

ISSUE BRIEF

RETAIL CONSTRUCTION IN ILLINOIS: WHY THE SLUMP?

CHRIS BREWER, JOE VITONE, AND JOE SCHWIETERMAN
AECOM TECHNICAL SERVICES INC. AND DEPAUL UNIVERSITY

This issue brief evaluates the pace of new retail construction in urbanized regions of the state since 1982 and offers practical guidance to municipal officials concerned about the sluggish pace of retail construction over the past several years. After reviewing the trends for both metropolitan Chicago and downstate regions, it considers how the Internet and other factors are encouraging major retail brands to reassess their growth strategies.

INTRODUCTION

Most municipalities in Illinois have economic development plans that focus in large measure on recruitment of new retail businesses – a segment of the economy that has been extraordinarily volatile over the past decade. Newly-released statistics show that the retail real-estate sector faces a difficult moment. Dramatic expansions of suburban retail space between 2004 and 2009, Internet buying, and other factors have left many communities with saturated markets for “brick and mortar” facilities.

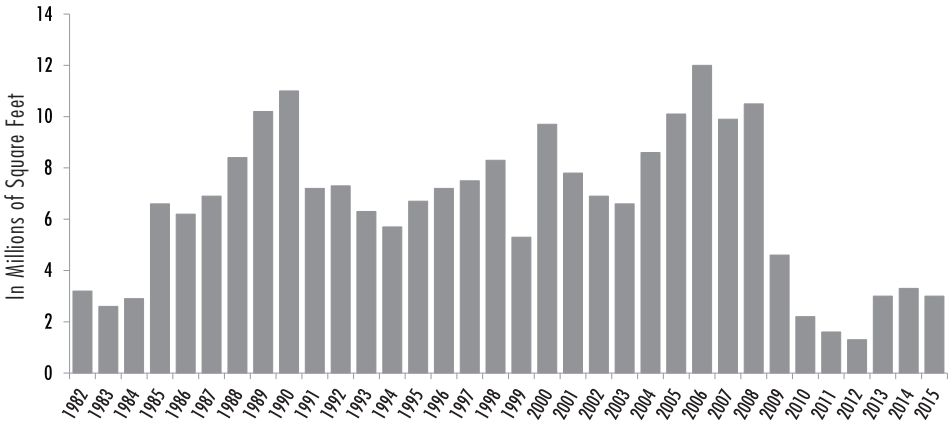
The sections below evaluate trends in retail construction for metropolitan Chicago and downstate regions using data from CoStar Group (a Washington, DC-based commercial real estate information and marketing provider) and retail sales estimates from the U.S. Census Bureau. The analysis also considers retail statistics for municipalities and counties from the Illinois Department of Revenue.

TRENDS IN METROPOLITAN CHICAGO

Between 1982 and 2006, the construction of new retail real-estate exhibited an erratic up-and-down pattern in the Chicago metropolitan region (Figure 1). Following strong gains in the 1980s, construction peaked in 1990 before falling sharply after the start of the 1990-91 recession. After hitting another high in 2000, construction ebbed again, and then followed a U-shaped pattern before peaking again in 2007.

FIGURE 1

Retail Space Construction Trends in Metropolitan Chicago



Source: Costar Group

The heavy construction leading up to 2007 can be partially attributed to larger-format chains such as Walmart, Target, and warehouse clubs, including Costco and Sam’s Club, taking advantage of dramatic changes in spending preferences. Only 2.8% of general retail dollars nationwide were spent at such chains as Costco, Sam’s Club, Walmart and Target in 1992, but by 2014, this share had increased to 11.9% (USCB, 2016).

Another notable trend involves drug stores and pharmacies, most notably CVS and Walgreens, which offer an increasingly large array of products and services. The average size of these stores grew while the number of locations rose exponentially. Furthermore, building material stores, particularly Home Depot, Lowe’s, and Menards, also followed a rising trajectory, transforming the home-improvement supply business.

As history would show, access to low-cost debt as well as competitive battles for market shares were also part of the mix. Some retailers kept older stores “dark” to prevent competitors from relocating into a market. Such a phenomenon resulted in construction that greatly outpaced the underlying growth in retail sales.

The Great Recession then brought austerity to the sector, spurred by tight credit markets and slumping consumer spending. Many communities that had grown accustomed to seeing retail projects move forward suddenly found their dockets for new construction not only empty, but existing shopping centers weakened by the under-performance or failure of anchors. Between 2011 and 2015, new retail construction sunk to levels not seen since the early 1980s.

