frequency of use by age group, by income level, and by residency. It estimates the market share from residents, tourists, and downtown workers, and provides an estimate of supportable square footage and expected sales per square foot. All of these statistics paint a positive outlook for development of street retail in the Granby Street district.

Reinvestment by key property owners has occurred as building owners have recognized the need for basic property improvements as a prerequisite for generating tenant interest. Investment by new property owners has occurred as aggressive landowners have acquired the holdings of passive or absentee property owners. New business openings are perhaps the most exciting results of newly generated interest in the Granby Street district. As expected, restaurants are leading the return to the district; specialty retailers are following.

Within six months of the release of the study, there has been significant local and national tenant interest in the area. The following results have been realized:

- A major property owner began renovation of a 22,000-square-foot building for a national chain tenant.
- Four vacant buildings underwent facade upgrades as the first step toward making them more attractive to potential tenants.
- A florist relocated from the suburbs.
- Two upscale bistros have opened and a 50,000-square-foot dining/entertainment center is underway.
- A minimum of three national restaurant chains expressed interest in locating in the district.
- The Downtown Norfolk Council (a voluntary member organization) initiated efforts to convert to a BID to maximize property-owner interests in the Granby Street district.

## Retail Entertainment Center: The Lake at Riverdale

Jill Bensley

Four years ago, Bill Johnson's dream was to create a place where people in Riverdale, an upscale suburban community, could come with their families to meet friends, stroll, relax and unwind, shop, eat, and play. His firm's previous retail projects had succeeded in the town: an 80,000-square-foot center with a big-box bookstore, several fast-food restaurants, a home store, and several service shops; and a 50,000-square-foot center just up the road, with a six-screen cinema, the best local restaurant, and several convenience shops. But this project would be far bigger, and far more elaborate.

Today, going over the second-year sales volumes, Johnson was struck with the extraordinary figures. Sales were so impressive that he suspected a miscalculation: \$500 per square foot for the retail; \$550 for the restaurants; \$125 for the cinema and \$175 for the game center. Overall sales averaged just under \$460 per square foot, well above the productivity of typical retail centers.

He checked the projections in the feasibility study; sales were significantly higher than predicted. The feasibility consultant had explained to him that this project could not be viewed as a conventional shopping center. The methodology, she said, is totally different. It involves data collection, analysis and projections of many diverse market segments, projection of discretionary spending for recreation and entertainment, and surveys of many types of restaurants, game centers, cinema, and retail venues in the market.

### Riverdale, A Town on the Edge

The town of Riverdale is located in the shadow of a major metropolitan area; it is an edge town. Residents can drive 40 minutes and sample the finest restaurants, stores, cinemas, performing and visual arts, and nightclubs in the United States. But Riverdale residents had left the busy urban sprawl to settle here and create the type of life they had earned. They built a glamorous performing arts center so residents would not have to go downtown. They created the best school system in the state. And they enjoyed one of the highest income and quality-of-life regions in the state.

About one mile away, a 1.5 million-square-foot regional mall with five anchor department stores is achieving sales

of \$380 per square foot. How could potential demand be measured for Johnson's dream center, The Lake at Riverdale? The following pages summarize the process used to conduct the market feasibility analysis.

### Project Description

The plan for the new center included a program of 270,000 square feet of gross leasable area with the following uses:

Type of Use	Square Feet
15-screen cinema	75,000 (5,000 seats)
Retail	100,000
Food and beverage	60,000
Nightclub	10,000
Family and children's attraction	25,000
Total	270,000 square feet

Going into the project, two anchor tenants had been secured. The upscale grocer had been looking for a location in the area, as had the cinema.

### New Methodology

As entertainment-themed projects began to evolve, it became obvious that the commonly used gravity model (see page 147) would not apply. The first studies conducted for a specialty retail center attempted to measure performance of other entertainment-anchored centers with retail components in like areas of the country. It was extremely difficult to construct a model based on limited data. As more centers were developed, performance indicators were established measuring attendance, per capita expenditure at the center, trip purpose (i.e., dining, strolling, visiting, shopping, etc.), percentage of attendance from residents versus overnight visitors, and market penetration rate of visitors.

In the early 1980s, Disney Development Company proposed a whole new concept in urban entertainment. It conducted market research and feasibility testing on a new "urban entertainment center" planned to include a major regional shopping center, an indoor theme park, cinemas, nightclubs, and food and beverage venues. The project

underwent extensive feasibility testing, including a complete gravity model for the retail component, a modified theme park study for the ride component, and separate analyses for the restaurants and nightclub components. After these studies were complete, a massive amount of consumer research (telephone surveys and focus groups) was conducted to test the new products. In the end, the project was abandoned because of several factors, including difficulties with the site, the demographics of the close-in population, and the construction cost of building the attraction.

It is from this exercise, however, that a new methodology for testing retail entertainment center feasibility emerged. The methodology combines a detailed comparable project analysis, market and site analysis, and consumer research to develop probable levels of attendance and expenditure. This model has been successfully employed to test the feasibility of several new projects in the marketplace, including The Lake at Riverdale.

### **Demand Analysis—What's Missing in Riverdale?**

The methodology derived to predict market feasibility of retail entertainment centers is based on the following three key assumptions:

1. The product is not a retail center.
2. Consumers are extremely discriminating in their choice of entertainment and leisure experiences.
3. People are missing a collective human bonding experience in their lives.

The first is easy to understand. The second and third are much more subtle. According to focus groups and opinion polls, today's consumer sees goods as interchangeable. Thus, in order to get a consumer to shop at a location, it is necessary to differentiate the product and presentation from those of competitors. Shopping today is not about goods and services; it is about experiences. Further, consumers—especially female consumers, who comprise approximately 75 percent of primary purchasers at shopping centers—are afraid to shop at night for safety reasons. The female consumer is sick of waiting in lines, and she is busy and harried in her

dual-earner household. She needs shopping and recreation provided in a convenient, high-quality, entertaining package.

Modern consumers view shopping in two ways, the "have to" shopping and the "want to" shopping. A retail entertainment developer's job is to make the "have to" shopping into the "want to" shopping. The developer must provide a safe, fun, emotionally bonding experience, within an entertaining, changing themed environment.

When viewed with these factors as background, it is easy to conclude that a huge void exists in Riverdale for this product.

### **The Many Markets**

Demographic analyses for a retail entertainment center must consider the overall population and identify the appropriate submarkets. For example, the extended market area in this case is the market-containment area of those living within 25 miles of the site. From that distance, an estimated 80 percent of total sales will be generated, based on comparable market analyses. A closer market-containment area is also important, that is, the 10-mile radius. According to studies of centers with retail and entertainment elements in suburban locations, this market can comprise from 60 to 75 percent of the sales at the center. If this were an urban downtown, the market area would be extended considerably. Further, overnight visitation could be a major market segment. However, in this suburban location, no tourism exists and the closest visitor area is more than 20 miles to the west.

Demographic factors to consider include the size of these two market-area populations, the number of households, the average household size, and their income characteristics, levels of educational attainment, and employment characteristics including occupations.

Within these market segments, various submarkets must be quantified and qualified. For example, a game center will attract young males; thus one must know the number of males aged 12 to 24 within the market areas. Nightclubs need a market area with large numbers of people aged 18 to 35. Fast-food retailers need to know the size and characteristics of the nearby office population. And all retailers must know all they can about their female consumers.



### **The Submarkets**

#### **THE FEMALE CONSUMER**

Because women purchase between 70 and 85 percent of all goods sold at a shopping center (according to a 1996 survey by the Mass Retail Association), they are a formidable segment for retail entertainment products. Characteristics such as the number of working women, family structure, and presence of children under 17, must be quantified.

In this case, the population is family dominated; 67 percent of households include children. Bucking national trends, only 45 percent of the women in this market work. These factors must be kept in mind when programming the center.

#### **OFFICE WORKERS**

This market segment, estimated at 50,000 workers within three miles, provides demand for food service at lunch and some convenience retail; they are also prospective consumers for the cinema, if the workers live nearby. In this case, most workers live within ten miles of their worksite. This lucrative market segment, if large enough, can generate demand for a fast-food food court, which, if executed well, can also serve busy mothers with children in the after-school shopping hours.

#### **UNIVERSITY STUDENTS**

The state university located five miles north of the site boasts an enrollment of 20,000. This market segment has a large appetite for nightclubs, movies, low-rent bars, and beer halls, and will occasionally browse in a bookstore. The analyst must remember, however, that the university bookstore provides students with most of their retail academic needs.

#### **PASSING MOTORISTS**

The site is located at an off-ramp of the freeway. Average daily traffic is approximately 80,000 vehicles. Although these motorists will probably not create a large share of business for restaurants, movies, or retail, the center will be a constant billboard for these passing motorists, who will return to the center as a destination at another time.

### **Psychographics**

Because a retail entertainment center sells lifestyle and experience, not goods and services, it is important to know just who customers are, what they like to buy, where they vacation, and other characteristics. Psychographic analysis is an inexpensive way to identify and target like groups.

A sample psychographic analysis is provided in Table 5.3-1. The summary section at the top of Table 5.3-1 highlights the largest psychographic groups in the Riverdale market and will be used to test the proposed plan and to target tenants. Each category has a detailed explanation associated with it. For example, the Upward Bound category is defined as upper middle-income, family-oriented, college-educated non-Hispanic white households, aged 25 to 54, living in single-family homes. Second City Elite are affluent, college-educated, white-collar executive, mostly non-Hispanic white couples, aged 35 to 64. Table 5.3-1 shows all of the high-income clusters in the market area. It is notable that Riverdale is a very high-income market area, with 93.6 percent of its households falling within the higher-income segments.

### **Focus Groups**

Many retail entertainment projects will offer products new to the market. Modeling projected attendance, per capita expenditure, and affordable rents can be problematic with no market comparables available. In the case of The Lake at Riverdale, the developer is considering a family entertainment center sponsored by a large national company. Collectively, the owner and developer will conduct a series of five focus groups to determine response to the concept, pricing, hours, food and beverage choices, and other important factors. Carrying the research this far may appear unnecessary, but because initial investment in tenant improvements will be so significant, testing the concept as thoroughly as possible is important to ensure that the investment is worth the risk.

### **Supply Analysis**

Surveying and quantifying comparable projects for a retail entertainment center is more art than science. Because the project includes many categories of shopping

Retail Entertainment Center: The Lake at Riverdale (continued)

Table 5.3-1

**Higher Income/Expenditure Potential Lifestyle Clusters in the Riverdale Market Areas, 0-10-Mile Band**

Cluster	Population Distribution (%) 0-10-Mile Band	Cluster	Population Distribution (%) 0-10-Mile Band
<b>Total Population</b>	100.0		
<b>SUMMARY OF FOUR LARGEST CLUSTERS</b>		<b>Educated, White-Collar Singles &amp; Ethnic Families in Upscale Urban Areas (U1)</b>	
Upward Bound (C1)	52.0	Urban Gold Coast	0.0
Second City Elite (C1)	23.4	Money and Brains	0.0
Winner's Circle (S1)	5.6	Young Literati	0.0
Blue Blood Estates (S1)	5.1	American Dreams	0.0
<b>Subtotal</b>	<b>86.1</b>	Bohemian Mix	0.0
		<b>Subtotal</b>	<b>0.0</b>
<b>SUMMARY OF HIGH-INCOME CLUSTERS</b>		<b>Educated, Young, Mobile Families in Exurban Satellites &amp; Boom Towns (T1)</b>	
<b>Educated Affluent in Suburbs (S1)</b>		Country Squires	0.4
Blue Blood Estates	5.1	God's Country	3.6
Winner's Circle	5.6	Big Fish Small Pond	0.0
Executive Suites	2.2	Greenbelt Families	0.2
Pools and Patios	0.0	<b>Subtotal</b>	<b>4.2</b>
Kids and Culs-de-sac	0.0		
<b>Subtotal</b>	<b>12.9</b>	<b>Educated, Affluent Families &amp; Retirees in "Second Cities"/ "Edge Cities" (C1)</b>	
<b>Couples/Singles in Upscale White-Collar Suburbs (S2)</b>		Second City Elite	23.4
Young Influentials	0.0	Upward Bound	52.0
New Empty Nests	1.0	Gray Power	0.0
Boomers and Babies	0.0	<b>Subtotal</b>	<b>75.4</b>
Suburban Sprawl	0.0		
Blue-Chip Blues	0.0	<b>Total Higher-Income Population</b>	<b>93.6</b>
<b>Subtotal</b>	<b>1.0</b>		
<b>Middle-Income, Child &amp; Post-Child Families in the Inner Suburbs (S3)</b>			
Upstarts and Seniors	0.0		
New Beginnings	0.0		
Mobility Blues	0.1		
Gray Collars	0.0		
<b>Subtotal</b>	<b>0.1</b>		

Sources: NDS/UDS Data Services and JB Research Company.

## Retail Entertainment Center: The Lake at Riverdale *(continued)*

and entertainment, it is important to assess the competition in each category. This research means collecting sensitive sales information from local cinemas, restaurants, specialty retailers, game centers, nightclubs, and other categories of potential tenants.

Projects to survey include all entertainment-oriented districts and centers in the local area. Retail experience at regional malls is not relevant; however, cinema and restaurant sales at the regional mall are. More to the point, any shopping district, such as a downtown offering restaurants, bars, nightclubs, and retail, represents competition. And any recently developed retail entertainment centers are also considered competitive. Factors to research include square footage of each center, year opened, tenant list, estimated sales per square foot, rents, overages, terms, and future plans.

Estimated annual attendance at each of the projects surveyed is a key factor to research. In many cases, this figure is not known, even by the owner or operator. Estimates and sometimes educated guesses are the best one can do under these circumstances. However, the number is critical to the analysis, because it will be used to deter-

mine an array of market penetration rates upon which to base attendance at the proposed project.

A comparable project survey is given in Table 5.3-2. With the data provided in this table, per capita expenditure can be calculated, and market share for each center can also be determined. Market share analysis can be derived using demographic ring analysis, which must be ordered from a data service. (See appendix for list of sources.) These factors will be used to project attendance and per capita expenditure for The Lake at Riverdale.

For this exercise, the analyst used the *Zagat* restaurant guide, which surveys every major U.S. metropolitan area annually. Although the subject location is in the suburbs, the guide was helpful in pointing out the most popular spots. Local guides can also be purchased to identify top nightclubs, nightspots, and bars in the region.

Obtaining sales volumes at individual restaurants and retail stores is difficult, sometimes impossible. Brokers, other analysts, and knowledgeable sources can assist in identifying sales achieved in the best nightclubs and restaurants. For cinemas, movie grosses for individual locations can be purchased from Entertainment Data, Inc., Los Angeles.

Table 5.3-2

### Retail Entertainment Center Experience

Center	Gross Leasable Area (Sq. Ft.)	Sales (\$000)	Attendance (000,000)	Sales per Sq. Ft. (\$)	Sales per Capita (\$)
A	240,000	\$312,000	17.0	\$1,300	\$18.35
B	136,100	51,000	16.1	375	3.19
C	219,000	98,600	13.0	450	7.58
D	248,000	108,800	10.0	439	10.88
E	231,200	55,700	10.3	241	5.41
F	200,000	85,500	10.5	428	8.14
G	173,400	55,000	3.8	317	14.47
H	89,000	35,500	4.8	399	7.40
I	150,000	100,000	6.0	667	16.67
J	164,000	30,000	4.0	183	7.50
K	138,000	60,000	3.0	435	20.00
L	144,000	60,300	4.0	419	15.08
M	255,000	58,000	4.0	227	14.50

Source: JB Research Company.

### National and Regional Comparable Projects

For this exercise, the analyst chose four national models that have been operating for several years in the marketplace and ordered demographics of ten-mile markets for each. The results presented in Table 5.3-3 give a good background on the size and character of the primary markets of these successful centers. The smallest market surveyed includes a population of approximately 300,000. The subject market, with 450,000, is on the low side, but still within range of the comparables.

The table also provides telling data regarding income and occupational characteristics. For the most part, all of these centers have high median household incomes, high home ownership, and are extremely white collar. Comparing the subject market with the others shows that it is close to the profile of an area that can support a retail entertainment project.

### Projected Attendance and Per Capita Revenue

Projected attendance at the proposed project can be derived from the data collected and analysis conducted in the supply and demand analysis. The comparables indicate penetration rates ranging from a low of 10 percent in a large urban market to a high of 400 percent in a small suburban market. The Lake is most similar to the suburban project.

The 200 to 400 percent penetration of the 25-mile radius market exhibited by the suburban projects is a function of multiple monthly visits by locals. Also responsible for this high penetration are weekly lunchtime visits from nearby office workers. Interviews of visitors at one national comparable project indicate that 25 percent of patrons returned to the project at least weekly (52 visits annually), while many only visited once or twice a year. At The Lake, cinema, retail, specialty, nightclub, restaura-

Table 5.3-3

#### Demographic Characteristics of Retail Entertainment Center Markets

	Reston Town Center, Reston	Mizner Park, Boca Raton	Country Club Plaza, Kansas City	The Spectrum, Irvine	Main Street, Miami Lakes	The Promenade, Westlake
<b>10-Mile Market Area</b>						
Population (000)	482	529	786	848	1,111	295
Households (000)	175	248	333	300	384	100
Families (000)	125	150	200	585	272	76
Per Capita Income (\$)	32,862	26,730	17,708	26,349	13,014	31,024
Median Household Income (\$)	71,622	38,534	33,076	56,115	32,203	65,224
Average Household Income (\$)	90,269	56,830	41,542	74,022	37,521	90,916
Home Ownership (percent)	72.7	73.8	59.6	61.6	58.0	76.7
Occupation, White-Collar (percent)	80.7	66.0	64.6	70.0	53.8	72.8
Median Age (years)	34.4	45.7	35.3	31.8	35.3	34.6
<b>Racial Characteristics (percent)</b>						
Non-Hispanic White	83.6	86.1	74.8	81.0	65.3	86.0
African-American	5.5	11.5	21.1	2.0	28.7	1.9
Asian	0.2	1.3	0.5	10.5	1.6	6.7
Hispanic Origin	6.0	6.5	5.0	26.2	46.2	13.2

Source: JB Research Company.

## Retail Entertainment Center: The Lake at Riverdale *(continued)*

rants, and children's attractions will draw customers back several times each month.

Several ways exist to apply this methodology to derive a penetration rate for The Lake. First, the most comparable projects must be identified in terms of market size, character, and retail program. An average can be calculated, or data from the two most likely candidates can be averaged. This methodology generates a reasonable market penetration on which to base projections. These mathematical manipulations yield a 175 percent penetration of the 2.0 million 25-mile market, or projected annual attendance of 3.5 million.

### Projected Per Capita Expenditure

Per capita expenditure is the mathematical average of the total number of visitors divided by gross revenue at comparable centers. In the demand analysis, this number was derived on the basis of estimates of attendance and gross sales. The exercise provides a range of per capita expenditures.

To choose the appropriate per capita for The Lake, it is necessary to analyze the projects with similar programs and to apply information about industry average pro-

ductivity for the various tenants. An additional exercise is provided in Table 5.3-4, which applies expected sales productivities by tenant. In fact, the analysis indicates that projects with cinemas produce the highest per capita, theoretically because they generate more activities (e.g., dinner and a movie, movie and a drink, movie and browsing at retail shops, etc.).

With the projected annual visits as high as 3.5 million and per capita expenditure at an estimated \$26 annually, gross sales are projected at nearly \$91 million in a stabilized year. Sales per square foot on this basis are approximately \$336 including the cinema. Sales net of the cinema, which has a much lower yield than the retail and restaurant, are at \$417 per square foot.

