

Thinking Outside the Big Box: Retailers Look to America's Inner Cities

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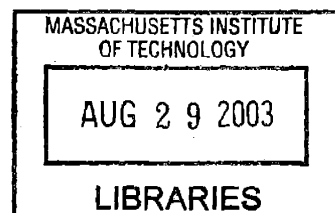
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ABSTRACT

Recent studies have shown there is a considerable retail opportunity in established but historically underserved markets in the United States. The goal of this thesis is to investigate to what extent national big box retailers are entering historically underserved markets in America's inner cities. This thesis will study the reasons for retail in underserved markets, determine to what extent retailers are willing to change their prototype formats to enter these markets and determine what measures must be taken by retailers and developers to allow for success. Six case studies will analyze recently completed and proposed projects where big box retailers entered urban markets.

Thesis Supervisor: John T. Riordan

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## Chapter 1: Introduction

The purpose of this thesis is to study urban retail markets in America's inner cities, characterized by low household income and high unemployment. This thesis will explore why "underserved markets" is a buzzword in the retail and development industry today and to what extent big box retailers are willing to modify their prototype stores in order to enter an inner-city market.

An underserved market is one where demand exceeds supply. A new suburban housing development could be technically underserved because retail has not yet been built in the area and residents need to travel long distances for basic household needs. Historically, retail has caught up with the suburbs and shopping centers have been built on previously underutilized land, to the delight of shoppers and town tax collectors. In the suburbs, big boxes (Wal-Mart, Home Depot, Costco, Target, etc.) dominate the retail landscape, occupying one shopping center after another where a constant stream of shoppers drive in for their weekend buying. As a point of clarification, this thesis uses the term "big boxes" to mean 50,000 to 180,000 square foot, single story buildings without architectural distinction that derive their profits from high sales volumes instead of price mark ups. Big boxes rely almost exclusively on automobile access and usually have plenty of surface parking.

Targeting the suburbs has made good business sense for retailers as they have followed population trends and experienced huge growth. Between 1940 and 1970 the suburban population of the U.S. grew from 24.2 million to 75.6 million, and retail has followed these residential trends.<sup>1</sup> Residents of the inner-city on the other hand have long suffered from a lack of a national retail presence. As a result, inner-city residents often pay higher prices for goods of inferior quality compared to what can be found in the

suburbs. This limited retail presence and weak product selection has left inner-city residents feeling neglected and somewhat skeptical about new developments. For products not available in their neighborhoods, residents often have to make long trips to purchase basic household needs. An underserved neighborhood is less attractive to new residents and usually results in a stagnant or declining housing market.

## **Chapter 2: Problems with Traditional Data**

To understand the weak national retail presence in America's inner cities, one must look at the data that has justified firms to avoid these locations. Before making the large capital investment decision to open a new retail store, developers and retailers rely on detailed maps of population density, home ownership, household income, automobile ownership and crime statistics from commercial firms.<sup>2</sup> Standard commercial methods for assessing market strength can be inadequate for inner-city neighborhoods and tend to underestimate business potential in two ways. Consumer purchasing power is undervalued and unique market characteristics (niche markets, barriers to entry, etc.) are not well understood.<sup>3</sup> Market data companies have historically discounted income density and have ranked inner-city neighborhoods as losers while looking at household income and ranking sparsely populated suburbs as winners.

Not only do private market data companies often paint a misleading picture of market opportunities in inner-city markets, but they also tend to exacerbate negative myths about inner-city neighborhoods and residents.<sup>4</sup> Market data companies often rely heavily on U.S. Census information, which can often be obsolete when used. Additionally, U.S. Census counts have historically undercounted minority residents in inner-city neighborhoods. For example, the 1990 U.S. Census missed 4.8 percent of the

African-American population and 5.2 percent of the Latino population in New York City.<sup>5</sup> Using income statistics from the U.S. Census is effective for middle and upper income households but is not for lower income, inner-city households where unreported income plays a significant role. Studies have proven that low-income consumers spend more than their reported incomes.<sup>6</sup> Individuals reporting income under \$10,000 make expenditures equaling about 250% of their income.<sup>7</sup> Substantial information gaps inhibit inner-city development as traditional sources of business data are often poorly equipped to measure the special features of an urban marketplace.