The erratic pattern that resulted from these factors is evident in statistics published in Walmart and Target's financial statements. From 2000 to 2007, Walmart added an average of 32.7 million square feet of space annually (8.7% annual growth), while Target contributed 13.1 million square feet (9.1% annual growth), despite national retail sales growth averaging just 4.3%. Since 2008, Walmart has grown at only a 2.6% annual rate (the same rate as national retail sales), while Target has grown just 1.1% annually. Early this year, Walmart announced that it would be closing 154 stores nationwide, including all Walmart Express locations, and a significant number of neighborhood markets.

Auto sales were among those hardest hit in the past decade, falling by 26% from 2007 to 2009 nationwide. Although auto-related sales have recovered dramatically since 2014, the geographic distribution of dealerships took on a different pattern, resulting in material shifts in sales tax revenues. Over-optimistic outlooks, meanwhile, set the stage for an initial wave of bankruptcies among prominent retailers, including Levitz, Sharper Image, Circuit City and Linens 'n Things. Office Depot, Lowe's and J.C. Penney scaled back significantly, and, as noted below, many aging indoor malls suffered an uncharitable fate as sales faltered at anchors.

The aftermath has left communities rethinking their approach to retail. Vacancy rates now differ greatly across communities. The severity of this can be seen by looking at three high-income "primary clusters" in metropolitan Chicago: i) the area within an eight-mile radius of Downers Grove, which includes Naperville and Oak Brook; ii) the North Side of Chicago, including the Gold Coast and Lincoln Park neighborhoods, as well as the Magnificent Mile; and iii) the area within an eight-mile radius of Barrington, including Lake Zurich and Palatine. These high-income areas support about 105.7 million square feet of space, some 20% of the entire retail inventory across the Chicago region.¹

Vacancy rates average 7.5% in the Downers Grove radius area, but reach 10% in the Barrington area. Yet the vacancy rate is a mere 4.4% on the North Side of Chicago – despite this area having far more inventory per capita than the other regions. The national average for retail vacancy rates is about 11.2%.

TABLE 1

Retail Space and Vacancies in three Metropolitan Chicago Retail Clusters

RETAIL VARIABLES	DOWNERS GROVE 8-MILE RADIUS	CHICAGO NORTH SIDE	BARRINGTON 8-MILE RADIUS
Population	610,679	529,978	325,965
Per Capita Income	\$43,797	\$48,420	\$42,901
Total Income	\$27 billion	\$26 billion	\$14 billion
Retail Inventory (ft²)	40,836,702	47,255,924	17,640,868
Inventory Per Capita	67	89	54
VACANCY	7.5%	4.4%	10.0%

Such retail vacancies have been fueled by store closings. Nationwide, announced store closures in 2014 and 2015 totaled 12,955, about half as many closures as occurred in 2009 alone (13,262).² While closures have decreased since then, they remain distressingly high in many locales.

The downturn in construction since 2008 is not unique to retail, as the recovery in housing starts and construction of new office space has been similarly challenged. Still, the pace of industrial space construction in metropolitan Chicago is approaching pre-Recession levels. The rebound is linked in large measure with the emergence of Will County as an inland port of national importance, and facilities created to support the growth of Internet retail spending.