### Financial Analysis—Projected Rents, EBDITA, and Return on Investment

The financial analysis at this point provides a rough estimate of the return on investment. In this case, the firm expects a 12 to 15 percent cash-on-cash return, excluding land and financing. The developer estimates hard and soft costs to be approximately \$210 per square foot. Total project cost on this basis is \$56.7 million.

Table 5.3-4

#### Estimated Gross Annual Sales, Retail Entertainment Center

Program	Sq. Ft.	Estimated Productivity	Annual Gross Revenue
Cinema	75,000	\$125	\$ 9,375,000
Restaurants	60,000	400	24,000,000
Retail	100,000	513	51,250,000
Nightclub	10,000	225	2,250,000
Children's Attraction	25,000	150	3,750,000
<b>Subtotal/Average</b>	<b>270,000</b>	<b>\$336</b>	<b>\$90,625,000</b>
Sales Per Square Foot, Overall			\$336
Sales Per Square Foot, Net of Cinema			\$417
Estimated Annual Attendance			2.5 million to 3.5 million
Estimated Per Capita Expenditure			\$25.89–\$36.25

Source: JB Research Company.

## Retail Entertainment Center: The Lake at Riverdale *(continued)*

An estimated rent roll is given in Table 5.3-5 and assumes rents based on local, regional, and national comparables. Those rents are cross-checked with expected sales to determine affordability by the tenant. Gross rent is approximately \$7.6 million, net of \$6.1 million EBDITA (earnings before depreciation, interest, taxes, and amortization). Under these assumptions, return on investment is 12 percent, a moderate, but acceptable, rate of return.

The first analysis to determine return suggests that the project should continue. The relatively low return is expected to be bolstered by percentage rent collections, which will be considerable, parking subsidies from the city of Riverdale, and favorable financing.

### Summary

The following assumptions and conclusions are key to understanding the market for entertainment retail:

- An identified need must exist in the marketplace for a people-gathering locale, a place to see and be seen.
- Trip motivation is recreation and entertainment, not shopping.
- The commodity sold is an experience, not a good.
- Project cost will always be higher than conventional retail.
- Sales volumes must be similar to or greater than those for a regional shopping center because of high development costs.
- Average per capita expenditure on an entertainment trip is less than half the average per capita expenditure on a shopping trip. Therefore, the center must create repeated experiences for local patrons.
- Several market segments must be identified, quantified, and qualified.
- Psychographic analysis is a requirement of the market study.
- Focus groups are necessary to test new development types.

Table 5.3-5  
**Stabilized Year Operating Pro Forma  
Retail Entertainment Center**

Program	Sq. Ft.	Base Rent per Sq. Ft.	Annual Rent
Cinema	75,000	\$24	\$1,800,000
Restaurants	60,000	36	2,160,000
Retail	100,000	29.50	2,950,000
Nightclub	10,000	24	240,000
Children's Attraction	25,000	18	450,000
<b>Subtotal</b>	<b>270,000</b>		<b>\$7,600,000</b>
At weighted average 8.0 vacancy non-cinema space			(\$464,000)
Expense: Management Fee, G & A, Other @ 7%			(\$532,000)
<b>Net Operating Income</b>			<b>\$6,604,000</b>

Source: JB Research Company.

- The supply analysis must include profiles of successful bars, restaurants, cinemas, game centers, and specialty retail locales in the market.
- Because competitive projects may not answer questions regarding performance, key competitive data may have to be interpolated or estimated.
- If entertainment retail is successful, sales will surpass a comparable model.
- Consumer safety and perception of safety are a key component of success. Convenience is also crucial.
- Return on investment may not tabulate well at first. The project often needs municipal subsidy and stores contributing overage rents to earn a healthy return.

## Town Center: Wilanow, Warsaw, Poland (2000)

Anne B. Frej

Conducting market research in countries outside the United States can be tricky, especially if public sources of information are unreliable or if they provide less detail than is required to draw conclusions. In countries with newly emerging economies such as those of central Europe, historical data are also lacking because commercial real estate markets have been in existence only since the early 1990s. This case study of the Wilanow Town Center in Warsaw, Poland, illustrates the methodology used for retail research when data availability is an issue.

### Project Description

The Wilanow Town Center project is planned as the heart of a new community to be developed at the southern edge of Warsaw. This large new community of 420 acres will be developed by several different companies and is anticipated to include a mix of uses including low-density residential neighborhoods, shopping facilities, offices, and public facilities. The master plan places a major focus on leisure activities with plans for a skating rink, water features, and open space areas. At buildout, the community is expected to house a population of 10,000 to 15,000 residents. The retail and entertainment components are estimated to attract 8 million to 12 million off-site visitors per year.

The Wilanow Town Center to be developed by IDM encompasses about 27.1 acres and is planned to include a variety of complementary uses. The shopping center component of the project will include a hypermarket, a two-level shopping gallery, a multiplex cinema, and a food court, with a total area of around 914,962 square feet. Completion is expected by December 2003. Given the wide variety, high quality, and large size of its retail and entertainment offerings, the development is planned to serve local residents as well as the wider market of the surrounding areas.

The developer, IDM, is headquartered in Warsaw, Poland. IDM invests in, develops, leases, and manages urban retail centers and larger retail mall projects throughout central Europe. The principals of IDM have worked in the region since 1989 on a variety of real estate projects supported by European institutional investors.

In May 2000, the Real Estate Consulting Services Group of Arthur Andersen in Warsaw completed a market feasibility analysis for the proposed shopping center for the Wilanow Town Center. The purpose of the study was to provide an objective assessment of the project for IDM's internal decision-making team. Data on the estimated market area's spending power and resulting figures for supportable floor space were used by the company as a guide in determining the optimum project size and mix of uses.

### Site Assessment

The site is located in the Wilanow area, a prestigious and wealthier-than-average residential district characterized by high-end single-family homes, parks, and historical monuments, including the Wilanow Royal Palace. This baroque palace and park, originally established in the 17th century and rebuilt after World War II, is located only a few blocks from the proposed development site and plays an important role in all planning and design decisions for the project.

The main advantages of the shopping center site include the positive image of the surrounding neighborhood and excellent access to the center of Warsaw, several miles to the north. Many shoppers in Warsaw, as in other cities of central Europe, tend to use public transit in the form of buses and trams because car ownership is still relatively low. Therefore, an assessment of public transportation service and frequencies is an important component to a shopping center market analysis.

Analysis indicates that site disadvantages include the low-density character of the surrounding area, the lack of existing infrastructure, and possible constraints to future development because of the presence of protected areas such as parks and forests in the immediate area. These disadvantages were examined in depth to determine how they would affect project feasibility.

Existing master plans and zoning regulations are purposely quite general in Warsaw. Therefore, interviews with local authorities are often the best way to obtain up-to-date information on planning regulations and infrastructure improvements affecting a project. Interviews with

local officials and planning staff, as well as staff of various transportation-related authorities, reveal important information about the future development opportunities in the surrounding area. The schedule for a proposed sewage treatment plant was one of the most important questions to be answered because it significantly affects the growth potential of the entire area. The schedule for construction of a major bridge over the Vistula River was also crucial to ascertain because it could greatly facilitate access for households living in areas to the east.

### Defining the Market Area

Market areas were defined for the proposed shopping center on the basis of drive times to the site, population concentrations, physical features, competing retail schemes, and local shopping patterns. The primary market area surrounding the site was estimated to encompass populations within a 12- to 15-minute drive of the site. The secondary market area was defined as populations within a 15- to 20-minute driving radius of the site. Because of strong competition from two existing shopping centers, the subject's west and southwest borders were not expected to extend significantly beyond the primary market area.

Base data on market-area populations were obtained from 1999 government statistics for the subareas of Warsaw known as *gminas*. *Gmina* data provide the smallest population breakdowns possible, but unless their boundaries coincide with market area's boundaries, which is unlikely, subarea populations must be estimated by other means. At the simplest level, such methods can include visual surveys to estimate the percentage of the population of the area that is included within the market-area boundaries. No age breakdown or income data are available for subareas; they must be extrapolated from citywide data.

Population projections for city subareas may also be unavailable or unreliable in countries outside the United States or western Europe. In the case of the proposed shopping center at the Wilanow Town Center, this information was considered crucial to a realistic determination of the future feasibility of the project. The surrounding market area of the project is still relatively unpopulated but could

grow dramatically in the future. To estimate population growth up to 2003, when the shopping center is planned to enter the market, the consultants projected growth trends on the basis of land availability, residential densities allowable under current zoning, and proposed infrastructure plans. They conducted interviews with planning authorities of the relevant subareas, as well as with residential developers active in the area.

As a result, the consultants determined that the primary market area would grow to approximately 270,000 people in 2002, whereas the secondary market area would grow to 416,000 people by that year. For the longer-term period 2003 to 2007, the primary market area was estimated to grow by some 50,000 people. This figure was recognized as highly speculative and dependent upon public and private investment in infrastructure, but it was considered a useful estimate for general planning purposes. For example, in Wilanow, the population is expected to grow significantly after the local sewage system is upgraded and important arterial streets are improved, but the exact timing for those improvements is uncertain. In other parts of the market area, growth potential will be limited by decreasing availability of land and local plans that restrict the density of new residential developments.

### Spending Potential

On the basis of government statistics for the city of Warsaw, the average annual per capita expenditure for residents of the primary and secondary market areas was estimated at \$3,300 in the year 2002. Of this total sum, the expenditures on shopping center-type goods were estimated at \$2,046. These citywide figures were recognized as potentially conservative for the residents of the more affluent Wilanow area; however, no indicators were available from which to make a more reliable determination of income within the market areas.

Breakdowns of expenditures by category (such as food, fashion, and entertainment) were based on official statistics for Warsaw and Poland as a whole. The data were collected by household surveys dating from 1997;



therefore, adjustments were necessary to take into account recent changes in shopping patterns. It was recognized that since 1997 Poland has moved closer to the norms in other European countries because of growth in the proportion of expenditures on clothing, household goods, and leisure activities relative to spending on food.

The total market-area expenditure on shopping center-type goods (the amount of expenditures available to retailers in the area) was calculated by multiplying the number of residents by expenditures per capita within the primary and secondary market areas. This figure is estimated at \$555,591,300 for the primary market area and \$851,197,380 for the secondary market area.

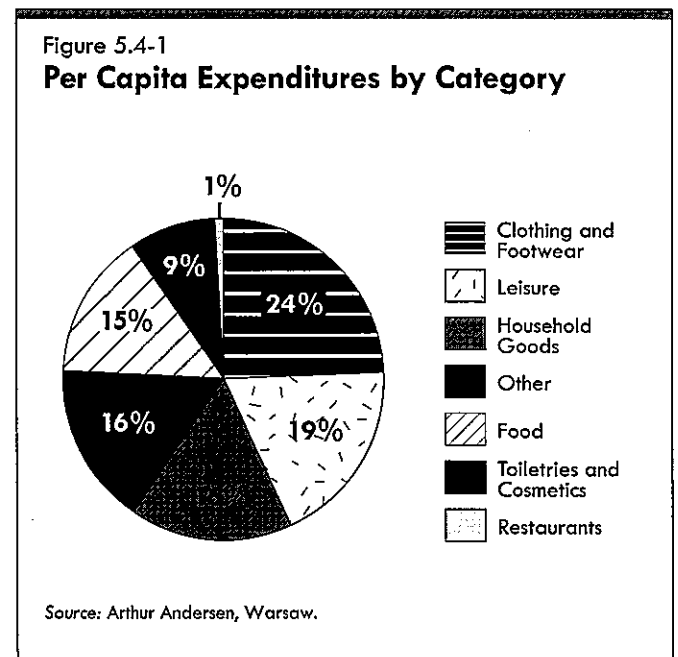
To estimate the share of expenditures that could be captured by the proposed shopping center, the consultant analyzed a number of factors, including the size and character of the proposed center, existing and proposed competition, access to the site, and European industry norms. The estimates for market share for the primary market area ranged from 10 percent for restaurants and 15 percent for food to 40 percent for clothing and footwear. As is typical in any region, capture rates for the secondary market area were much lower because of retail competition and greater distance to the site for shoppers within that area. The capture rates used in this analysis are relatively high compared to those used in similar analyses in the United States because they take into consideration the lack of competition and lower opportunities for growth that cause Poland's relatively low ratio of modern shopping space per capita. As a result of these calculations, the total captured market expenditure expected for the center from both the primary and secondary market areas was determined to be \$226,800,668.

### Estimating Supportable Floor Space

To determine the amount of floor space that could be supported at the new shopping center, Arthur Andersen divided the figure for captured market expenditure by estimates of turnover (sales per square meter) for categories such as food or clothing. These figures are crucial to a realistic analysis but are extremely difficult

to quantify in an immature market. In Poland, no published sources exist, and retailers, both local and international, are very reluctant to reveal sales data. In the United States, in contrast, these data are readily available (ULL's *Dollars & Cents of Shopping Centers*<sup>®</sup> is one example). To estimate turnover, the analysts interviewed a variety of retailers active in the Warsaw market and compared these data to norms in the United States, Great Britain, and Germany to come up with estimates for Poland. On the basis of these assumptions, they further estimated that the total potential supportable gross leasable floor space for the proposed Wilanow Town Center Shopping Center was 895,000 square feet.

The breakdown by category is shown graphically in Figure 5.4-1.

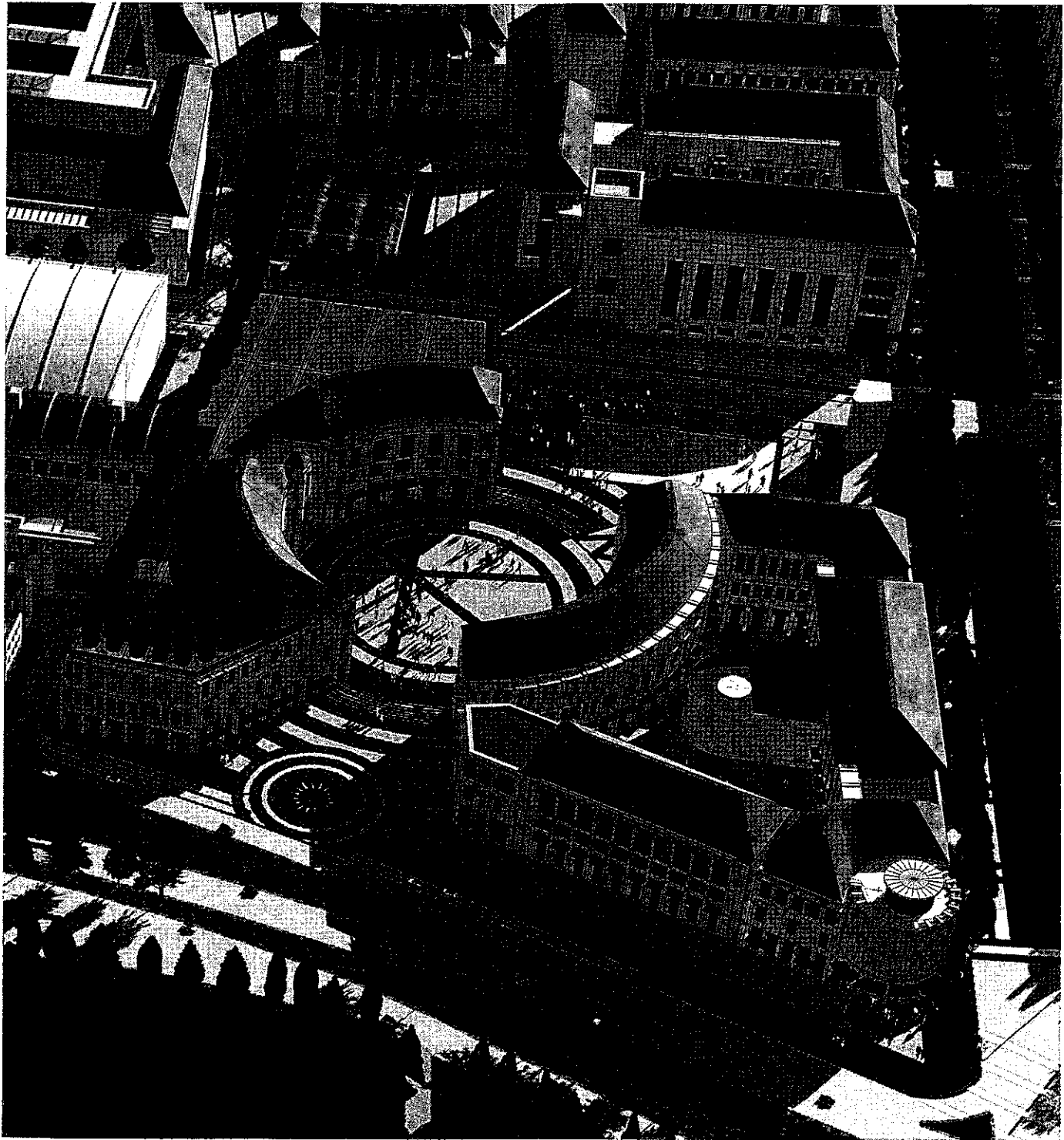


### Supply Analysis

An analysis of Poland's retail market provided useful background information and a basis for projecting future trends. Poland's retail market has undergone substantial changes in recent years, particularly in the larger urban areas. From just a small number of state-owned and small

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Town Center: Wilanow, Warsaw, Poland *(continued)*



Wilanow Town Center, Warsaw, Poland.

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## Town Center: Wilanow, Warsaw, Poland *(continued)*

private enterprises at the beginning of the 1990s, the country's retail inventory has grown to encompass a rapidly increasing number of domestic and international retailers.

Poland's first phase of retail development in the early 1990s focused on supermarkets. This trend continues today because Polish consumers still spend a high percentage of their overall expenditures on food (33%). Most of the recently constructed shopping centers throughout the country feature a supermarket or hypermarket as the anchor store. The next generation of retail developments, including the proposed Wilanow Town Center, will feature a smaller proportion of food offerings and more choices for comparison shopping and entertainment.

Warsaw's total retail inventory stands at about 3.7 million square feet, but less than 20 percent of this can be considered modern shopping center space suitable for international retailers. About the same amount is made up of hypermarkets, which focus on food items in addition to a range of consumer durables and clothing.

An undersupply of good-quality retail space has meant that vacancy rates at shopping centers have remained at less than 5 percent in recent years. But starting in 2000, the amount of new space entering the market began to show a large increase.

### Competitive Analysis

On the basis of an analysis of existing and proposed shopping centers in Warsaw, the most direct competition to the proposed Wilanow Town Center was projected to come from Galeria Mokotow, a 516,684-square-foot shopping center scheduled to open in 2000. As illustrated in Figure 5.4-2, other potential retail centers are not competitive because they are smaller scale, farther than ten or 15 minutes drive from the site, or unlikely to proceed in the near term.

Because of its potential competitiveness to Wilanow Town Center, Galeria Mokotow was analyzed in greater detail than other existing and proposed retail facilities

identified in Warsaw. This center is located approximately 12 minutes drive from the project site, so the primary market areas for the two overlap slightly.

Galeria Mokotow entered the market in late 2000. As the first example of the second generation of shopping centers in Warsaw, it features a supermarket and various fashion and home anchor tenants rather than the earlier format of one major hypermarket and a limited range of smaller shops. The project leased quickly in the months before its completion, and it achieved higher-than-expected rents.