A study conducted in Milwaukee Wisconsin by John Pawasarat and Lois M. Quinn for the Brookings Institution questions the traditional methods of market research used by large firms. It proposes a new methodology that looks not only at household income, but calculates annual income and purchasing power per square mile using state income tax filings by zip code to show retailers the buying power of previously ignored neighborhoods. This study found holes in several of the national market data firm's reports. An inner-city area in Milwaukee that national firms such as Claritas and CACI determined to be declining in population by as much as 10% using a "complex methodology" based on computer modeling was proven to be growing by 5.5% (verified by the U.S. Census in 2000).<sup>8</sup>

The Milwaukee study also found that market data firms often used stereotypes to categorize neighborhoods. Working class neighborhoods were labeled by CACI as "distressed" and "unemployment is high; those who do work have only part time jobs." Residents of African-American neighborhoods were characterized as "splurging on fast food and spend leisure time going to bars and dancing." Hispanic neighborhood's residents were generalized as "splurging on videos, long-distance phone calls, cable TV,

theme parks and casino visits.”<sup>9</sup> Meanwhile, residents of affluent white suburbs in Milwaukee were described as being interested in “civic activities, volunteer work, contributions and travel.”<sup>10</sup> Claritas classified African-American households with names like “87.23% difficult times” and described the populations as very low-income families who “buy video games, eat at fast food chicken restaurants, use non-prescription cough syrup and use laundries and laundromats.”<sup>11</sup> Other cities across the country were characterized by identical descriptions based on ten and twenty year old U.S. Census data.<sup>12</sup>

Studying state income tax returns for Wisconsin raises serious questions about the validity of some of the private firms’ data. A predominately African-American zip code, 53206, has one of the largest concentrations per square mile (3,737) of income tax filers in the Milwaukee MSA while the wealthy suburb of Oak Creek has only 405. While Oak Creek’s average household income is significantly higher, the inner-city income per square mile is more than triple that of Oak Creek (\$67.2 vs. \$20 million).<sup>13</sup> Analyzing a different study in Chicago, the South Shore neighborhood has a median family income of \$22,000 compared to \$124,000 in the affluent suburb of Kenilworth. However, South Shore has a retail spending power per acre of \$69,000 compared to Kenilworth’s \$38,000.<sup>14</sup> Disregarding inner-city spending power appears to be a classic example of looking at the trees instead of the forest. The “trees” may be smaller in the inner-city, but they comprise a much larger “forest” of spending power. Even though average inner-city incomes tend to be relatively low, high population density translates into an immense market with considerable buying power.

The Milwaukee study demonstrates the need for American cities to dispel negative stereotypes and allow retailers to see the real picture of buying power. Proactive

city Mayors, like Milwaukee's John Norquist, are essential spokespeople for change. Norquist promoted his city's strengths in 2001 by saying "Our central city neighborhoods are becoming the new land of opportunity in Milwaukee. Because of our neighborhoods' dense population and total purchasing power, developers and retailers are discovering the value of central city locations. This [development] is indicative of this trend and is a symbol of the opportunity and potential of a true urban marketplace."<sup>15</sup>

### **Chapter 3: Market Potential in America's Inner Cities**

"Our greatest untapped markets are not overseas – they are right here at home. And we should go after them." (President Bill Clinton, State of the Union Address, 1999)<sup>16</sup>

The huge buying power of America's inner cities makes them true emerging markets. Two recent reports provide different estimates of inner-city buying power. The Boston Consulting Group (BCG) and the Initiative for a Competitive Inner City's (ICIC) report, The Business Case for Pursuing Retail Opportunities in the Inner City (1998), estimates America's inner cities 7.7 million households represent over \$85 billion in annual retail spending power.<sup>17</sup> This figure does not include unrecorded activity that could add an additional \$15 billion. The BCG/ICIC report also estimates that retail purchasing power in inner-city zip codes comprises nearly seven percent of the total retail spending in the U.S.<sup>18</sup> A report issued by the U.S. Department of Housing and Urban Development in 1999 estimates America's inner-city neighborhoods possessed retail purchasing power of \$331 billion in 1998.<sup>19</sup> This thesis will not investigate the cause of the difference in these two figures, but will focus on the fact that a very large, untapped opportunity exists in America's inner cities.