TRENDS IN DOWNSTATE ILLINOIS

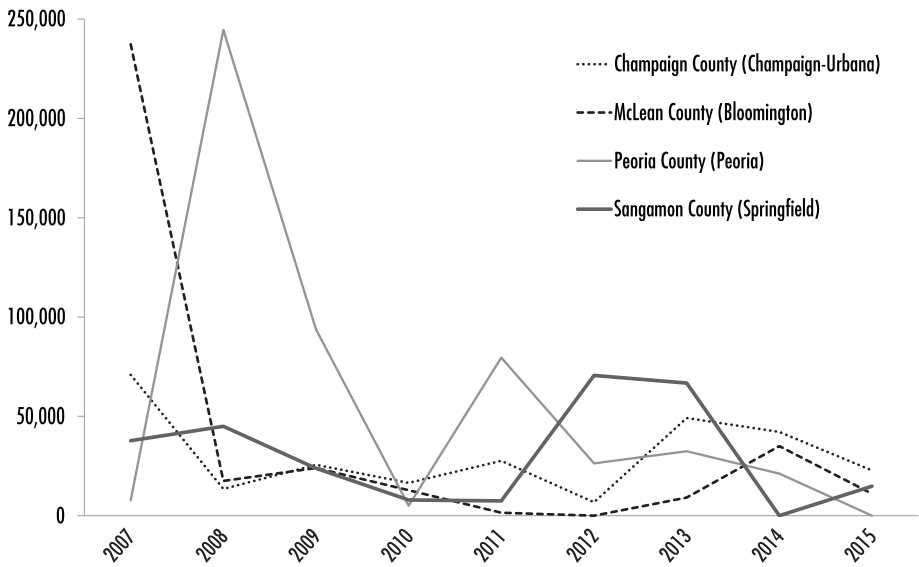
Some of the same trends seen in the Metropolitan Chicago region are evident in four downstate counties that have more than 200,000 square feet of retail space: Champaign, McLean (Bloomington), Peoria, and Sangamon (Springfield) counties, as shown in Figure 2. These counties cumulatively experienced a *faster* decline in construction during the Great Recession than the Chicago area. Whereas construction in the Chicago area fell by only about half from 2008 to 2009, it fell in Champaign and McLean County by more than 75%.

Peoria County had the unusual pattern of having virtually no construction in 2007 before seeing a spike in 2008. Since then, construction has gradually

fallen, save for a modest rebound in 2011. Much of the up-and-down pattern in this county may be attributable to the dramatic reductions in employment at Caterpillar that began in 2009.

FIGURE 2

Retail Space Construction Trends in Selected Downstate Counties
Square Feet of New Construction



Source: Costar Group

McLean County has also faced above-average volatility, perhaps due in part to the anticipated closing of the city's Mitsubishi automotive plant (completed this year). Champaign and Sangamon counties have been, in relative terms, more stable, apparently due to muted construction prior to 2008 and the continuity of economic activity afforded by the University of Illinois at Urbana-Champaign and state government, respectively. In Sangamon County, construction was actually higher in 2012 and 2013 than it was during the 2007-08 period. Even so, construction in these two counties fell to modest levels at the end of the observed period.

IMPACT OF THE INTERNET

Internet buying accounted for just 0.2% of all non-food service retail sales in 1998 but rose to 6.4% by 2014 (USCB, 2016). The share of total retail sales from e-commerce has been growing by an average of about 10% per year. Changes in consumer behavior have prompted department stores, such as Best Buy, Kohl's, Target, and Walmart to boost their online presence (albeit with purported marginal success) and to reduce traditional store square footage. Although this reallocation of a brand's retail sales from brick-and-mortar to online platforms can succeed, it often has negative implications for municipalities relying on retail sales taxes.

Diversion to online shopping is forcing retailers to develop new distribution and sales channels, thus blurring the boundaries between traditional brick-and-mortar store retail and Internet retailing. "Omni-channel" retail is emerging, with the goal of providing consumers a consistent, integrated experience across retail channels. For example, some traditionally online-only retailers are opening small brick-and-mortar stores while other traditionally offline retailers are integrating online and in-store sales. While growth in e-commerce sales has increased demand for large scale fulfillment and distribution centers located close to major metropolitan areas, some anticipated changes in store layouts to meet growth in online fulfillment have yet to emerge.

THE CHANGING FOOTPRINT OF MAJOR CHAINS

Considering the turbulence in this sector, it behooves municipal officials to be cognizant of major moves undertaken by national chains:

MACY'S

The effect of Internet buying on Macy's has garnered particular attention. Although the initial rollout of Macy's as a national brand in 2003 marked the demise of more than ten regional department store brands (including Marshall Field's), the company did not initially close many stores. Recently, however, the tide has turned, with store counts diminishing, and another 100 closures nationally announced during the summer of 2016.

THE GAP AND KOHL'S

Kohl's experienced robust expansion from 2000 to 2007, adding an average 6.4 million square feet of retail space per year. The Gap saw similar growth

adding about two million square feet annually. Since 2008 though, Kohl's has added just 1.7 million retail square feet per annum, on average, while Gap has eliminated approximately 212,500 square feet of store space each year. Both retailers are attempting to aggressively move into online sales.

SEARS AND K MART

The pivot of Sears and Kmart towards a Real Estate Investment Trust (REIT) structure heightens concerns for the eventual need to reposition a large number of regional malls anchored by these chains (Carlyle, 2015). Sears and Kmart have been closing stores consistently since 2013. Media reports in the fall of 2016 speak to anxiety over additional store closures and bankruptcies of mall properties with space occupied by such stores as Nine West and Claire's, as well as Sears (Banjo, 2016).