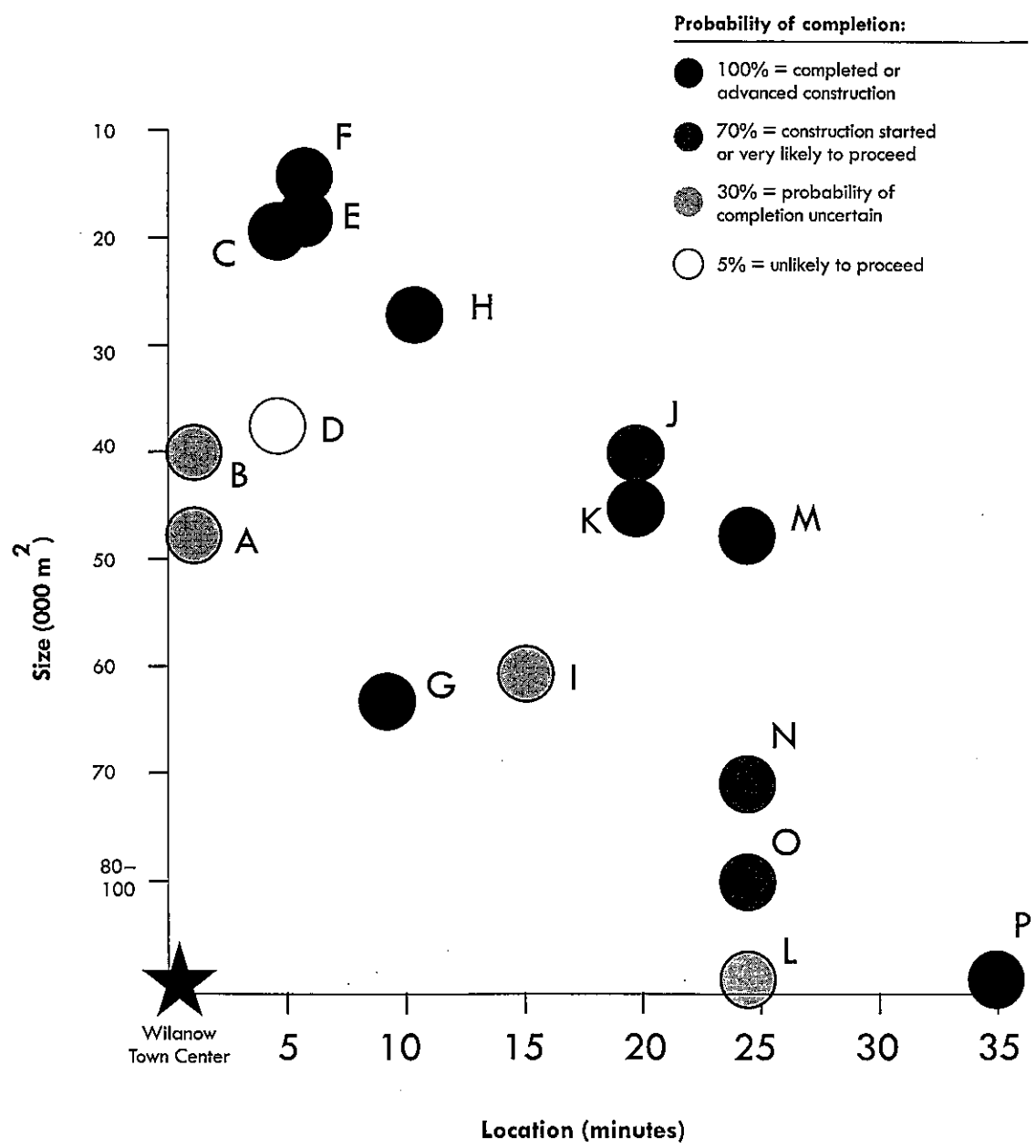
Although Galeria Mokotow had the advantage of entering the market several years before Wilanow Town Center, it was not expected to have a significant effect on the proposed project. Wilanow Town Center is planned as a major regional shopping center that will be able to take advantage of its location in a larger new community with on-site residents, daytime office workers, and leisure uses that will be able to attract shoppers from a wide area.

### Conclusions

Market-area analysis indicates that more than sufficient spending power exists in the primary and secondary market areas to support a major retail center of approximately 861,000 square feet at the Wilanow Town Center. In its early years of operation, it will be important for the center to capture expenditures from the densely populated neighborhoods to the west and north of the site.

After 2005 to 2007, the population of the primary market area is likely to grow significantly because of the expected completion of infrastructure improvements that will encourage new residential development. In addition, the completion of a new bridge across the Vistula River and improvement of new roads serving the Wilanow area will facilitate access to the site from locations to the east and could increase the size of the secondary market area. The acquisition of additional land should be considered for expansion of the retail and leisure uses at the center several years after it opens.

Figure 5.4-2  
**Probability and Competitive Analysis of Existing and Proposed Shopping Centers**



Source: Arthur Andersen, Warsaw.



Marriott Wardman Park Hotel, Washington, D.C.

# Hotels and Resorts

**T**he success of a hotel depends on the developer's and the operator's understanding of the dynamics of each segment of market demand. Equally important is an understanding of consumer trends such as the demographics and values that influence demand within each market segment. An accurate hotel market analysis calls for a close look at (1) the location of the subject site with regard to market demand generators such as tourist attractions, (2) the growth of business demand within the market area, (3) the sources and strengths of transient travel, (4) the location of competitive properties and their physical and operational characteristics, (5) current and future travel patterns, and (6) special local conditions and trends.

Increasingly, hotel demand is dependent on convention and meeting business, plus tourists' ability to easily obtain information and reservations. Affinity clubs, like Hilton Honors and Starwood Preferred Guest, are very important in building brand loyalty.

## Product Types

Hotel development has followed paths taken by other types of commercial real estate in the United States. In the first half of the 20th century, most hotel development occurred in downtown areas where most office and retail development was also taking place. Then, highways began to change development patterns and demand for hotel rooms accompanied the outward movement of offices, stores, and residences. Today the trend is reversing somewhat, with downtowns being reinvigorated and again attracting new

commercial, institutional, and residential development, thus renewing demand for downtown hotels.

Beginning in the 1970s, hotel product became more segmented and specialized as developers and operators attempted to define more narrowly their potential markets and to develop facilities targeted specifically at those markets. The two principal methods of classifying hotels are by location (downtown, airport, resort) and by the market niches they serve. Hotels are probably more accurately described on the basis of markets served than by locations, which have blurred somewhat because of urban sprawl and evolving land use patterns.

Locationally, the primary distinction is downtown hotel versus suburban hotel. Other frequently used categories include airport hotels (those located on airport grounds or near airports) and highway hotels (those located outside city or suburban nodes along travel routes). Classifiers sometimes include resort as a locational category, but the term "resort" more accurately refers to the facility's amenities than to its location. Resort hotels can be located almost anywhere, but the vast majority are found in either waterfront or mountain locations.

Some major niche hotel categories are described in the following sections. It is important for market analysts to understand that most hotels appeal to overlapping market segments and to delineate each of those segments when assessing a property's market potential.

## Convention Hotels

Probably the best-known type, the downtown convention hotel generally contains 400 to 500 rooms and

considerable banquet and meeting space. In many cases, convention hotels are physically connected with or adjacent to large convention centers. They usually include several eating establishments of varying styles and price ranges. Many also include substantial amounts of retail space.

Convention hotels generally feature large lobbies to handle the check-in and checkout functions that occur in a concentrated period at the beginning and end of every convention. It is common for up to 10 percent of the guest rooms to be suites. Guests can use the living rooms of the suites as hospitality rooms, or the hotel can furnish them as meeting spaces for small groups. Many convention hotels have set aside concierge floors for valued patrons or for those paying higher rates. With controlled access, concierge floors offer separate check-in areas, lounges, extra in-room amenities, and complimentary snacks, beverages, and services.

### **Luxury Hotels**

Luxury hotels tend to be located in large metropolitan areas, places frequented by visitors willing to pay a premium price for accommodations. Most have fewer than 300 rooms, and the few larger luxury hotels tend to cater more to corporate travelers and overseas visitors. Such hotels are distinguished by high-quality furnishings, amenities, and services. Many, but not all, house fine restaurants. Their high ratio of employees to guest rooms affects the economics of operations. Although luxury hotels may accommodate some meeting and banquet business, they do not target large groups.

### **Commercial Hotels**

Commercial hotels are generally smaller than convention hotels, offering between 100 and 500 guest rooms. Although meetings may represent an important part of their business, the groups that are served generally are smaller than those using convention hotels. Compared with convention hotels, most commercial hotels provide less public space and a less-extensive array of food and beverage outlets.

### **Budget/Economy Facilities**

At the opposite end of the spectrum are the economy hotels, which go by many names, including budget, hard budget, limited service, and economy. Hotels at this level are a response to the emergence of more value-conscious travelers in the late 1970s and 1980s,

when many businesses began to control travel expenditures more carefully. At the same time, tourist travel expanded rapidly, but much of the growth came from a price-sensitive portion of the market.

The first economy hotels were built along highways outside metropolitan areas, on inexpensive land. They have since moved into suburban areas, airports, and even some downtowns. The original economy properties were one- and two-story structures with exterior corridors. Generally, they contained 50 to 150 rooms.

The economy hotel offers limited services, and average room rates are typically 20 to 50 percent below the rates of full-service facilities in the same area. Economy hotels usually do not have restaurants or banquet space, recreational facilities, or many other amenities found in more traditional hotels. The economy segment of hotel chains has expanded greatly since 1970. That year, only half a dozen chains operated fewer than 200 budget hotels. By 2000, more than 40 chains operated more than 9,200 budget properties. The segment has diversified as well, and it now offers at least three separate tiers of product:

- **Upper Tier.** Hotels at the high end of the budget segment offer more upscale furnishings and decor, and generally charge rates closer to market-area averages. These hotels are generally larger—usually more than 100 rooms. Though the guest rooms are small, the level of quality is often close to that of commercial hotels.
- **Middle Tier.** Mid-economy hotels generally have 60 to 125 guest rooms and charge rates that are usually 25 to 40 percent below the rates of full-service hotels. Their corridors can be either external or internal.
- **Lower Tier.** Economy hotels at the lower end have room rates that are about 50 percent below market. They generally have 50 to 125 modestly furnished rooms and exterior corridors.

Economy properties tend to operate at higher occupancy levels than do full-service hotels, and they achieve income-to-expense ratios that are significantly higher as a consequence of lower staffing requirements and the lack of food and beverage facilities, the latter of which generally operate at fairly low profit margins.

### **All-Suite or Residence Hotels**

All-suite hotels came into existence as a separate category in the 1970s. Their guest spaces are larger than normal (usually containing more than 500

square feet) and have a living area separate from the bedroom. Some all-suite facilities offer a compact, or even full-scale, kitchen.

The all-suite hotel was developed to meet the needs of business travelers who spend a lot of time on the road and long-stay guests like corporate personnel who are relocating or consultants who are on a project that will last some time. Many leisure travelers, especially families, also find these facilities desirable. This product category varies widely from property to property. Still, all-suite hotels generally take one of three basic forms:

1. **Urban.** Urban all-suite hotels are usually mid- to high-rise structures containing 200 to 300 suites, a size generally considered small enough to retain a residential atmosphere and large enough to provide the desired level of service.
2. **Suburban.** Usually found in areas containing a concentration of office buildings, such as edge cities or built-up highway corridors, suburban all-suite hotels generally have four to eight stories.
3. **Residential.** In contrast, residential all-suite hotels usually occupy two-story structures and resemble apartment complexes more closely than hotels. Guest spaces are large, with separate living and sleeping areas, full kitchens, exterior entrances, and a variety of amenities and services. As long-stay hotels strive to become more homelike, the line between hotels and apartment properties has blurred. Residential all-suite facilities usually attract guests who stay longer and, because of the higher occupancies and smaller staffing needs attributable to low guest turnover, they are often more profitable than regular hotels.

## **Executive Conference Centers**

Although many hotels market themselves as conference centers, truly dedicated conference centers are designed to provide a setting free of distractions for executive and professional meetings. Usually located in rural areas or in suburban office communities near major metropolitan areas, they combine meeting and conference facilities with lodging in a way that can accommodate groups in a self-contained learning environment.

Conference centers usually contain 200 to 400 guest rooms and a large number of dedicated conference and meeting rooms. They provide a carefully designed and more or less isolated learning environment, with comfortable seating, suitable lighting, audiovisual equipment, conference support services,

and living and recreational facilities to occupy the hours when conferences are not in session. The food offered is typically of a sufficient quality and variety to make leaving the facility unnecessary. Conference centers offer more extensive recreational facilities than those in traditional hotels. In most cases, occupancy by transient guests is a relatively small part of the operations.

## **Resort Hotels**

Resort hotels cater to both vacation travelers and meetings or conferences. The emphasis is on recreational amenities both on site and off. A resort hotel might feature golf, water sports, skiing, or health spa facilities. Resort hotels have been built in conjunction with theme parks, casinos, and other attractions.

Resort hotels usually include a range of restaurants and meeting and banquet space. Depending on the climate of the resort area, lodging demand may be prone to seasonality, with distinct peak and off-peak periods. Peak periods generally yield maximum published room rates and high occupancy levels. In contrast, off-peak periods are characterized by lower published room rates and reduced occupancy levels. In certain market areas, intermediate periods marked by moderate demand are referred to as "shoulder seasons."

## **Other Hotel Products**

The catalog of hotel products contains some other noteworthy entries. Mom-and-pop hotels usually are fairly small, older motels often located along older highways. B&Bs (bed-and-breakfasts) are usually small inns (fewer than 20 rooms) that are heavy on charm and provide breakfast as part of the room price. Boutique hotels are small, mostly urban hotels (usually fewer than 125 rooms) that cater to upscale clientele desiring a high degree of luxury and personalized service. Condominium hotels offer hotel services and amenities within a condominium ownership structure, usually a timeshare.

A hotel might serve more than one market segment, increasing its potential and making the project less susceptible to market downturns. However, broadening the target market might cause an increase in competition from other hotels. It might also weaken the product's appeal to those originally targeted. Some examples of crossover niches include amusement park hotels, such as those at Disney World, combining family entertainment with conference business, or Las Vegas casino hotels, combining adult-style entertainment with family-oriented activ-



ities. In many cases, convention business overlaps with other market segments.

## Hotel Market Analysis

Hotel market analysis is similar to that for other product types in terms of the basic methodology. However, some important differences exist. Hotel demand is not generated by the hotel itself, in most cases, but by local businesses, convention facilities, tourist attractions, and other draws that bring travelers to a location. These demand generators must be understood to properly analyze the hotel market. Unlike other kinds of real estate, which respond to relatively local demand, hotels cater to patrons from outside the local area.

### Determining the Market Area

For most types of real estate development, the market areas for supply and demand are either identical or overlapping. For hotel development, however, the two market areas are distinctly different, sometimes varying greatly in location and size. For example, the competitive supply for a convention hotel is the inventory of hotels with a similar price range and location in relation to the local convention center. The market area might encompass a ten-minute walking distance from the subject site. But the demand for lodging might come from a national or even an international base of convention travelers. A beach resort hotel with a regional draw would compete with similarly priced and amenitized hotels along the same strip of beachfront. Patrons might be drawn from a nearby metropolitan area or from several surrounding states.

To determine the boundaries of the market area, the analyst needs to identify (1) the location of competitive hotels, (2) the segmentation and origination of the facilities' major sources of business, (3) the trends in travel patterns for vacation, commercial, and convention visitors to the proposed site, (4) the proximity and scope of major demand generators, (5) the expenditure patterns of area visitors, and (6) existing socioeconomic boundaries. For a business hotel, a generator would be business and commercial centers, whereas for a resort hotel, the generators would be nearby theme parks, ski slopes, beaches or lakes, golf courses, sports facilities, and the like. The sources of demand for a resort lodging facility may be segmented into three major categories, which, in descending order of importance, include vacation or

pleasure travelers, convention travelers, and commercial travelers. The following methodology is useful in identifying and assessing the sources of lodging demand:

- Interview representatives from the local tourist and convention bureaus and chambers of commerce to identify the number, length of stay, expenditure patterns, typical group size, lodging demand, and seasonality of tourists and convention delegates. (Note that these agencies sometimes overstate tourist statistics. In addition, they frequently do not maintain a research program that adequately quantifies travel patterns.)
- Interview corporate travel officers, meeting planners, association executives, wholesale tour operators, travel agents, brokers specializing in group or corporate travel, incentive-travel organizers, and spokespersons for travel clubs in feeder cities. Determine their clients' lodging needs, perception of the area, frequency of visits to the area, primary reasons for visiting, typical group size, and seasonality of travel plans. Find out their clients' views of the competitive strengths and weaknesses of existing properties in the subject area and other market areas, the services and amenities they seek, the magnitude of their typical lodging budgets, their future travel plans, and their perceptions of the need for additional local lodging facilities.
- Conduct an occupancy and room rate survey, or purchase data from a hotel association or consultants such as PKF. Examine trends over the last three to five years.
- Identify and speak with officials of comparable hotels to determine their properties' number of guest rooms, average annual occupancy, average annual room rate, market mix of guests, and type and class of facilities. If no comparable properties exist in the market area, locate similar facilities in nearby market areas and then adjust the associated data for the subject location.
- Assess existing capacity and arrival and departure patterns at the major airport within the market area and then determine the mix, seasonality, and growth rate in the number of airport passengers. Data on airline arrivals must be adjusted to reflect stopovers at hub airports.
- List the major tourist attractions, community special events, regional and state fairs or expositions, athletic events, and the like, and determine their typical needs for lodging facilities. Interview attraction or event organizers, hotel operators, tourist bureaus, and others.

The market analyses for roadside motels are approached differently. Such properties, typically located at highway interchanges, serve as a convenience for travelers making an overnight stop on their way elsewhere. For that product type, analysis based on traffic counts usually suffices. Major motel chains typically devise rules of thumb for estimating the minimum number of vehicles required for a new hotel outlet. They also tabulate the inventory of surrounding uses that are desirable amenities for the proposed motel.

## Demand Segments

In general, market segments are defined in terms of purpose of trip, seasonality, length of stay, price sensitivity, the nature of the facilities and amenities required, and the number of rooms required. In measuring demand, analysts used to consider that people traveled for only two purposes: business or pleasure. But today, marketers identify more specific purposes for travel. Is the business traveler on his or her own or attending a conference? Is the conference a training meeting or an executive retreat? Is the business traveler attending a trade show or convention? Is the pleasure traveler part of a tour group or traveling independently? Is the visitor from the United States or abroad? Is this stop the final destination or part of an extended trip? The responses to such questions help define the distinct demand segments available to a hotel. Some of the major demand segments are described as follows:

- **Commercial Market.** The commercial market segment, made up of individuals and groups of both domestic and international business travelers, typically represents a major source of demand for downtown and suburban hotels and a minor source for resorts. Business travelers include managers at all levels, sales representatives, official trainees, and recruits. A crucial criterion in the selection of lodging facilities is location. Primary locational considerations include proximity to centers of business activity and ease of access to and from airports. The typical length of stay is approximately one to two days with demand typically concentrated on Monday through Thursday nights. In some markets, particularly resort areas, however, some commercial visitors extend their stay through the weekend to enjoy the resort and its amenities. Seasonality and price sensitivity are limited concerns. Within the commercial travel sector, further delineations can be made.

- ◆ **Corporate/Commercial Individuals.** This demand segment consists of individuals whose purpose is related solely or predominantly to their jobs or businesses.
- ◆ **Corporate Groups.** This segment is distinguished from the corporate individual segment by virtue of its booking rooms on a block basis. The specific purpose of travel is likely to be a company-sponsored meeting or training session in the hotel or at a nearby location. Because of the nature of the clientele and the source of business, room rates for this segment are negotiated and specify the number of rooms booked and the time of year that the rooms are available.
- ◆ **Convention and Association Groups.** Conventions and association meetings can have thousands of attendees, many of whom travel as corporate groups or book rooms on a block basis through the sponsoring organization. A major trend in the operation of resort hotels has been the marked shift to conference business as one of the principal contributors, if not the principal contributor, to resort occupancy. Although a limited number of resort hotels rely almost entirely on occupancy by independent travelers, most have mounted major efforts to attract conferences and business meetings as an economic necessity. For most large resort hotels, between 45 and 70 percent of occupancy now takes the form of group business.<sup>1</sup>
- **Tourists and Leisure Travelers.** This demand segment encompasses most pleasure travelers and includes many family groups. Double or higher occupancy of rooms is common. Travel tends to occur at peak periods of demand. Lengths of stay vary widely from single-night stopovers a day's drive from home to vacations lasting a week or longer at a resort thousands of miles from home. Market segments include the free independent traveler (FIT) market, the group market, and the wholesale market.
- ◆ **FIT Market.** The FIT market segment consists of destination tourists and other transient travelers. Destination tourists represent visitors who have selected a vacation destination and arranged for their accommodations either directly with the hotel or through a travel agent. Because individuals book their own accommodations, little or no discounting is available beyond that offered to affinity club members.

A range of sight-seeing opportunities and on-premises recreational amenities and facilities,

such as beach frontage, casino gaming, swimming pools, tennis courts, and golf courses, attracts the FIT segment. In addition, a strategic location near recreational and entertainment centers, such as theme parks, world-class golf courses, snow-skiing areas, watersports venues, shopping opportunities, cultural activities, or spectator sports facilities, can be important in effectively marketing to the FIT segment. Peak seasons and weekends account for significant FIT demand. The FIT market encompasses many demographic subsegments, including singles, couples, and families—all in a variety of price ranges.

- ◆ **Wholesale Market.** The wholesale market segment extends to tourists who purchase discount packages that include any combination of hotel, airfare, food and beverage, automobile rental, tours, and discounts at retail outlets. Travel agents and tour operators, the primary vendors of discount packages, typically negotiate room rates with a range of properties on an annual basis. The negotiations specify the number of rooms booked and the time of year that the rooms are available. Accordingly, room rates are generally much lower relative to other demand segments.

Discount packages are popular, particularly among European tourists, because of the assurance that travelers' full range of needs will be addressed without unexpected expenses. Some consumers purchase discount packages based on the price/value relationship while others like the convenience of making a single purchase for all their vacation needs. Wholesale travelers are generally extremely price sensitive and therefore tend to travel during off-peak seasons. As with the FIT market segment, the wholesale market segment looks for the availability of a range of on-premises recreational amenities and facilities coupled with a strategic location near recreational and entertainment centers.

- **Other Kinds of Stays.** In addition to the major demand segments, the following niches can be identified:
  - ◆ **Long-Term Guests.** Hotels can serve as temporary residences for executives, corporate employees, or others who have relocated to an area and need lodging until they can make permanent living arrangements. They can house consultants, auditors, or other workers assigned to projects lasting several weeks or months. Families often accompany relocating employees. Increasingly, lodging facilities that special-

ize in longer stays, such as Residence Inn and Extended Stay America, are filling this need.

- ◆ **Contract Demand.** Airlines contract with hotels for crew lodging and emergency housing for stranded travelers. They typically reserve a block of rooms for this purpose and negotiate a very low rate. Businesses with employees who travel to perform low-budget jobs also frequently negotiate contract rates with hotels, which usually are heavily discounted. Construction crews, disaster relief workers, and truck drivers are typical kinds of contract guests.
- ◆ **Government and Military Personnel.** Government workers and members of the military travel with generally modest per diems and thus tend to strongly prefer low-rate rooms. They gravitate to establishments that offer special discounts to government and military personnel.
- ◆ **Getaway Guests.** Downtown and suburban hotels catering to weekday corporate guests pioneered the getaway concept to bolster sagging weekend occupancies. The practice has been adopted by virtually all nonresort hotels. Typically, guests are offered a package plan that includes the room, some meals, entertainment of some sort, and other perks. Rates often are discounted substantially.

## Fluctuations in Demand

Nationally, annual room occupancy averages in the 65 percent range,<sup>2</sup> but varies considerably by region, season, and product type. Of all demand characteristics, fluctuation in demand is the one most frequently overlooked. In a sense, the guest rooms and space that a hotel offers are perishable commodities. One day's nonsales cannot be made up at a later date. A careful analysis of demand trends for each segment of the market for a specific project permits a realistic projection of annual occupancy. Commercial travel remains relatively constant throughout the year, whereas the volume of pleasure travel changes with the seasons, peaking in the summer quarter when many families take vacations.

In the United States overall, August is the month of peak hotel demand. June is usually second, followed by October, a popular month for meetings and conventions. The demand for hotel rooms reaches its lowest point in December, when business travel declines because of the holiday season.

Seasonal profiles for particular geographic areas tend to be weather related. The seasonal fluctuations

Table 6-1

## Top Hotel Market Performers: 2000

Highest Occupancy Rate (Percent)		Highest Average Room Rate	
San Francisco	88.3	New York	\$180
Seattle	87.6	San Francisco	150
Boston	86.8	Boston	146
New York	86.5	Chicago	118
San Diego	85.7	San Diego	116
Minneapolis/St. Paul	82.3	Oahu	115
Anaheim-Santa Ana	81.5	New Orleans	109
Denver	80.7	Philadelphia	107
Chicago	78.8	Washington	107
Los Angeles/Long Beach	78.6	Seattle	105
Oahu	78.2	Los Angeles/Long Beach	104
Norfolk/Virginia Beach	77.3	Miami	102
Orlando	74.7	New Orleans	89
Washington	74.7	Norfolk/Virginia Beach	89
Miami	70.3	Anaheim/Santa Ana	88

Source: Smith Travel Research, *Lodging Outlook*, October 2000.

in demand in some resort destinations are so extreme that some hotels stay open for only part of the year. Rocky Mountain ski lodges and New England shore resorts are highly seasonal, for example. But the purely seasonal resort has become a rarity today. Some resorts have successfully made the transition from seasonal to year-round operations by identifying market segments that could be attracted in their off-seasons. For example, ski resorts have added recreational amenities to attract summer tourists. Others have pursued group meetings business for the non-ski season.

### Measuring Demand

Knowing the demand segmentation and seasonal patterns for the demand in a given market is the beginning. But the analyst must evaluate the potential for a new hotel's projected demand based on population growth, new commercial or industrial development, new tourist attractions or recreational development, changes in transportation networks, and new competitive—or synergistic—lodging facilities.

Demand is affected by many factors. Growth or decline in the supply of competitive hotel rooms, shifts in market segmentation, and renovation or repositioning of competitive hotels all affect demand. Analysis must include historical market performance

as well as solid forecasts of the supply of competitive hotel rooms and the demand for rooms by market segment. Research should include an analysis of whether the target market is able and willing to pay the room rates projected and an analysis of what target hotel guests want in terms of facilities, design, amenities, and services.

In assessing the market for an existing hotel, two key measurements are its penetration and yield. A hotel's "penetration" is its share of demand (occupied rooms) in relation to its share of supply (available rooms). Table 6-2 provides an example of the penetration and yield analysis for an existing 300-room hotel being considered for purchase. It presents a picture of the historical and projected performance of the competitive market for the subject hotel and its performance within the market. In 1998, for example, the subject hotel's share of demand was 17.46 percent ( $165 \div 945$ ), and its share of supply was 20.0 percent ( $300 \div 1,500$ ). Thus, its penetration was 87.3 percent ( $17.46 \div 20.0$ ). Comparing the property's occupancy rates with the overall market rates is another method for calculating penetration ( $55 \div 63 = 87.3$  percent). Penetration rates are useful for determining whether a hotel is performing up to its potential, and whether its performance has improved or slipped in relation to the overall market.

A hotel's "yield" in this analysis is its revenue per available room (revPAR) divided by the market's revPAR. It reflects the property's relative position in terms of occupancy and room rate.<sup>1</sup> RevPAR is derived by multiplying the average daily room rate<sup>3</sup> by the occupancy percentage. In 1998, the yield for the subject property was 70.6 percent ( $\$53.35 \div \$75.60$ ) based on its \$53.35 revPAR ( $\$97 \times .55$ ) and the market's \$75.60 revPAR ( $\$120 \times .63$ ).

The table shows strong growth in demand over the past several years in this market area. Demand is projected to grow at more modest levels over the next several years, with the exception of 2002 when a new hotel will be added to the market. New hotels in strong markets often create demand (supply-induced demand) or accommodate previously unsatisfied demand. The average room rate has grown modestly, a trend that is projected to continue except while new supply is being absorbed.

Demand may shift because of developments in transportation, technology, or environment. A thriving motel corridor might decline when a new highway replaces an existing one. Hotels adjacent to a convention center might become locationally less desirable when a new convention center is built, even if the new center is only a few blocks away. New tech-

Table 6-2

## Penetration and Yield for a 300-Room Hotel

Year	Average Daily Rooms				Occupancy Rate (%)		Average Daily Room Rate		Performance of Subject	
	Available Market	Subject	Occupied Market	Subject	Market	Subject	Market	Subject	Penetration <sup>1</sup>	Yield <sup>2</sup>
1998	1,500	300	945	165	63	55	\$120	\$97	87.3%	70.6%
1999	1,500	300	1,005	168	67	56	123	97	83.6%	65.6%
2000	1,500	300	1,065	174	71	58	125	97	81.7%	63.4%
projected										
2001	1,500	300	1,097	—	73	—	128	—	—	—
2002	1,650	300	1,163	—	71	—	128	—	—	—
2003	1,700	300	1,186	—	70	—	130	—	—	—
2004	1,700	300	1,210	—	71	—	136	—	—	—

<sup>1</sup>The hotel's share of demand (occupied rooms) divided by its share of supply (available rooms).

<sup>2</sup>The hotel's revPAR (revenue per available room) divided by the market's revPAR.

nologies may eventually make business travel obsolete, although such predictions have yet to materialize. Miami Beach is an example of a thriving tourist destination that went through a long decline and then rebounded when the historic architecture of South Beach became a new draw for tourism. Today, old hotels are being restored, new ones are being built, and room rates and occupancy rates are soaring.

### Demand Generators

The link between new commercial, industrial, recreational, or transportation development and increased hotel demand is fairly direct and easy to quantify. More difficult to project is supply-induced demand, which is the new room demand that can emerge simply because a new lodging facility opens that meets some previously untapped market. Room demand is affected not only by local, regional, and sometimes national economic trends, but also by hotel marketing strategies and changes in the competitive supply of hotel rooms.

Business and leisure travel are both tied closely to the health of the economy. When analysts project lodging demand potential, they must analyze the market's economic and demographic trends. A review of various economic and demographic data can provide evidence on whether the economy of a specific market area will grow, stabilize, or decline. The analyst should focus on the most relevant economic data to the subject property. Not all trends need to be

examined for every market study. The following economic indicators might be considered as part of the hotel market analysis.

- **Employment.** The characteristics of an area's workforce and employment data by establishment provide an indication of the performance of the local economy and of the type and amount of room demand it may generate.
- **Office and industrial space.** Data on the amount, vacancy rates, and rental rates of a market's office and industrial space are useful measures of its potential.
- **Income.** A market's income levels are a good indicator of its demand potential. The amount of disposable income available determines how much spending can be devoted to leisure travel.
- **Retail sales.** Analysts use retail sales data to gauge the purchasing power of both visitors and residents.
- **Attendance at major attractions.** Historic and projected attendance figures by local or out-of-town origin of the visitors for demand generators such as theme parks, convention centers, and other attractions are valuable for determining potential demand for lodging.
- **Airport activity.** Reflecting both local business activity and the overall economic health of a market, airport passenger volumes and other data on airport activity can be good indicators of current and potential lodging demand.

- Hotel operating trends. Trends and projections of hotel operating statistics are clearly an important market indicator.
- Travel spending. Expenditures for travel are another good indicator of current and potential room demand. However, local data are not usually available.

## Competitive Supply

An analysis of the inventory of the existing and proposed competitive lodging supply in the market area helps predict the likely success of a new lodging facility. For each existing and proposed facility that, because of its location, size, and room rate, will compete with the subject hotel, the analyst should quantify the number of rooms, location, affiliation (chain or independent), orientation (convention delegates, business travelers, vacationers, etc.), amenities, average annual room rate, average annual occupancy, and competitive strengths and weaknesses.

Proposed hotels should be scrutinized to determine what innovations they are bringing to the market that may change the standards for the entire market. In Las Vegas, for example, several major new theme resort hotels built in the early 1990s were larger and more upscale than any hotels previously built in the city. They raised the bar on luxury amenities and created new competitive standards for hotels. To remain competitive, any proposed hotel in Las Vegas must respect these innovations and anticipate those of tomorrow.

The ultimate result of the market analysis process is the identification of an opportunity, that is, currently underserved market demand. A new or expanding airport generates new opportunities for hotels. Sometimes hotel owners and operators already in the market can easily identify the underserved market. For example, at the Pebble Beach Resort in Monterey, California, the resort's owners became acutely aware that they could not adequately serve the expanding conference business with one small hotel in a high-demand golf resort setting. To tap this demand, they developed the Spanish Bay Resort on an adjacent site; the resort's original hotel was positioned as a group meeting hotel while the Pebble Beach Lodge was positioned as a hotel for the free independent traveler, although both properties can be used jointly for larger meetings. In this case, the market analysis process was simplified by the fact that supply was severely restricted in an environmentally sensitive, world-class resort location.

## Demographics and Psychographics

Targeted marketing will be the watchword for the coming decades. Particularly when assessing a resort or luxury hotel's leisure-market potential, the analyst needs to approach demand in terms of the demand for the enjoyment of a particular amenity or lifestyle that is to be offered and marketed to the visitor. The analyst must determine what recreational and leisure pursuits interest specific market segments as defined by geographic area, income level, and psychographics. For these reasons demand analysis for leisure-travel markets must go beyond the quantitative methods of demographic and economic analysis and inevitably must involve some original research and surveys. Specifically, the analysis must determine what combination of leisure pursuits, settings, and accommodations are underrepresented in the market.

From a broad perspective, it is critical to gather and evaluate data on recreation and sports participation rates to understand what the potential market prefers in leisure activities and whether the market encompasses underserved segments. The National Sporting Goods Association conducts an annual national survey to determine the recreation and sports participation rates for 54 separate recreation or sports activities. The data can be used to identify emerging trends in recreational patterns.

Most activities in the survey can be accommodated both within and outside a resort; however, resorts can offer especially attractive environments for many of the activities. Swimming, the second-ranking activity, is a perfect example of a recreational activity that can be more attractively offered in a resort than in most urban areas. Many activities are poorly suited to urban areas but lend themselves well to a recreational or resort setting. These include fishing, camping, hiking, hunting, mountain biking, backpacking, Alpine skiing, canoeing, snorkeling, climbing, kayaking or rafting, and scuba diving. Other activities such as bicycle riding, boating, golf, and tennis can be accommodated attractively in both urban and resort environments.

A resort must carefully assess how it can differentiate its recreational offerings to attract a market with access to the same offerings in an urban setting. Usually, the setting itself is the primary means of differentiation, but other design and programming features should be considered when assessing market potential.

Surprisingly, resorts often fail to accommodate some of the simplest activities in an appealing fashion.

For example, exercise walking—the top-ranking activity in the survey—merely requires an aesthetically pleasing pathway or trail. Yet, it is striking how many resorts do not provide attractive walking facilities.

### Synthesis of Demand and Supply

After the competitive projects have been analyzed, the performance of the subject property should be projected. The most commonly used method is fair-share analysis, in which a percentage of market capture is estimated for the subject based on the number of rooms in the subject divided by the total number of rooms in the market. Projected market share must be tempered by qualitative factors, such as location, quality, and reputation. Case study 6.1 illustrates fair-share analysis.

### Sources of Data

Federal, state, and local government agencies are the primary source for most of the economic and demographic data used by hotel market analysts. Numerous private data sources provide data on competitive projects and hotel markets. PKF's annual *Trends in the Hotel Industry* which covers hotel statistics for major U.S. cities. Travel statistics, including spending data, are available from the U.S. Travel Data Center, local chambers of commerce, the U.S. Department of Commerce, and various trade associations. Smith Travel Research publishes *Lodging Outlook*, a monthly mar-

ket summary. These and other sources are described in greater detail in the appendix.

## Overview of Case Study

This chapter includes a case study for a 250-room full-service hotel to be built in downtown Austin by a large national hotel chain. The case study shows how published data sources are combined with field survey data to provide the necessary information for the analysis. One of the factors explored is seasonality of demand. In this case, demand is partly derived from state government, which meets only in odd-numbered years, creating an unusual kind of seasonality for this hotel market. The study illustrates how important it is to understand the nuances of the market before drawing conclusions.

## Notes

<sup>1</sup> J. Richard McElyea and Gregory L. Cory, *Resort Investment and Development: An Overview of an Evolving Market* (San Francisco: Economics Research Associates, 1998).

<sup>2</sup> Smith Travel Research, *Lodging Outlook*.

<sup>3</sup> Average daily room rate is the total room revenue for a given period, divided by the number of occupied rooms during the same period. It reflects discounts and other rate reductions. Rack rates, or published rates, are the highest rates charged for the room and are the rates listed in hotel directories.

## A New Hotel: Downtown Austin (1997)

John M. Keeling

### The Project

A major hotel chain proposes to build a new 250-room full-service hotel in downtown Austin, Texas. The hotel will have about 10,000 square feet of meeting space, including a 6,000-square-foot ballroom. It will offer a resort-style pool with a view of Town Lake. The hotel will provide services and amenities typical of a four-star property.

The Austin economy is quite strong. In addition to being the state capital and a university town, Austin has experienced rapid growth in technology-related industries. The area's computer industry has reached a critical mass where existing companies attract both suppliers and industrial consumers to the area. Approximately 200 high-technology semiconductor companies are located in the area, providing 22,000 jobs. In addition, more than 160 computer and electronics companies and 600 software firms employ more than 20,000 and 17,000 workers, respectively. Austin has become Texas's "Silicon Gulch," offering clean industry and using a highly educated workforce as well as research facilities of the University of Texas. The university's campus is located downtown, as is Austin's convention center, and the state capitol. With its scenic hills, limestone rock formations, and numerous waterways, Austin is known for its high quality of life and as a nonresort tourist destination.

### Methods

The following steps are followed when conducting market research for a hotel project:

- Define the product to be evaluated.
- Identify the properties to be included in the competitive analysis and evaluate their strengths and weaknesses relative to the proposed facility.
- Collect information on the competitive properties through interviews with property managers and/or owners and by accessing available databases.
- Evaluate the strengths and weaknesses of the proposed site.
- Assess the strength of the area economy and the likelihood of change in hotel demand from historic patterns.

- Estimate future hotel market performance.
- Based on the subject's strengths and weaknesses relative to its competitors, estimate its ability to penetrate the various market segments and the resulting occupancies and average room rates.