OFF-PRICE STORES

As some chains suffered, off-price stores, such as T.J. Maxx and Marshall's, are reportedly doing well. Even full-price chains have invested in off-price stores, such as Nordstrom Rack or Macy's Backstage.

BANKRUPTCIES AND ACQUISITIONS

The bankruptcy of Radio Shack, the effort by Office Depot and Staples to merge (which did not gain SEC approval), and the closure of Sports Authority were emblematic of the challenges facing traditional retailers. The loss of Blockbuster, for example, has removed what would otherwise be a typical anchor store in neighborhood-sized retail centers.

LESSONS FOR MUNICIPAL LEADERS

With hindsight, the frenetic 2005 - 2008 period was an anomaly, fueled by easy credit and traditional big box retailer battles for market share, as well as over-optimism. Many retailers expanded at a far higher rate than national retail sales would support, spurring a boom that could not last. The ensuing lag in retail construction is now testing the patience of some economic development officials and planners.

Municipal leaders should remain mindful of several trends that stand out:

First, communities with older retail centers (and older shopping malls in particular) should anticipate closures at weaker locations by Macy's, Sears,

Kmart, and other department stores. Similarly, communities with retail development concentrated along “older” commercial corridors built in the 1970s and 1980s (such as Ogden Avenue in Downers Grove or Harlem Avenue and 159th in Tinley Park) are faced with both opportunities and challenges for redevelopment and revitalization. In communities that are largely “built-out”, strategies to sustain revitalization of older commercial corridors should be a priority. Experience suggests that revitalization may include improvements to public amenities, enhanced walkability, changes to transportation infrastructure, and provision of mixed use development.

Second, the grocery business will remain a driver of change. The Chicago region has undergone enormous change in the grocery business, with Dominick’s leaving the market, and Whole Foods and Mariano’s entering the market and expanding. While a number of Dominick’s locations have reopened as other grocery retailers, there is a general sense that a final shakeout is still looming in 2017.

Finally, municipalities should remember that, despite the weakness in traditional retailing, spending at hotels, night spots, off-price retailers, and service-oriented businesses, such as cellular phone stores as well as fast food eateries and restaurants – all of which generate sales tax – is projected to remain strong.

Chris Brewer and Joe Vitone are Vice President, Economics and Planning, and Analyst, respectively, at AECOM; Joe Schwieterman is Director of the Chaddick Institute for Metropolitan Development at DePaul University. Corresponding author: Chris.Brewer@aecom.com.

¹ Income data is obtained from Esri, an international supplier of geographic information system (GIS) software, web GIS and geodatabase management applications

² For information about the store closing, see The Balance, available at <https://www.thebalance.com/all-store-closings-2891887>

REFERENCES

- Annual Reports including: Kohls, Macy’s, Sears, Target, The Gap, & Walmart. (2015)
- Banjo, S. (September 14, 2015). Message to all Owners of Department Stores: See Ya!. *Bloomberg News*. Retrieved from <https://www.bloomberg.com/gadfly/articles/2016-09-14/department-stores-leaving-malls-is-fine-by-mall-owners>.

Charyle, E. (April 1, 2015). A Sears REIT Could Unlock Value In Failing Retailer, But Saving Stores A Different Task. *Forbes*. Retrieved from <http://www.forbes.com/sites/erincarlyle/2015/04/01/a-sears-reit-could-unlock-value-in-failing-retailer-but-saving-stores-a-different-task/#573c4ba933fe>.

CoStar Group. *Commercial Real Estate Information Data for (1992-2016)*. CoStar Group, Washington, DC.

Illinois Department of Revenue (2016). *Standard Industrial Classification Code Reporting Sales Tax Receipt Database*. Retrieved from <http://tax.illinois.gov/AboutIdor/TaxStats>.

State of Illinois Economic Forecast (2016). Commission on Government Forecasting and Accountability. *State of Illinois Economic Forecast*.

U.S. Census Bureau (2016). Monthly & Annual Retail Trade. Retrieved from <https://www.census.gov/retail/index.html>.

Yerak, B., & Cancino, A. (2015). Mitsubishi closing Normal plant in Illinois, Ending U.S. Production. *Chicago Tribune*. Retrieved from <http://www.chicagotribune.com/business/ct-mitsubishi-normal-0725-biz-20150724-story.html>.