### Competitive Supply

More than 160 hotels exist in the Austin metropolitan area offering more than 18,500 guest rooms. The proposed development is a 250-room, full-service, chain-affiliated hotel to be located in downtown Austin. Hotel properties have been identified that are likely to compete with the subject because they share similar characteristics of location, size, and quality. A great deal of information on hotel properties can be collected from readily available publications. Among the more useful publications are

- Directories of the various hotel chains;
- *Mobil Travel Guide*;
- *American Automobile Association Tour Book*;
- *Hotel & Travel Index*;
- *OAG Business Travel Planner*;
- *Official Meeting Facilities Guide*;
- Publications by local chambers of commerce, hotel associations, or convention and visitors bureaus;
- Internet Web sites for the various chains or individual properties.

In this case, the competitive properties are described in Table 6.1-1.

Fortunately for those conducting hotel market research, an excellent national database provides accurate and timely data on most markets in the United States. For a reasonable fee, Smith Travel Research (STR) "Standard Historical Trend" reports provide a six-year history of aggregate occupancies and average room rates by month, as well as year-to-date information for a designated market area. Of course, not every property in every market is tracked by STR. Professionally managed and chain-affiliated hotels tend to be included whereas smaller, owner-operated hotels and motels tend not to participate. For this case study, every hotel in the competitive set is a partici-



## A New Hotel: Downtown Austin (continued)

pant. Typically, one or more of the properties needed for information will not be participants. In certain markets, such as South Beach in Miami Beach, Florida, where most of the competitive properties are small and entrepreneurially managed, not enough STR participants exist to generate a report. A summary of data from an STR report for the competitive set follows in Table 6.1-2.

A number of facts are immediately apparent from these numbers. First, supply has been static. No new rooms have

been added to the market that would compete directly with a new project. Room rates have demonstrated very strong growth, two to three times the rate of inflation, while increases in demand have remained low. If one were to conclude that demand is not increasing very fast, however, it would likely be an incorrect conclusion. Rather, it appears that the market has reached capacity and additional demand cannot be accommodated within the competitive set and must seek room accommodations outside of the set.

Table 6.1-1

### Competitive Hotel Properties

Property	No. Rooms	Year Open	Total Seats		Square Footage		Mtg. Sq. Ft. per Guest Room
			Restrnt	Lounge	Ballroom	Total Mtg.	
DoubleTree Guest Suites	189	1987	120	30	2,166	4,942	26
Driskill Hotel	177	1886	110	60	2,535	18,000	100
Embassy Suites	262	1985	80	—	1,026	2,380	9
Four Seasons	292	1987	90	60	7,029	18,021	62
Holiday Inn Town Lake	320	1967					
Hyatt Regency	446	1982	60/170	70	10,290	25,000	56
Marriott at the Capitol	365	1986	155	45/80	9,600	14,750	40
Omni Austin Center	304	1986	162/68	45/50	3,500	22,000	72
Radisson Town Lake	280	1965	300	20	6,080	9,600	34
Sheraton Waller Creek	254	1985	105	65	4,224	11,370	45
<b>Total</b>	<b>2,889</b>						

Source: PKF Consulting.

Table 6.1-2

### Summary of Standard Historical Trends in Downtown Austin Market Area

	1992	1993	1994	1995	1996	1997	Annual % Change
Occupancy	71.2%	74.0%	75.3%	76.3%	72.6%	75.5%	
Room Rate	\$74.41	\$80.15	\$86.13	\$96.23	\$103.20	\$110.79	8.3
Supply	1,054,485	1,054,485	1,054,485	1,054,485	1,054,485	1,054,485	0.0
Demand	751,067	780,096	794,119	804,671	765,793	795,808	1.2

Source: Smith Travel Research.

## A New Hotel: Downtown Austin *(continued)*

This unaccommodated demand is called "turn-away demand" and is important because the addition of new hotel rooms in the market will have the opportunity to recapture this lost demand.

Although the STR reports are excellent for providing both a good statistical overview and a historical context, they are insufficient for gaining useful insights into the dynamics of the market. For this information, on-the-ground fieldwork is required. It is important to conduct interviews with hotel managers and marketing directors in order to get a qualitative as well as a quantitative sense of the market. From these interviews, the researcher should learn what the makeup of the competitors' business is; what percentage of business comes from individual business travelers (IBT), leisure travelers, conventions, in-house groups (groups that use the meeting facilities of the hotel and do not require a convention center), and any special sources of demand such as airlines, medical facilities, contracts, and government. Table 6.1-3 provides a breakdown of 1997 market segmentation for the competitive set.

Of particular importance in property interviews is gaining an appreciation of how each hotel competes. Interviews with property managers should include questions regarding the strengths and weaknesses of their hotels. Managers are also a good source for understanding the strengths and weaknesses of their competitors. Although property managers may be less than candid when discussing their own weaknesses, they have no reticence in discussing those of their competitors. Other important data to gather include information about the last renovation and any planned changes to the property that might alter its future competitive position. Each property representative should be asked which hotels they consider to be competitors. The competitive set initially selected by the researcher should hold up after discussions with the property representatives. A researcher may discover that a property thought to be competitive is not considered to be so by the other hotel managers. Or one may discover a hotel that at first did not appear to compete with the project, but based on interviews, does on some level.

The researcher should ask for operating information about each property, including occupancy and average room rate information for at least the past few years and up to five years if possible. It is also useful to ascertain the property's anticipated performance for the current year. The degree of candidness obtained will vary from property to property. In general, the more professional the management, the more comfortable it is with sharing information.

Combining the market segmentation information accumulated during interviews with the statistics from STR results in the analysis described in Table 6.1-4. This analysis reveals some additional information. It appears that all of the growth in the market has occurred in the group segment. The IBT segment is stagnant, while the leisure segment has declined. This analysis confirms earlier observations that the market is at capacity. Returning to the STR data, the seasonality of the market can be determined. (See Table 6.1-5.)

Very little seasonality occurs in this market, which is typical for a largely commercial area like downtown Austin. Also typical in a commercial market, December and January are soft months. Although many commercial markets see

Table 6.1-3  
**Competitive Hotel Market Segmentation**

	Individual Business Travel (%)	Group/ Convention (%)	Leisure/ Tourist (%)
DoubleTree Guest Suites	47	34	19
Driskill Hotel	40	39	21
Embassy Suites	60	13	27
Four Seasons	33	34	33
Holiday Inn Town Lake	60	15	25
Hyatt Regency	23	59	18
Marriott at the Capitol	40	30	30
Omni Austin Center	40	50	10
Radisson Town Lake	40	30	20
Sheraton Waller Creek	48	42	10
<b>Market Average<sup>1</sup></b>	<b>41.6%</b>	<b>35.5%</b>	<b>21.4%</b>

<sup>1</sup>Weighted averages.  
Source: PKF Consulting.

## A New Hotel: Downtown Austin (continued)

Table 6.1-4

### Summary of Estimated Competitive Market Conditions

	1993	1994	1995	1996	1997	Annual % Change
Rooms Available	1,054,485	1,054,485	1,054,485	1,054,485	1,054,485	0.0
<b>Room Nights of Demand</b>						
IBT	335,000	345,900	349,600	318,100	331,000	(0.3)
Group	265,900	267,800	270,000	272,900	282,200	1.5
Leisure	179,000	180,700	184,900	163,000	170,000	(1.3)
Total Demand	779,900	794,400	804,500	754,000	783,200	0.1
Market Occupancy	74.0%	75.3%	76.3%	72.6%	75.5%	
Average Daily Rate	\$80.15	\$86.13	\$96.23	\$103.20	\$110.79	8.4

Source: PFK Consulting.

some seasonality in the summer months, Austin's summer occupancies are buoyed by strong summer leisure visitation. When the same analysis is performed in a tourism-driven market like Scottsdale, Arizona, or Aspen, Colorado, it reveals dramatic differences in occupancies between in-season and out-of-season periods.

A type of seasonality that is particular to Austin is its even-year, odd-year seasonality. According to the Texas constitution, the state legislature may meet only in odd-numbered years, except when a special session is called by the governor. The data display this seasonality, but because the market operates at near capacity, the seasonality is not pronounced. (See Table 6.1-6.)

After the existing lodging market is clearly understood, it is time to look to the future. Are any changes occurring in the market that would either benefit or harm the prospects of the project? Competitive interviews may have revealed information about planned or rumored developments. A search should be conducted with the local government to see if building permits are on file for new properties. The researcher should try to determine the likelihood of any rumored development actually being built because not all planned developments will actually be constructed. Full-service and center-city properties in particular are much more difficult to bring to fruition than suburban limited-service properties. An important factor in assessing this probability is the sponsor of the project. If it is an experienced hotel developer with a proven track record, the project's completion is more likely than if the sponsor is an individual with no development experience. The researcher needs to understand how far the project is in the development process. Most property sponsors claim their project is imminent when it is far from certain. Do they

Table 6.1-5

### Seasonality Analysis

	Occupancy Range 1992-1997 (%)	Seasonal Index
January	61.0 - 67.2	85
February	73.7 - 82.8	107
March	76.3 - 88.6	111
April	76.4 - 84.2	109
May	78.1 - 84.9	110
June	74.1 - 79.6	102
July	73.4 - 83.0	104
August	69.5 - 75.5	98
September	68.2 - 78.0	100
October	75.4 - 86.8	108
November	68.4 - 75.6	99
December	48.1 - 52.5	69
<b>Annual</b>	<b>71.2% - 76.3%</b>	<b>100</b>

Source: Smith Travel Research.

Table 6.1-6

**Odd-Year, Even-Year Seasonality**

	Year	Occupancy	Year	Occupancy	Year	Occupancy	Average
Even Years	1992	71.2%	1994	75.3%	1996	72.6%	73.0%
Odd Years	1993	74.0%	1995	76.3%	1997	75.5%	75.3%

Source: Smith Travel Research.

own the site or just have an option? Have they had a market study prepared? How far along are they in the design process? Do they have a financing commitment? From whom? Both permanent and construction financing? Is their equity in place? Often, sponsors claim that a project is financed and ready to go; they "just" need to line up their investors. Many projects fail at this stage.

If it is determined that a project is likely to be built within a period that will affect the proposed project, the researcher must evaluate the project's competitiveness with the proposed subject. Will it be similar in concept, facilities, and location? To the degree that it varies from the subject, its competitiveness may be significantly diminished. If the proposed hotel is to be a full-service four-star hotel, a limited-service hotel may not be at all competitive, even if it is only a block away.

During interviews, it was discovered that the Radisson Town Lake is adding 135 two-room suites, a conference center, an expanded health facility, and a business center with completion anticipated in July 1998. Also, the former Stephen F. Austin Hotel, which has been closed for some time, is being renovated and will reopen with 188 rooms in October 1998. The reopened hotel will include 5,000 square feet of meeting space, a full-service restaurant, and a cigar bar. It will operate as an independent hotel. The impact of both of these properties must be considered in the analysis. A new Adam's Mark hotel has been rumored for several years, but according to the corporate office, although the firm would like to be in Austin, it has no site or current plans. A Ritz-Carlton hotel has also been rumored, but the firm is currently focused on developments in New Orleans, Dallas, and Houston. Proposed 100-room expan-

sions at the Four Seasons and the Marriott are reportedly on hold. Although the Marriott has land available, an expansion would require a variance from the city.

The researcher must estimate whether the demand for lodging is growing or decreasing, and by how much. To do this, one could examine past market trends, particularly over the past few years. This review is useful in markets where new development can occur with few constraints. In the case of downtown Austin, significant barriers to new development exist, and no competitive hotel has been added to the market since 1992. With the market effectively operating at capacity, historical growth rates will understate future growth of demand.

**Demand Analysis**

At this point, only the competition, or "supply," has been examined in this evaluation of the hotel market. It is also necessary to study the users of hotel rooms, or "demand." Interviews with corporate meeting planners, association executives, and other users of local hotels are necessary to broaden the understanding of the market. From these interviews, the researcher will get a consumer's-eye view of how the existing properties serve the market. The researcher should learn where employees, customers, and suppliers stay; why they choose one hotel over another; how often they require meeting facilities, and the size and nature of their meetings. If possible, the researcher should discuss the proposed hotel to size up the likelihood of the interviewee using the facility. During interviews it may be discovered that an important demand generator always uses full-service hotels or never uses full-service hotels. In

## A New Hotel: Downtown Austin *(continued)*

one market, for example, it was determined that a major demand generator only stayed at hotels that used a soft drink manufactured by a related company.

Other indicators of growth should be determined, such as airport activity, job formation, convention attendance, and population growth. Data are generally available from chambers of commerce, economic development agencies, and area improvement districts. Also, published economic and demographic information are available from Sales and Marketing Management's annual "Survey of Buying Power" published each August for the previous year. The firm of Woods & Poole, Inc., is also an excellent source of economic and demographic information. Large real estate brokerage firms often track office, retail, and industrial space absorption for cities and suburbs.

Employment growth, office and industrial space absorption, new business formations and relocations, airport activity, population growth, and commercial building permits are all factors to be considered in looking at growth of IBT demand. To estimate growth in group demand, convention attendance, airport emplanements, tourist visitation, visitor counts at attractions, and population growth should be studied. Leisure growth should consider tourist visitation, visitor counts at attractions, and population growth.

According to Austin hotel managers, 1995 was a banner year when everything came together (legislative year, state basketball tournaments, the South by Southwest Music Festival, and a record number of convention bookings). Most of those interviewed anticipated the drop in occupied rooms in 1996 as well as the significant increase in average room rates. Capacity constraints are evident from Tuesday through Thursday from mid-January to mid-May and during football weekends and special events.

With occupancies as strong as they have been in recent years, hotel managers are reluctant to commit discounted, group rooms for future bookings at the convention center. This policy has been especially hard for the center, which has lost a significant amount of business because of a lack of commitments for nearby rooms.

Future growth in room demand will be influenced by several factors. Notwithstanding the fact that 1998, 2000, and 2002 will be on the even-year down cycles reflecting

nonlegislative years, capacity constraints during peak periods will affect overall maximum occupancies. In 1999, 2001, and 2003, commercial demand should displace group demand at many hotels during those legislative years. The years 1998 and 2001 will receive boosts with the introduction of the additional rooms at the Radisson and Stephen F. Austin hotels, as well as the subject 250-room property. The addition of rooms to the downtown Austin market will enable previously unaccommodated demand that overflowed to other areas to return to the Austin market area.

Demand for hotel rooms in a given market can be categorized in one of three ways:

1. **Demonstrated Demand**—demand that can be quantified as existing occupancy levels at competitive hotels;
2. **Unaccommodated Demand**—demand that desires accommodations in the competitive market but is turned away because of capacity constraints;
3. **Created Demand**—demand that does not presently seek accommodations in the competitive market, but could be persuaded to do so through marketing efforts, room rates, location, available facilities, services, and amenities.

An evaluation of economic indicators in the Austin market indicates that the growth in each market segment will occur as shown in Table 6.1-7.

Table 6.1-7  
**Demand Growth**

Year	Individual Business Travelers	Group/Convention	Leisure/Tourist
1998	2.0%	0.0%	0.0%
1999	2.0%	1.0%	0.0%
2000	2.0%	2.0%	1.0%
2001–2005	2.0%	1.0%	1.0%

Source: PKF Consulting.

## A New Hotel: Downtown Austin (continued)

Table 6.1-8

### Market Supply and Demand

Market Segment	1997		1998		1999		2000		2001	
	Demand	% Change	Demand	% Change	Demand	% Change	Demand	% Change	Demand	% Change
<b>Individual Business Travel</b>										
Demonstrated	331,024	2.0	337,600	2.0	344,400	2.0	351,300	2.0	358,300	
Created			5,900		13,600		18,900		24,300	
<b>Group/Convention</b>										
Demonstrated	282,200	0	282,200	1.0	285,000	2.0	290,700	1.0	293,600	
Created			5,000		11,500		23,000	1.0	23,300	
<b>Leisure/Tourist</b>										
Demonstrated	170,000	0	170,000	0	170,000	1.0	171,700	1.0	173,400	
Created			3,000		6,900		10,200	1.0	10,300	
<b>Total</b>	<b>783,224</b>	<b>2.6</b>	<b>803,700</b>	<b>3.4</b>	<b>831,400</b>	<b>4.2</b>	<b>865,800</b>	<b>2.0</b>	<b>883,200</b>	
<b>Rooms Available</b>	1,054,485	4.9	1,106,311	6.0	1,172,380	7.8	1,263,630	0.0	1,263,630	
<b>Market Occupancy</b>	74.3%		72.6%		70.9%		68.5%		69.9%	

Source: PKF Consulting.

The new rooms being added to the market at the Radisson, the Stephen F. Austin, and the subject 250-room property will accommodate individual business traveler and leisure demand that was turned away during peak periods. Additionally, the Stephen F. Austin and the subject property will have marketing staffs to sell group business that might otherwise have been accommodated outside Austin. A capture rate of two fill nights per week, 50 weeks per year, for the new rooms can be assumed. The rooms were distributed to the demand base at their respective percentage segmentation. (See Table 6.1-8.)

### Estimating Performance for the Subject

After the likely performance of the competitive projects is established, the next step is to estimate the performance of the subject hotel. This projection is usually accomplished through a fair-share analysis. "Fair market share" is the percentage of demand allocated to a given property based on the ratio of its available guest rooms to the total number of rooms in the competitive market. In this case,

the fair market share of the subject property is calculated as follows:

Size of subject property	250 rooms
Number of rooms in competitive set	3,462 rooms
Fair market share	$250 \div 3,462 = 7.2\%$

Market penetration is based on the attributes of a hotel relative to the competitive market. Historic penetrations of properties in the competitive set are considered, as well as any potential changes caused by changing property attributes or marketing strategies. A penetration rate of 100 percent or greater indicates that a property is capturing more than its fair market share, while a penetration rate of less than 100 percent indicates that the property is losing fair share to its competition. Properties with large amounts of meeting space tend to penetrate the group segment at higher levels than properties with less space. In general, a property's attractiveness to the various market segments will determine how it will penetrate each segment. The primary competitive supply

## A New Hotel: Downtown Austin *(continued)*

has penetrated its fair share of room demand at the rates shown in Table 6.1-9.

The subject hotel is anticipated to be similar in quality to the Marriott at the Capitol. The hotel will have the equivalent of 40 square feet of meeting space per guest room. It is anticipated that it will achieve its fair share of demand from the IBT segment. Although it will be attractive to small groups, the hotel is seen primarily as a facility that will cater to individual business travelers. Accordingly, it is estimated that the subject will penetrate the group segment at less than its fair share or 90 percent. With its resort-style pool, the subject should be quite attractive to the leisure segment. It is expected that the property will penetrate this segment at 130 percent of its fair share. The resulting property occupancies are calculated in Table 6.1-10.

After a likely occupancy for the subject property has been arrived at, the next step is to apply the achievable room rates that were obtained from the market research

to the various market segments to estimate annual room revenue. Taking the stabilized year, 2003, the calculation would be as shown in Table 6.1-11.

This method of determining a hotel's anticipated performance is the most widely used; however, it does not apply in all circumstances. It works well when the subject property will compete against a number of other properties. In such cases, the relationships between the properties can be discerned and the appropriate penetration rates applied. However, this method fails in circumstances when few or no competitive properties exist, as is often the case with resort destinations, executive conference centers, and large convention hotels. In Phoenix and Scottsdale, Arizona, where there are a large number of existing resorts, this penetration model would be useful. It would not work, however, in markets where there are few or no existing comparable and competitive properties. The methodology for evaluating such projects is beyond the scope of this case study.

Table 6.1-9

### Penetration Rates of Competitive Supply

Property	Individual Business Traveler (%)	Group/Convention (%)	Leisure/Tourist (%)	Overall (%)
DoubleTree Guest Suites	115-120	85-90	70-75	105-110
Driskill Hotel	70-75	80-85	70-75	90-95
Embassy Suites	140-145	35-40	125-130	95-100
Four Seasons	80-85	100-105	165-170	100-105
Holiday Inn Town Lake	135-140	35-40	110-115	85-90
Hyatt Regency	55-60	165-170	85-90	100-105
Marriott at the Capitol	95-100	85-90	145-150	105-110
Omni Austin Center	95-100	140-145	45-50	100-105
Radisson Town Lake	100-105	90-95	100-105	95-100
Sheraton Waller Creek	105-110	110-115	40-45	95-100

Source: PKF Consulting.

A New Hotel: Downtown Austin (continued)

Table 6.1-10

**Estimated Property Performance**

Year	Market Segment	Market Demand	Fair Market Share		Market Penetration		Occupancy (%)
			Percent	Demand	Percent	Demand	
2001	IBT	372,400	7.2	26,800	100	26,800	
	Group	305,500	7.2	22,000	90	19,800	
	Leisure	180,500	7.2	13,000	130	16,900	
	<b>Total</b>	<b>858,400</b>	<b>7.2</b>	<b>61,800</b>	<b>103</b>	<b>63,500</b>	<b>70</b>
2002	IBT	379,900	7.2	27,400	100	27,400	
	Group	311,600	7.2	22,400	90	20,200	
	Leisure	182,200	7.2	13,100	130	17,000	
	<b>Total</b>	<b>873,700</b>	<b>7.2</b>	<b>62,900</b>	<b>103</b>	<b>64,600</b>	<b>71</b>
2003	IBT	387,500	7.2	27,900	100	27,900	
	Group	314,700	7.2	22,700	90	20,400	
	Leisure	184,100	7.2	13,300	130	17,300	
	<b>Total</b>	<b>886,300</b>	<b>7.2</b>	<b>63,900</b>	<b>103</b>	<b>65,600</b>	<b>72</b>

Source: PKF Consulting.

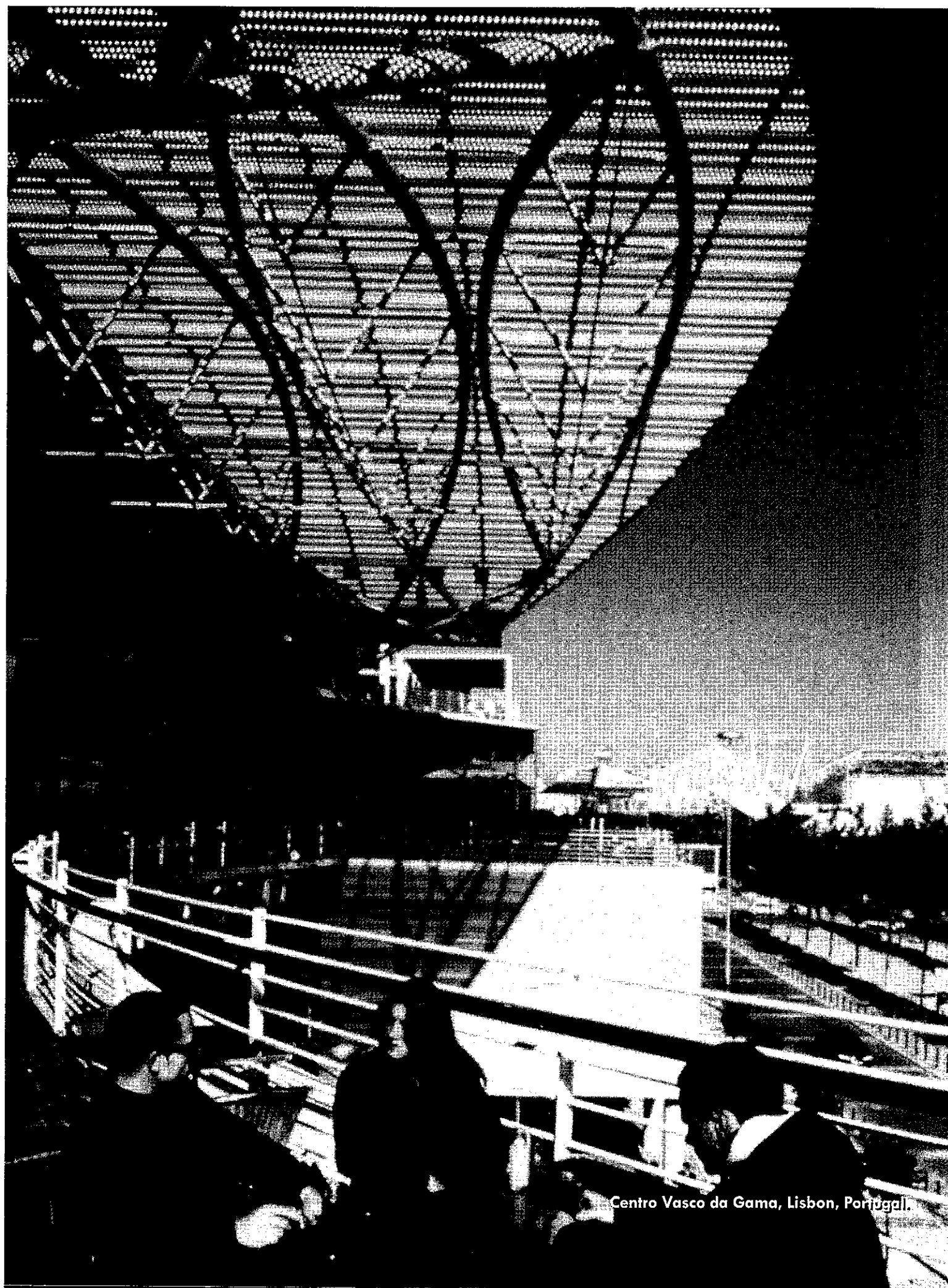
Table 6.1-11

**Estimated Rooms Revenue by Market Segment**

Market Segment	Occupancy	Occupied Rooms	Room Rate	Rooms Revenue
IBT		27,900	\$120	\$3,348,000
Group		20,400	100	2,040,000
Leisure		17,300	135	2,335,500
<b>Total/Average</b>	<b>72%</b>	<b>65,600</b>	<b>118</b>	<b>7,723,500</b>

Source: PKF Consulting.





Centro Vasco da Gama, Lisbon, Portugal.

# Mixed-Use Developments

**M**ixed-use development is complex for both the developer and the market analyst. It involves more than the sum of the parts. The developer must strategize the proper placement and timing of components. The market analyst must evaluate each use individually and understand the synergies created—both positive and negative.

Mixed-use was a common development pattern throughout history until after World War II, when suburbanization and separate-use zoning became the norm. By the 1970s, mixed land uses were again becoming an important development form, and today mixed-use developments are often the preferred form for both developers and local governments. The smart-growth and new urbanism movements encourage mixed-use development because it enhances opportunities for improved pedestrian accessibility through increased density and mixing of activities, both of which shorten the distances between destinations.

Since the 1976 publication of ULI's first book on mixed use—*Mixed-Use Developments: New Ways of Land Use*—both the concept of mixed-use development and the actual product have grown and evolved tremendously. However, the original definition developed in 1976 still holds today. Mixed-use developments are characterized by

- Three or more significant revenue-producing uses (such as retail, office, residential, hotel, and entertainment/cultural/recreation), which in well-planned projects are mutually supporting;
- Significant physical and functional integration of project components (and thus a relatively close-knit and intensive use of land), including uninterrupted pedestrian connections;

- Development in conformance with a coherent plan (which frequently stipulates the type and scale of uses, permitted densities, and related items).

## Three or More Significant Revenue-Producing Uses

Although many real estate projects have more than one use, mixed-use developments as defined and discussed in this chapter include at least three major revenue-producing uses. The three or more uses should be significant (for example, retail space should offer more than site-serving convenience facilities) and should produce revenue (for example, to amortize costs over time and to provide a reasonable return). In most mixed-use projects, the primary revenue-producing uses are usually a combination of retail, office, and residential or hotel facilities. Other revenue-producing uses are also possible in a mixed-use project, including wholesale trade marts, arenas, convention centers, performing arts facilities, and museums. In the case of the last, revenue may need to be derived in part from philanthropic sources for the project to be viable. The important factor is that they be significant uses that draw their own users to the project.

Three or more significant uses together in one development usually implies a project of considerable scale and impact. Although smaller-scale projects have been developed, the typical sizes of the components of a mixed-use project usually exceed 100,000 square feet; thus, total project square footage usually exceeds 300,000 square feet, sometimes running as high as several million square feet.

Developers often seek a minimum critical mass for mixed-use developments to create the requisite public image and market penetration. The size and diversity of uses in these projects, if effectively programmed and designed, can result in a project that becomes a significant new place on the urban landscape. Thus, many mixed-use developments are much more than simply developments; they are exercises in place making. A good mixed-use development can turn a lesser location into a prime one.

Sometimes, mixed use can make possible a socially desirable, but economically risky, use because the more profitable uses can carry the less profitable ones. For example, a performing arts center becomes feasible when paired with an office complex. A mixed-use project is sometimes favored by a locality and has improved chances of getting zoning approval. This favorability is not always the case, however, since some localities are still tied to old notions of separate-use zoning.

## Physical and Functional Integration

The second descriptive characteristic of mixed-use developments is a significant physical and functional integration of the project's components and, thus, an intensive use of land. All components should be interconnected by pedestrian links, although this integration can take many physical forms, as follow:

- A vertical mixing of project components into a single megastructure, often occupying only one city block;
- Careful positioning of key project components around central public spaces (for example, a street, park, plaza, atrium, galleria, or shopping center);
- Interconnection of project components through pedestrian-friendly connections (such as sidewalks along streets, interior walkways, enclosed corridors, underground concourses, retail plazas and mall areas, escalators, and even aerial bridges between buildings).

Integrated, shared parking is a key component, improving land-use efficiencies and reducing costs. Pedestrian circulation and orientation are critical elements in the planning process, because without them, the project will not work as a whole and will not achieve the desired synergies and sense of place that are the hallmarks of mixed-use developments.

This second criterion distinguishes mixed-use developments from other real estate projects that may

include three or more significant revenue-producing uses but do not fully integrate them. Some examples of such lower-intensity, more-spread-out developments include master-planned communities and business parks, in which densities and physical integration tend to be significantly less than in mixed-use developments, resulting in less-regular interaction among uses and more reliance on automobiles for movement within the project.

Large-scale business parks often include light industrial uses, office buildings, retail and restaurant space, hotels, health clubs, golf courses, daycare centers, and a host of other uses. Usually, however, they are configured in a low-density environment that is primarily auto-oriented and does not provide for good pedestrian circulation. Many master-planned communities also exhibit multiuse characteristics, incorporating shopping centers, office buildings, and hotels, as well as a variety of residential and recreational uses. Those projects are generally large scale—often reaching several thousand acres—and tend to be low density; they typically require automobiles for internal movement.

## Development in Conformance with a Coherent Plan

Mixed-use developments are usually developed from the outset in conformance with a coherent development strategy and plan. Master planning for a mixed-use development, compared to a single-purpose project, demands a much greater diversity of specialized participation from developers, market analysts, architects and land planners, property managers, and capital/financing sources. The planning process—including the market analysis—is therefore far more complex than for most other real estate projects.

From a marketing perspective, the point of mixed-use is that the diversity of activities can enhance the economic viability of the project. Because each use can be marketed and absorbed simultaneously, a larger scale can be achieved in a shorter amount of time—if the project is well-planned and in tune with the market.

## Analyzing Market Potential of Mixed-Use Projects

Mixed-use development projects present certain unique challenges as well as opportunities for the market analyst. The opportunity for the analyst is to

help the project's developer and investors capitalize on synergies among complementary uses and create an overall cumulative market attraction that exceeds what the individual project components would generate independently. The challenge for the analyst is to identify and measure these market premiums. The market analyst should begin with the caveat that each element of the project must be able to stand on its own in terms of marketability.

The basic real estate theory of mixed-use development is that people will take advantage of colocated land uses to concentrate their trips for commuting, shopping, and entertainment plus other activities within the project or location. This phenomenon can have the advantage of creating certain captive-market advantages for the various project components. It can also create economic advantages from a shared investment in supporting infrastructure, such as off-site road improvements, and on-site parking and open space, as well as common services ranging from trash collection and disposal to marketing and advertising.

Interactions among uses are not always positive. Critics often cite the noise and odors from street-level restaurants as a negative factor in locating residences above them. Nighttime activity from theaters or other entertainment facilities may be a detriment to marketing a hotel. In some cases negative effects can be minimized or eliminated through careful planning and design. In assessing the market potential for a new project, the analyst must answer the following questions.

- Are certain kinds of locations more suitable? The site should have good access and exposure, often within a larger multiuse context like a downtown or edge city. It should be in a jurisdiction that favors such projects. Sometimes an emerging or reemerging locale is good. Also, proximity to transit, convention facilities, historic districts, and other advantages may produce a superior site.
- How should each element be phased? Proper timing and phasing of project components are crucial. Each phase must be able to work independently of future phases, because there might be a considerable lag between each. The project should begin with the uses that have the strongest current market potential, creating cash flow that can be funneled into later phases of the project.
- How should the uses be configured in the project to take advantage of market forces? Visibility is important for retail and entertainment uses; hotels must have pedestrian and vehicular access, convenient parking, and security; privacy and security

should be maximized for any residential component. A site plan for a large mixed-use project usually places offices in the interior locations, with hotel, retail, and entertainment uses at the edges for the best visibility and access.

Notwithstanding the presumed advantages of mixed-use developments, the market analyst must start with the basics described in previous chapters: the analysis of market demand, an assessment of effective competition, and a determination of potential market capture. These key steps are performed for each separate use as if each were to be independently located and built. The research can then be refined to reflect cross sales between colocated uses and to estimate any cumulative attraction in terms of greater market penetration and higher rates of capture of available outside patrons.

The matrix in Figure 7-1 identifies the interrelationships between markets for different types of development that are typically found in a mixed-use project. Where strong market synergy exists among uses, there are opportunities to realize market premiums from these combinations. Naturally, every mixed-use development is different in design and configuration as well as in relation to its sources of market support. So there can be no hard-and-fast rules. Nevertheless, the relationships suggested by the matrix hold true in most instances. They are discussed briefly in the following paragraphs.

## Residential

Clearly a powerful relationship can exist between residential development and office employment. Hence, the popularity of downtown housing is growing where there is a tradition of urban living supported by good services and public transportation, such as in San Francisco, Chicago, New York, and Boston; or where there has been a successful concerted effort to create needed urban amenities, such as in Cleveland, Kansas City, and Minneapolis. Likewise, a natural affinity exists between residential development and convenience retail activity, although there can be a conflict between the image and scale of price-competitive convenience retail uses and that of image-conscious resident owners and renters.

Two key questions the market analyst must answer are (1) whether people will be attracted to living in the mixed-use development by the option of office employment in the same complex, and vice versa, and (2) whether they will concentrate their convenience-retail expenditures within the complex when

Figure 7-1

## Market Grid for Mixed-Use Developments

Primary Use Components	Health Care	Marina	Entertainment: Sports	Entertainment: Theaters	Entertainment: Bars & Restaurants	Retail: Comparison	Retail: Specialty	Retail: Convenience	Hotel	Offices	Residential
Residential	□	●	×	×	□	□	□	●	×	●	
Offices	□	-	□	-	●	□	□	□	●		●
Hotel	□	□	●	□	●	□	●	□		●	×
Retail: Convenience	-	●	□	□	□	□	×		□	□	●
Retail: Specialty Stores	-	●	□	●	●	●		×	●	□	□
Retail: Comparison	-	□	□	●	●		●	□	□	□	□
Entertainment: Bars & Restaurants	-	●	●	●		●	●	□	●	●	□
Entertainment: Theaters	-	-	□		●	●	●	□	□	-	×
Entertainment: Sports	□	□		□	●	□	□	□	●	□	×
Marina	-		□	-	●	□	●	●	□	-	●
Health Care		-	□	-	-	□	-	-	□	□	□

### Level of Market Synergy in MXD

- Strong
- Weak or Uncertain
- Neutral, Absence of Synergy
- × Potential Market Conflict

they are likely to pay higher prices because merchants will probably lack broad market patronage from a large residential community. These questions can best be answered by careful attitudinal research—surveys and focus groups—involving a sample of prospective residents and office employees.

### Office

More than any other use, office development has been the driving force behind mixed-use development, with nearly all mixed-use projects including an office component. The office component often does not achieve the strong identity that a freestanding

building does, which can mean the project will not appeal to tenants who want to create a strong image in a distinct building. Projects in which office space is a secondary use often have a different look and feel, and the office space is positioned and marketed differently. The demand for such space tends to rely on the sense of place created by the project's other elements. Analysts should not assume that a high percentage of people who work in a mixed-use development will want to live there, or vice versa.

Office development has clear market synergy with hotels, bars, and restaurants, and, to a lesser extent, with most types of retail activity. Most offices have occasional, if not frequent, out-of-town visitors

and find it desirable to refer them to a nearby lodging facility. The extra boost to hotel patronage from a companion office facility can be readily estimated, especially if the major tenants are known and can be interviewed. Such research will indicate the frequency at which these firms attract visitors from out of town and the types of accommodations the visitors prefer. Likewise, bars and restaurants are natural amenities expected by office employees and employers alike.

## Hotel

Hotels can be a vital component in mixed-use developments for several reasons. Hotels can be the most profitable component of the project where the market is strong. They can be important for market synergy, thereby improving the overall marketability of the project. A good hotel can enhance the project's image and provide name recognition. Hotels attract visitor patronage that would otherwise not be drawn to the development. Thinking that the office component will generate enough demand for rooms to support the hotel, however, is a major mistake. Such demand is rarely the case.

In addition to the strong positive relationship of hotels to office users, hotels tend to provide patrons for most types of retail activity, especially unique specialty shops and boutiques, bars and restaurants, and sports entertainment. The type of hotel, however, can have a big influence on the amount of retail patronage that is generated. Most business travelers do not take the time to shop, but conference attendees, tourists, and vacationers do. Failure to know and consider the nature of the hotel patrons can lead to serious misjudgments of hotel-generated demand for retail goods and services in a mixed-use project.

## Retail

Because of the market support that can be gained from on-site uses, the potential for retail uses often cannot be determined until the size and character of the other uses are determined, and market potential for each of the other uses is assessed. Most mixed-use developments include a retail component, which can range from a small amount of convenience- and service-retail space ancillary to the project's major components to a super-regional shopping center that offers a full array of shopping goods and services.

The analysis proceeds differently depending on the nature of the retail component. For example, a major shopping destination relies on a regional

market, whereas a service- and convenience-retail component would focus on local and on-site markets.

- **Convenience Retail.** When the single head or both heads of a household work, the tendency is to shop for convenience items just once or twice a week. Thus, a car is required to conveniently transport several days' or a week's provisions. The exception would be an intensely pedestrian- and transit-dependent urban environment such as New York City or San Francisco. Thus, the most significant market synergy in a mixed-use development would be for convenience-retail uses scaled to the needs of the project's resident households. This demand can be readily measured by conventional market analysis.
- **Specialty Retail.** In addition to the strong affinity between unusual specialty shops and convention travelers and tourists, specialty-retail use is otherwise primarily drawn to cluster with other types of shopping and entertainment. The niche nature of most such specialty merchants requires a large, fairly affluent base of residential market support. Thus, although specialty-retail uses may enliven and enrich the mixed-use development, they will fail unless combined with other comparison shopping, entertainment, and dining uses that together achieve a critical mass capable of attracting patrons from a large area.
- **Comparison Retail.** Like specialty-retail projects, comparison-retail developments achieve market synergy primarily with other types of retail activity that create a critical mass to attract broad residential patronage.

## Specialized Uses

In addition to office, retail, and residential uses, several special categories of uses can be part of mixed-use developments. Specialized analysis is required for each use. As indicated earlier, the standard techniques discussed in previous chapters would be used to analyze the sources and scale of demand for each component of a mixed-use development. Then, it is necessary to estimate cross sales between colocated uses: How many hotel nights will be generated by office users that are part of the complex? How many office employees will rent or buy an apartment or condominium in the complex? What percentage of lunchtime expenditures by office employees for meals or comparison goods can be captured within the complex?

## Entertainment

Often the key factors affecting the success of a mixed-use development are related to the sense of place that the project can create and the project's activity cycle. Usually, a primary objective of commercial mixed-use projects is to create an environment that generates activity throughout the day and the week, including evenings and weekends. Entertainment facilities—theaters, concert halls, cinemas, restaurants, and clubs—serve this objective well, and they have become key ingredients in many mixed-use developments. The kinds of entertainment uses that may be included vary considerably depending on the location and nature of the development. The most common are multiplex cinemas, but this product has become overbuilt in many regions, as have certain types of theme restaurants.

Sometimes a cultural facility like a museum or performing arts center is part of a mixed-use development. Such institutions add two elements that other entertainment cannot. They expand the mix of audience, often adding a well-educated and affluent

component. Cultural facilities give the development a strong identity, marketing focus, and image of quality. However, including these uses generally requires forging a public/private partnership involving private developers, public agencies, and arts organizations.

Within the entertainment category, bars and restaurants tend to have the greatest market synergy with both retail and nonretail uses. Theaters tend to be destinations in themselves without much interdependence with hotels, offices, or residential uses located in the mixed-use project.

## Marina

Because many urban waterfronts are shifting away from industrial uses to mixed uses, cities are looking to commercial and recreational uses to fill these remaining underused areas. Pleasure boaters can be a key demand segment, making marinas a focal point of many redevelopment projects. Although marinas are a very specialized use, an appropriately located marina can contribute to a wide range of market synergies with other uses in a mixed-use



Yokohama Bayside Marina, Yokohama, Japan.

development. Analysts should study comparable marinas and learn about marina patrons for an indication of how extensive the market potential might be. As with other market sectors, it is crucial not to overstate potential and to understand that a new development cannot create a market, but can only capitalize on an untapped existing market.

### **Health Care**

Considerable market synergy can be gained from the location of physicians' offices and associated health care practitioners within a mixed-use complex that includes both residential and office components. But like various forms of retail goods and services, health care businesses need an independent marketing image or identity to enable them to attract patronage from beyond the project's boundaries.

### **Non-Revenue-Generating Uses**

The development potential for public, non-revenue-generating, and other ancillary uses should also be studied. The addition of a cultural facility to the project must be assessed to determine whether the facility would attract patrons, as well as what its impact would be on the remaining uses. A public library does not generate revenue, but generates activity, and therefore may enhance the revenue of the overall project.

### **Data and Analysis**

Much data can best be derived from careful attitudinal research involving each of the key constituencies to be represented in the mixed-use development. This research would ideally involve some combination of focus-group interviews, intercept surveys of potential shoppers, and interviews of key representatives of potential retail and office tenants as well as homebuyers or renters. Although each survey technique has certain strengths and weaknesses, an optimum approach combines a set of professionally administered focus-group sessions with a broader survey program, whether by mail, hand delivery, telephone, or direct respondent interviews, that will allow for statistical inference to the larger market universe represented by the respondents. The overall question to be answered is whether the users, occupants, and visitors who are associated with one project component will concentrate and increase their patronage, as well as pay higher prices, to avail themselves of the convenience of the colocated uses and facilities. In other words, will they in fact generate market premiums?

After market demand has been measured for the individual and the combined components, the effectiveness of competing projects must be determined. Large-scale mixed-use projects usually have few, if any, directly comparable projects in the same market area with a similar combination of uses. (One notable exception would be North Michigan Avenue in Chicago, where at least three large mixed-use developments are situated within a few blocks of each other.) If such analogs do exist in the same market, their relative success or failure must be analyzed in detail. At the same time, it is necessary to document and analyze the inventory of competitive space for each use component.

### **Marketability**

The final step in the market analysis for mixed-use development is to estimate its overall marketability on the basis of the known demand for and supply of effective competition. As in all market studies, this last step requires the application of informed judgment regarding the likely response to the new product in the marketplace. To what extent will people shift their patronage from existing competition because it fails to meet their standards for convenience, quality, and value? Will the proposed development embody the physical and locational qualities that result in a landmark attraction in the marketplace? What increment of market capture for each use component can be attributed to the cumulative attraction of the mixture of uses? To what degree will the project be self-supporting based on cross sales among users, occupants, and patrons of the colocated uses? Ideally, final answers to these questions will be used to refine the design and the marketing strategy for the mixed-use project, thereby avoiding unrealistic expectations while taking advantage of the potential benefits of market synergies.

In conclusion, it is useful to review some of the lessons learned and reasons for market failure or underperformance of mixed-use developments. First, the mixed-use development too often has been assumed to be self-supporting to an unrealistic degree. In most instances, each project component requires a majority of its market support from outside the mixed-use development, with cross sales accounting for a smaller but marginally significant share of the economic benefits. Therefore, the design of the mixed-use development needs to present a marketable image for each of its major components to attract patrons from well beyond the



project. It is unrealistic to believe that the market premium for the colocation and interdependence of complementary uses will be generous.

Another major pitfall encountered by mixed-use developments is the sin of hubris—that is, the assumption that the project will, because of its design, anchor tenants, or other key attribute, establish such a dominant position in the marketplace that further competition will be precluded from entering. Such market domination is rarely the case in a highly competitive, open economy where success breeds competition and copycats.

Some of the most celebrated and successful mixed-use developments are shown in Table 7-1. In each example, the various project components contribute

patrons to the other components, thereby achieving superior levels of occupancy, rents, and overall project value.

## Case Study

Case study 7.1 illustrates a market analysis to formulate a plan for a military base reuse in Orange County, California. The objective was to use the 4,700-acre suburban site to stimulate growth, attract good jobs, and create synergies among uses. Economic drivers were identified and three alternative scenarios were laid out for mixed-use developments.

Table 7-1

### Selected Mixed-Use Developments

Project/Location	Description	Land Uses	Size
Phillips Place, suburban Charlotte, North Carolina	Pedestrian-oriented street grid with low-rise buildings	Retail Rental apartments Hotel Multiplex cinema	130,000 sq. ft. 402 units 124 rooms 10 screens
Heritage on the Garden, Boston, Massachusetts	12-story building with underground garage	Retail Office Condominium Garage parking	50,000 sq. ft. 125,000 sq. ft. 87 units 180 spaces
Pine Square, downtown Long Beach, California	Six-story complex with structured parking	Retail Multiplex cinema Rental apartments	37,000 sq. ft. 16 screens 142 units
Pioneer Place, downtown Portland, Oregon	Three city blocks: office tower with two-level department store, retail pavilion, structured parking	Retail Office Garage parking	215,000 sq. ft. 284,000 sq. ft. 630 spaces
Tower City, downtown Cleveland, Ohio	34-acre transit-oriented urban conversion, rehab and new construction	Retail Office Hotel Garage parking Multiplex cinema Transit station	360,000 sq. ft. 1,000,000 sq. ft. 208 rooms 3,150 spaces 11 screens 123,000 sq. ft.
Reston Town Center, suburban Reston, Virginia	85-acre pedestrian-oriented street grid; high-rise with street-level retail/entertainment	Retail/entertainment Office Hotel Parking Ice rink	240,000 sq. ft. 530,000 sq. ft. 514 rooms 3,000 spaces

## Mixed-Use Development: El Toro Military Base Reuse (1998)

*Emma Tjaransen*

The sharp scaling back of the defense industry initiated by the Base Realignment and Closure (BRAC) Act in 1988 has created opportunities for reusing a large number of military bases across the country. Although these closures significantly affect many communities, with potentially thousands of military-serving and military-dependent jobs lost, the strategic redevelopment of the former bases can provide strong opportunities for the long term by creating more jobs than the former base supported while providing substantial tax revenues to the communities.

The Department of Defense (DoD) has been using the BRAC process to reduce the number of military facilities and to transfer properties to civilian control. As part of that process, DoD requires that a reuse plan guide the conversion of each base from military to civilian use. The reuse plan demands a significant effort on the part of the benefiting local redevelopment authority (LRA). The LRA typically has a broad-based membership, including, but not limited to, representatives from jurisdictions with zoning authority over the property. Generally, only one LRA is recognized per military installation.

Typically, a team of consultants is hired by the LRA to assemble the reuse plan. The team generally includes market and economic experts, transportation planners, land planners, infrastructure engineers, environmental planners, and public relations and marketing specialists.

The initial step in base property disposal is called "screening." Screening gives other military departments the first opportunity to apply for base property. After the screening process is completed, that portion of the base not identified for military use is considered "excess." Other federal agencies may then apply to use the excess property. Property identified for use for military or other federal agencies through the screening process can be conveyed directly to the requesting agency from the authorizing military department at no cost. After screening for federal uses is completed, any remaining base property is considered surplus.

Before it becomes available for general public acquisition, surplus property on the base is made available to state and local agencies, as well as to federally recognized Native American tribes. All of these groups are accorded equal status. Applications are examined for

compatibility with the LRA's reuse plan and the goals and objectives for the redevelopment of the base. Property recommended by the LRA for conveyance is conveyed either to the benefiting entities directly or to the LRA itself for sublease to those entities.

### Background

This study addresses the economics-based market analyses that are required as inputs to the reuse plan of a military facility. This analysis includes (1) setting goals and objectives; (2) researching potential uses proposed for the property; (3) performing market, economic, fiscal, and financial impact analyses of alternative scenarios combining the proposed land uses; (4) refining alternative scenarios to create a market-driven strategic plan; and (5) generating a marketing and implementation plan for the program.

Such an analysis was recently completed for the reuse of Marine Corps Air Force Station (MCAS) El Toro, a military base located in Orange County, California, that has been slated for conversion by July 1999. MCAS El Toro, a 4,700-acre property, is one of the largest remaining areas of developable land in the county. Infill in character, it is surrounded by residential and commercial uses and open space.

Like many military facilities preparing for conversion, MCAS El Toro is the subject of a heated public debate regarding its future use. But unique to MCAS El Toro is the prospect of the conversion of the majority of the site to a commercial airport. Orange County, and the cities of Irvine and Lake Forest, formed El Toro Reuse Planning Authority (ETRPA) as a joint-powers agency in 1994 to plan for civilian reuse of MCAS El Toro. DoD then designated ETRPA as the LRA to prepare the required reuse planning documents. In November 1994, a county ballot initiative was passed that called for commercial aviation reuse of the base.

Orange County withdrew from ETRPA in 1995, and subsequently the county was designated as the LRA by DoD. In July 1997, the county began preparing an aviation reuse plan. ETRPA, now composed of seven Orange County cities, requested county acceptance of its MCAS El Toro Reuse Plan as the nonaviation alternative to be

addressed in the county-prepared Environmental Impact Report. The Orange County Board of Supervisors agreed to ETRPA's preparation of a nonaviation reuse plan, and ETRPA selected a consulting team to prepare the plan.

### **Establishing Objectives**

According to DoD, the LRA's objectives are to develop "a comprehensive redevelopment plan based upon local needs. The plan should recommend land uses based upon an exploration of feasible reuse alternatives.... [and] is enforceable under state and local land use laws." The overall objectives of the reuse plan process for a military facility are established by the LRA with input from the consulting team. Those objectives are subjected to the scrutiny of the public at large. Specifically, the objectives of the economic and market analyses that are components of the study are to develop scenarios that maximize the market opportunity of the property, balanced with the community's needs and respect for the environment.

The preferred reuse scenario serves as a guideline through the property's buildout. The time frame established for the buildout is the likely length of time necessary to achieve absorption of all proposed land uses. The time frame for buildout is based on the projected health of the economy, both national and in the region affected by the base closure, as well as on the needs of the surrounding communities. The buildout estimate is generated by the market consultant, reviewed by the other members of the consulting team, and approved by the LRA.

### **Definition of the Scope of Work**

The scope of work for the economic and market analyses is designed by the market consultant, then refined in a group setting by the entire consulting team, and finally approved by the LRA. Members of the consulting team provide input relating to their areas of expertise, conferring to test the validity of the assumptions used. Typically, the economic and market analysis portion of the effort involves the following:

1. Generating a menu of potential uses for the site. The process requires vision, starting with as broad-

based a set of choices as possible, then narrowing the options down to the most likely set.

2. Performing a physical inspection of the subject property and making an analysis by potential land use with respect to locational factors, visibility, access, topography, and effect of surrounding land uses, with specific focus on the market potential for the proposed land uses identified in the previous step.
3. Defining the primary market area (PMA) for each land use under consideration. The PMA is used as a framework for demographic and demand potential analyses.
4. Making a macro-level study of the economy. This step involves analysis of historical and projected employment trends by Standard Industrial Classification (SIC) to determine industrial sectors that are projected to grow over the lifetime of the redevelopment.
5. Identifying industries that drive both the local and global economy. The focus is to determine the land use and other requirements of each driver industry, and to determine the ability of the base property to respond to those needs.
6. Collecting and analyzing demographic data for the PMAs for each land use under consideration, including population and household trends, age and income distributions, household size, owner/renter preferences, and so forth.
7. Identifying the competitive market area (CMA), which is the area in which each project is expected to compete on a more or less equal basis. CMAs can vary greatly in size from one potential land use to the next.
8. Investigating and analyzing the supply conditions in the CMAs of the land uses under consideration. Existing supply is examined relative to defining characteristics, such as location, positioning, densities, tenant/owner types, marketing, and rates of absorption. Planned and proposed projects are analyzed relative to projected product type, timing of introduction, absorption, and sellout.
9. Preparing statistical analyses of potential demand and capture for land uses under consideration. The

analyses identify the depth of potential opportunity from the PMAs of the land uses under consideration and the annualized capture potential of the base facility.

10. On the basis of the research and analysis outlined in the previous steps, producing multiple land use scenarios to provide the framework of the reuse plan.
11. Performing quantitative analysis of the economic impacts of the scenarios. This step examines the effect that each land use scenario would have on employment (both on and off site), income, output, and land sales revenue. The results indicate the scenario(s) that best maximize the economic opportunities offered by the redevelopment of the property.
12. Making a fiscal analysis of the proposed land uses, which is used to determine the public sector revenues or costs that can be anticipated from the development, occupancy, and servicing of a new project. The analysis evaluates project-generated revenues and costs in terms of their net effect on a specific jurisdiction relative to particular land uses on a per acre basis.
13. Based on the economic and fiscal analyses of each land use scenario, refining the proposed mix of uses to maximize economic return to the communities surrounding the base.
14. Conducting a financial analysis of the implementation of the selected scenario(s). The analysis quantifies the cash flow generated by a particular scenario, overall through buildout, and by development phase, after accounting for all revenues and costs.
15. Creating an implementation plan for the preferred economic scenario (i.e., how and to which target audiences the property should be marketed relative to land sales, etc.).

## Market Analysis

### Identification of a Product Menu

As discussed, one objective of the economic and market component of a reuse plan is to identify the array of land uses that maximizes the economic opportunity of the site.

The identification of a product/land use menu should be undertaken with as broad a vision as possible, with the ultimate goal of creating a plan with a synergistic array of land uses. The menu of potential opportunities is compiled by the consulting team. Public input from individuals and various interest groups is expected and accepted.

Through the analysis that follows, the range of potential land uses is narrowed down to those that are most feasible and most likely to succeed at the subject site. One of the most important issues to consider regarding the identification of land uses appropriate for the redevelopment of any large property, including brownfield parcels, is that the land plan must always remain *flexible*. Major shifts in the global, national, or regional economy will almost certainly occur during the lengthy buildout period. Such shifts will influence the mix of land uses at the redeveloped base and could potentially influence the needs and priorities of the affected communities and the LRA.

To identify the initial product menu at MCAS EL Toro, the LRA and the consulting team met in a brainstorming session. In addition, the LRA was inundated with suggestions from the public, all of which were considered when generating the list of potential land uses for the property. Proposals from the public included development of the site for a World's Fair, a national cemetery, a film studio, a national sports complex, and as a campus for a religious organization. The list that was generated included an arena/stadium, a convention center, a mixed-use entertainment center, an auto center, and various types of residential, retail, office, and industrial uses.

### Site Analysis

The site analysis involves conducting a physical study of the base property and evaluating it from a market perspective. Site characteristics examined are regional location, regional and local access, size, topography, visibility, and surrounding land uses. The property is ranked according to its appropriateness for the land uses under consideration. This process serves to confirm the suitability of proposed land uses and to eliminate less-suitable ones.

The property is typically evaluated in its entirety. Particular attention is paid to existing conditions, such as areas formerly used to store hazardous materials, and to

existing structures that may have interim utility. Most important is how the site's characteristics relate to or affect development of the land uses being considered.

The El Toro site offers an outstanding development opportunity. A predominantly flat, infill site supported by a strong regional infrastructure network, the property is surrounded by clean residential, commercial, industrial, and open space uses, in an area (Orange County) recognized nationally for its high quality of living.

The reuse plan for MCAS El Toro was designed to incorporate as many of the existing facilities as possible. Existing uses that were designated for inclusion are

- The Marine Memorial golf course, which will be expanded and linked to residential uses and the planned Sports and Entertainment Village;
- Aviation hangars, which have been designated for industrial purposes such as warehousing, manufacturing, or sound stage uses;
- Recently constructed former barracks facilities, which can be reused as student dormitory housing or as a hotel;
- An equestrian center, which will be adapted for civilian use and linked to residential areas and to a regional riding and hiking trail.

As of January 1998, 85 percent of the MCAS El Toro site was "clean" and suitable for any land use. By the time of acquisition by the LRA, all of the site will be developable for urban uses. Thus, the land planning efforts considered no environmental constraints and assumed a clean property.

#### **Definition of the Primary Market Area**

The PMA for each land use under consideration is identified through interviews with representatives of relevant businesses already operating in the area and with operators of new and innovative uses that could be attracted to the redeveloped property. Depending on the product type, PMAs can range greatly in size—from a radius of a few miles in diameter, to a regional or even national level.

#### **Macro-level Economic Analysis**

Historic and projected employment trends provide data for the analysis of a region's growth potential and how

that will influence development at the reused property. Analysis by SIC identifies industrial sectors that show the strongest expansion potential and, therefore, that should be addressed during the buildout of the base facility. Additionally, this analysis helps in further refining the selection of uses that are most likely to succeed at the base property.

In the often politically charged environment of military base reuse, the use of growth projections that have been adopted by a number of major local and regional governing entities is strongly recommended. Such projections are typically published by a well-recognized university research center or governmental entity located in the region.

The Center for Demographic Research at California State University at Fullerton and the California State Economic Development Department provided the projections used for the analysis of MCAS El Toro. The study examined employment growth projections overall and by SIC in Orange County, comparisons to a national index, and the current and projected jobs/housing balance in the county. Strong employment growth is projected for the buildout period of the base, with the county maintaining concentrations in high-skill, high-income sectors. For instance, in the high-tech manufacturing sector, which includes biotechnology, computer software and hardware, and aerospace, Orange County has 2.4 times the national average concentration.

#### **Identification of Economic Drivers**

Important to the future economic growth of the region is the targeting of economic drivers for location or expansion at the former base. Economic drivers are industries that stimulate growth, create synergy, bring high-wage and high-skill jobs to the area, create spin-off jobs, and foster economic growth in the region. Typically, economic drivers are "export industries," that is, those that sell the majority of their goods and services outside of the region. For instance, an airport can be an economic driver, potentially generating strong demand for related uses and thus creating jobs. (The analysis of the market potential of development with aviation uses is typically done by specialty firms with expertise in aviation planning.)

Research into the most appropriate economic driver industries for the base redevelopment plan provides a framework for the uses to be included in the plan. The application of a widely accepted methodology and economic model is extremely useful in this process. Typically, the model calculates for a given study area the economic multiplier of a given industry. The economic multiplier is the cumulative effect of new jobs introduced (direct), inter-industry jobs created as a byproduct (indirect), and jobs created by household expenditures increased by the addition of income from new jobs (induced). An impact, or output, analysis combines these factors to assess change in overall economic activity, and yields data in dollars or number of employees for economic comparison.

#### Targeting Economic Drivers

The likelihood of an economic driver industry locating or expanding at the base depends on creating a magnet site to attract the most sought-after sectors. Creating a magnet site is addressed using the following research and analysis:

1. Identifying emerging industries in the region that have strong positive economic effects.
2. Interviewing representatives of those industries to determine their space and location needs and preferences. Specifically, identifying needs and preferences in terms of building type (low-rise, mid-rise, or high-rise office; research and development space; multitenant industrial; warehouse; or manufacturing space) and proximity to suppliers, labor force, educational facilities, other related firms, clients, and retail services.
3. Identifying industries that drive economies elsewhere, but that have only a limited local presence, and that would have a positive economic effect if attracted.
4. Interviewing representatives of those industries to determine their level of interest in locating at the former base and to identify features that might attract them.
5. Investigating the possibilities of attracting special uses to the site that would benefit the area's economy and/or quality of life. These uses may include

educational institutions, sports arenas, museums, entertainment complexes, and tourist attractions.

6. Interviewing representatives of such uses to determine their site-selection criteria, their level of interest in the site, and what features might attract them.
7. Analyzing case studies of areas elsewhere in the region, nation, and world where clusters of such uses have developed to identify features and conditions that are important to those industries that can be incorporated into the specific plan.
8. Analyzing in case study format successful redevelopment of former military bases and large brownfield sites throughout the country, identifying mistakes made and lessons learned with respect to land use synergy.

This type of research provides valuable input for determining criteria to create a magnet site at the former base. It is also useful for identifying a preliminary focus or theme for the land use plan.

Using factors from the widely recognized and accepted Minnesota Implan Group model that can be applied to Orange County, the analysis yielded key findings with regard to local economic drivers and resulted in the following three-part answer:

1. Those industry sectors with the highest employment multipliers (most spin-off jobs from each base industry job) are finance, insurance, and real estate (FIRE) (2.5 spin-off jobs); transportation and public utilities (2.4); high-tech manufacturing (2.3); wholesale trade (2.1); and standard manufacturing (2.0).
2. Industries that produce the greatest output per employee are transportation and public utilities (\$350,000), high-tech manufacturing (\$291,000), FIRE (\$287,000), standard manufacturing (\$266,000), and wholesale trade (\$200,000).
3. Industries with the highest total income per employee are FIRE (\$94,000), transportation and public utilities (\$93,000), high-tech manufacturing (\$91,000), and wholesale trade (\$80,700).

The analysis served to identify on a preliminary basis the industries that should be targeted for the MCAS El Toro

property. Interviews with regional economists confirmed that these sectors are feasible at the site and validated the economic effects suggested by their multipliers. Interviews with representatives of these sectors helped to define the requirements of those industries and how the site could be developed to accommodate them.

### **Demographic Analysis**

The demographic portion of the market analysis analyzes population and household growth for the local area and region. Strong demographic growth trends are an important engine of a growing economy.

The recognized academic or government source used for employment projections most likely publishes population and household forecasts as well. These should be used for consistency and to reduce any potential objections about source. The demographic projections are used to forecast growth in the PMA for each of the land uses proposed.

### **Definition of the Competitive Market Area**

The CMA, or trade area (TA) in the case of retail land uses, is the area in which the planned product is expected to compete on a more or less equal basis. It is determined through surveys and interviews with users, brokers, and representatives of the various uses under consideration. Depending on the use in question, the CMA can be as small as the five- to ten-mile radius surrounding the property (e.g., for residential product) or can encompass the entire nation (e.g., in the case of a major theme park or convention center).

Existing and projected competitive supply for the various land uses under consideration for MCAS El Toro were analyzed not only in Orange County, but also for worldwide case-study analogues. This extended analysis was found to be particularly useful for special land uses such as stadiums, convention centers, and mixed-use entertainment centers because these destination locations compete on a large geographic scale, and few comparables existed in the immediate market area.

### **Competitive Market Analysis**

A survey of the competitive market for the proposed product types is an essential component of the market analysis.

Given the long-range plans typically associated with base closure and reuse, most important with regard to the competitive market is a macro-level market analysis for each of the major land uses under consideration. An examination of historical trends (e.g., home sales and prices; rents and vacancies; and industrial, commercial, and retail occupancies and lease rates) can serve as a guide for the future. An examination of the existing supply of competitors in the given CMA provides the following information:

1. Indicates what has been successful for the various product types under consideration in the local area, and why;
2. Identifies product gaps that have occurred in the CMA and examines the potential of their being filled by redevelopment at the base facility;
3. Analyzes effective demand for each product type in its CMA, for use in the statistical analyses of future demand and capture potential for the site.

Analysis of existing supply is also necessary to determine achievable per acre land sale prices by product type in the CMA, which will be applied in the economic evaluation of one land use scenario against another (described in detail later in this study). Identification of future supply, or planned and proposed projects in the CMA, is important in projecting future competition for proposed product types and in pinpointing future opportunities. Key factors in the analysis of proposed product include projected product type, location, timing, and projections for absorption and buildout.

If no local comparables exist, analogous situations can be useful as case studies. Analyzing successful military base and large brownfield developments from around the country, and indeed the world, is a useful tool in determining the competitive benefits and drawbacks associated with large-scale redevelopment. Of particular importance to the study of a large-scale development are the mistakes made and lessons learned with regard to (1) land use distribution, (2) synergy of uses, (3) economic driver tenants and other employment generators, (4) satisfaction of the needs of the surrounding communities, and (5) harmony with surrounding land uses.

Comparable projects for many of the land uses under consideration for MCAS El Toro, such as residential, retail, office, and industrial, were found in Orange County. Analysis of analogous military base and brownfield projects elsewhere were useful as well. Case study analyses included Lowry Air Force Base in Denver, Colorado; Research Triangle Park in Raleigh, North Carolina; Sophia Antipolis Science Park in Nice, France; Chiba Industrial Triangle in Tokyo, Japan; and the Multimedia Super Corridor in Kuala Lumpur, Malaysia. The analyses provided examples of successful land use distributions; high-income, high-output job generation; and maximizing the opportunities offered by existing infrastructure and amenities.

#### **Analysis of Demand and Capture Potential**

Statistical demand potential and absorption forecasts are necessary for the majority of primary land uses. They identify supportable absorption on site that fits in with buildout in the local market area. Demand potential is generated by population and employment growth, as well as by turnover in the existing product supply.

Analyses of demand and capture potential for residential land uses are based on both quantitative and qualitative methodologies, including projected household growth in the PMA, affordability indices, and historical data such as sales trends in the CMA. The analysis yields an estimate of the total number of dwelling units that can be absorbed in a given time frame, by price or rent range, and by ownership versus rental.

Analyses of demand potential for industrial and office uses are based on employment projections by SIC for the appropriate CMAs. Incorporating factors such as (1) typical capture of a particular industrial sector by product type, (2) average square footage per employee by product type, and (3) existing and projected land use patterns by type of space, the analyses estimate annual absorption potential by square foot and type of space.

Demand potential analyses for retail land uses are based on population growth in a given TA. The analysis includes factors such as per capita spending by product type, sales potential per square foot by product type, floor area ratio, and additional demand from outside the

TA. Demand potential analysis for retail uses yields annual absorption potential figures in supportable square footage.

Estimates of demand and absorption potential using standard methodologies may yield conservative results. Analyses should be adjusted to include a qualitative factor to reflect the full effect of the on-site synergy among various uses, such as technology and educational space, residential and employment centers, and cultural resources, which cannot be quantified.

As discussed earlier, flexibility of product mix is essential for the success of a long-range reuse plan. Opportunities should remain open to intensify land uses as well as to reorganize the uses when market conditions change during the buildout period.

#### **Creation of Land Use Scenarios**

When the objectives of the economic and market analyses are applied to create a plan that maximizes economic return to the region in harmony with the needs of the surrounding communities and the environment, the proposed land uses are assigned an acreage amount. This process results in alternative land use scenarios that are tested using the following analytical tools. The mix is subject to revision and refinement.

#### **Economic Impact Assessment of Land Use Scenarios**

An economic model is used to evaluate the relative benefits of each scenario over a 20-year period, or to buildout; the model typically presents five-year development phases. It is based on assumptions generated by the market analysis and yields the following outputs by land use: total units or square feet, on-site employment, total employment generated, land sale revenue, total output, and total income.

The model allows the team to refine the land use scenarios by adjusting the jobs-to-housing balance, the concentrations of industrial and commercial uses, the inclusion of special uses, and the amount of open space. The goal of such refinements is to create a reuse plan that works in accordance with the study objectives.

At this point, the land planners apply the acreage mixes of each scenario to a map of the property. The



evolving land plans are closely scrutinized by the transportation and environmental team members to ensure that the scenarios are feasible from the perspective of their disciplines. Throughout the process, the consulting team meets regularly with the LRA to discuss evolving land plans, verifying that plans are in accordance with the agreed upon goals and objectives.

### **Fiscal Impact Analysis**

The fiscal impact analysis projects the public sector revenues that can be expected from development, occupancy, and servicing of the project. The analysis evaluates project-generated revenues and costs in terms of their net effect on a specific jurisdiction relative to particular land uses on a per acre basis. Certain recognized guidelines, assumptions, and factors from the locality may be required for the fiscal impact analysis.

Revenue to local agencies generated by the new development (fiscal revenue) includes a portion of the basic property tax, sales taxes (in some cases), transient occupancy taxes, taxes from the transfer of real property, subventions from other agencies, business license revenues, and other taxes and fees. Costs incurred by a local government to provide public services to a new project (fiscal expense) typically include the cost of general government, public safety, public works, parks and recreation, and in some cases, education and social programs.

### **Financial Analysis**

The financial analysis portion of the market study quantifies the cash flow generated by a particular scenario, overall and by development phase, after accounting for all revenues and costs through buildout. Advantageous mechanisms specific to the military base closure process (such as Public Benefit and Economic Development Conveyances) are incorporated into the analysis. Using these tools, the objective of the analysis is to provide a preliminary assessment of the plan's ability to pay for itself without the infusion of local public funding.

Revenues to the LRA are generated through land sales to third parties (private or public/private ventures) and interim leases of buildings before they are demolished or converted to the final plan use. Land sales and lease

values are determined in the survey portion of the market analysis.

### **Implementation of the Reuse Plan**

As the reuse proceeds to implementation, an effective organizational framework to guide the redevelopment, marketing, and management of property disposition is needed. Implementing a long-range reuse plan requires ongoing management by the LRA. It is the task of the LRA to review the feasibility of certain options such as

- Creating an operating company to direct the implementation process, including issues of staffing and financing;
- Working with a master developer to oversee development of the site, either as an active developer or by hiring subdevelopers or subcontractors to complete specialized phases of the project;
- Employing a development manager who is responsible for contracting out the development and construction management of the entire base or portions of the base;
- Using other alternatives that may be deemed appropriate.

Agencies that may administer the plan include a reuse agency, a department of the local jurisdiction, a redevelopment agency formed specifically for the base reuse, or a joint-powers authority.

### **Public Participation in the Development of the Reuse Plan**

Given the often contentious environment associated with the proposed closure and reuse of a military facility, public participation is extremely important. Local residents, whose futures will be affected by the base redevelopment, have a strong and valid interest in proposed reuse plans. The public's perception of the LRA should be as a "people's entity" working to create a "people's plan" with the good of the economy, the community, and the environment as its prime concerns. Public participation should be strongly emphasized and interwoven into the planning process. The public participation process, and any media attention, are typically handled by the public relations

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## Mixed-Use Development: El Toro Military Base Reuse *(continued)*

team member and can be addressed in the following ways:

1. Public meetings and community outreach programs. These efforts are conducted throughout the planning process and when the proposed scenario is taken on a "road show," presented to the public, and discussed in an open forum.
2. Community volunteer programs. Members of the affected communities have the opportunity to provide input throughout the planning process by serving on subcommittees. These subcommittees, which meet on a regular basis, help identify the goals and objectives of the reuse effort, provide critical input to the constantly evolving scenarios, and recommend the scenarios to be submitted to the review committee.

### Results of the MCAS El Toro Reuse Planning Effort

The ETRPA team developed three alternative scenarios for the nonaviation reuse of MCAS El Toro. Each alternative was reviewed by members of the public who served on subcommittees. The alternatives addressed three opportunities for the reuse of the base: (1) high economic output, (2) focus on open space, and (3) a balance of jobs and housing.

#### HIGH-ECONOMIC-OUTPUT ALTERNATIVE

The first alternative concentrated on uses that generate high economic output while maintaining acceptable traffic generation. It focused on a central mixed-use area of community commercial, museums, convention center, hotels, low- and mid-rise offices, and medium- to high-density residential development.

With 12,000 to 13,000 residential units, the plan would achieve a 50 percent jobs/housing balance. It includes more than 40 acres of commercial uses and 500 acres of industrial uses. Special uses include a stadium, an outdoor sports complex, a convention center, and a museum complex. This alternative also includes a major educational facility adjacent to industrial areas, encouraging synergies between teaching and technology facilities.

Nonresidential uses create 70,000 to 80,000 jobs on and off site, with a total county output of \$7.0 billion to \$7.5 billion by the year 2020, and a positive fiscal

impact of \$11.5 million to \$12.5 million. Preliminary calculations estimate that this alternative would generate traffic of 335,000 to 375,000 daily trips.

#### OPEN-SPACE-PRESERVATION ALTERNATIVE

This scenario optimizes the natural open spaces with a 300-acre regional park as its focus. Other uses include residential and many of the same nonresidential uses as the previous alternative: a stadium, an outdoor sports complex, a convention center, a university, and a museum complex.

Almost 200 acres are dedicated to office uses, and 400 acres to industrial uses. In addition, the plan calls for a 300-acre theme park/mixed-use entertainment facility. In an effort to create open space while maintaining an acceptable economic output, acreage was transferred from residential to open-space uses, reducing the jobs/housing balance to 25 percent.

Nonresidential uses result in a total economic output of \$6.0 billion to \$7.0 billion by the year 2020, with a positive fiscal impact of \$10 million to \$11 million, and the creation of 60,000 to 70,000 jobs. Daily traffic generation is estimated at 270,000 to 305,000 trips.

#### BALANCE-OF-JOBS-AND-HOUSING ALTERNATIVE

This alternative maintains a jobs/housing balance of 100 percent on the site. Uses include a 330-acre college campus, a stadium, an outdoor sports complex, a convention center, an entertainment center, and automobile commercial uses, as well as residential and other nonresidential. Although large portions of acreage go to residential uses, the plan calls for 40 acres of neighborhood and community commercial, 200 acres of office, and 300 acres of industrial uses.

The nonresidential uses create an estimated 50,000 to 60,000 jobs and result in a total output of \$4.5 billion to \$5.5 billion by the year 2020. Fiscal benefit to the county is estimated at \$5.5 million to \$6.5 million. Daily traffic is estimated at 275,000 to 315,000 trips, similar to the previous alternative.

### The Final Proposal

In response to the subcommittees' recommendations, the primary element of Alternative 3, the research and

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## Mixed-Use Development: El Toro Military Base Reuse *(continued)*

technology campus, was incorporated into Alternative 1, and Alternative 3 was eliminated from consideration. After further revision to Alternatives 1 and 2 in accordance with the subcommittees' recommendations, the proposals were sent to the ETRPA Coordinating Review Committee (CRC), whose members were a group of Orange County leaders and representatives of various interest groups. The CRC reviewed Alternatives 1 and 2, then recommended development of a third plan that would fully achieve the objectives of ETRPA. All three plans are outlined below.

### **CRC-1: Education/Research/Technology (ERT) focus**

- Urban village image including a large central park and major residential and retail areas within the 700-acre ERT campus
- Total job creation: 85,000 to 95,000
- Total economic output: \$8.5 billion to \$9.5 billion
- Total annual income at buildout: \$2.5 billion to \$3.5 billion
- Net fiscal benefit: \$10 million to \$11 million

### **CRC-2: Arts/Culture/Education/Sports focus**

- Two urban village centers with museums, entertainment centers, hotels, a convention center, an outdoor sports complex, and a 200-acre ERT campus, plus a 700-acre central park
- Total job creation: 55,000 to 65,000
- Total economic output: \$5.0 billion to \$6.0 billion
- Total annual income at buildout: \$1.5 billion to \$2.5 billion
- Net fiscal benefit: \$13.5 million to \$14.5 million

### **CRC-3: Economic and Open Space dual focus**

- Four districts, each with its own focus—(1) education, research, and technology, (2) arts and culture, (3) sports

and entertainment, and (4) habitat preservation—and a mixed-use village as its activity core, containing approximately 2,300 acres of active and passive open space (more than 50% of the total acreage)

- Total job creation: 80,000 to 90,000
- Total economic output: \$8.0 billion to \$9.0 billion
- Total annual income at buildout: \$2.5 billion to \$3.5 billion
- Net fiscal benefit: \$11.0 million to \$12.0 million
- Financial analysis: positive net cash flow of ±\$398 million by 2020

The CRC recommended some refinement of the CRC-3 plan, which resulted in the final land use program. Millennium, as the plan was called, was presented by the consulting team to the ETRPA board.

### **Final CRC-3: Millennium**

- Total job creation: 100,000 to 112,000
- Total economic output: \$10.4 billion to \$12.9 billion
- Total annual income at buildout: \$3.7 billion to \$4.4 billion
- Net fiscal benefit: \$7.5 million to \$8.5 million
- Financial analysis: positive net cash flow of ±\$397 million by 2020

The ETRPA board authorized the consulting team to use the recommended alternative to prepare the ETRPA MCAS El Toro Reuse Plan. The ETRPA planning team completed the Millennium plan in March 1998. The plan fulfills the economic, social, and environmental goals that reflect the quality of life ETRPA seeks to provide.

The next phase in the process involves submitting the Millennium plan to the county and the Department of the Navy. Should Millennium be selected as the preferred alternative, the reuse plan would serve as a specific plan for the property.