Despite this huge buying power, many of America's inner-city communities are under-retailed, with sales that fall significantly short of residents' retail purchasing power. Unmet demand reaches 20% in inner-city areas and approaches 60% in others.<sup>20</sup> Individuals reporting incomes of less than \$30,000 per year make one third of all the expenditures in the U.S, representing \$920 billion annually.<sup>21</sup>

### *The Unrecorded Economy*

A key ingredient to the inner-city's buying power has its source in the unrecorded economy; also known as the cash economy or the black market. The unrecorded economy is primarily based on legal activities (80%) such as contracting, nannies, tutors and small businesses but also includes illegal immigrant labor and the drug trade.<sup>22</sup> While there is no empirical way to determine the size and scope of the unrecorded economy and any estimate is bound to lack precision, reliable estimates hover around \$1 trillion annually. Economist Friedrich Schneider calculated the underground economy in the U.S. to be 9.4% of GDP in 1994, or approximately \$650 billion. The Commissioner of the Internal Revenue Service, Charles Rossotti, estimated Americans failed to pay \$200 billion of federal taxes that were owed. Assuming a 14% tax bracket, Americans failed to report almost \$1.5 trillion of personal income.<sup>23</sup> Standard forms of market data analysis do not take into account this incredibly large number.<sup>24</sup> Residents of America's inner cities spend much more money than the U.S. Census, IRS tax returns and market data would lead one to believe.

## **Chapter 4: Why Have Retailers Avoided the Inner-City in the Past? Perceptions and Realities**

With the huge market potential previously discussed, why have national retail chains avoided America's inner cities? Through interviews with industry leaders and analysis of current studies, this thesis determines the answer lies somewhere between perceptions and realities.

### Perceptions

The obstacles to developing in the inner-city are more widely known than the opportunities for success. This is largely due to negative perceptions of inner-city markets, their residents and local governments that have been perpetuated over time.

The perception of crime, more than crime itself, can be a major factor in firm's unwillingness to enter an inner-city market as higher levels of crime are often associated with inner-city areas. Crime actually varies greatly from neighborhood to neighborhood and developers may perceive that the security risks in an area are higher than they actually are. Like other demographic information, crime statistics are publicly available. Information that is not currently available is how much crime actually costs property owners and how much money is spent preventing it. This information could help developers and retailers quantify how much additional money needs to be allocated for crime prevention and if the project will be feasible with these additional costs.<sup>25</sup>

A common misperception is that inner cities enjoy cheap labor and real estate, which would in theory induce retail business to develop. The opposite of this is true. Land assemblage in urban areas often involves several land parcels and putting together one contiguous parcel can be very expensive, especially if local property owners learn of the assemblage plan and decide to holdout for more money.

While wages for inner-city retail can be kept low, they are not necessarily lower than wages paid by a suburban store. In addition, the costs of workers compensation,

insurance and other benefits usually make being an employer in the city more expensive than the suburbs.

There are many perceptions about the inner-city not being viable retail market. While many of these perceptions are false, there are several realities that challenge inner-city retail development.

### Realities

#### *Land Assemblage is Expensive*

Big box retailers are huge users of land. The supercenter formats for Target and Wal-Mart are now in excess of 180,000 sf. Home improvement centers like Home Depot and Lowe's have the added needs of outdoor lumberyards and garden centers. Given their choice, big boxes would build sprawling one-story stores with parking fields at least the same size as the store footprint. A trip through the U.S. suburbs provides a snapshot of prototypical big box development: sprawling development sites built on previously underdeveloped land. As lucrative suburban locations become more densely developed and the supply of premium sites becomes constrained, big boxes are actively rethinking development opportunities in urban areas.

In an urban development site, instead of buying land from a speculative landowner or farmer, developers and retailers usually need to work with several landowners to make the development work (community development corporations can play a vital role in assisting developers with land assemblage. See Chapter 5). Land parcels in urban areas tend to be smaller, requiring the developer to tie up several parcels in a process that could take years to gain clear title to all the required parcels and fight through litigation from opposing community groups and local governments. One area of urban development that has been attractive to retailers over the past ten years are

"grayfield" sites, former industrial zones where many contiguous acres are typically available and have good road access. Grayfield sites can look similar to brownfield sites in many ways, but do not carry the same connotations involving major environmental remediation. Three examples of these sites are the Brentwood Road shopping center in Washington DC, the South Bay Center in Boston's Dorchester neighborhood (see case studies) and the Home Depot/Wal-Mart shopping center on Columbus Ave. in South Philadelphia.

#### *Higher Construction Costs*

The cost of building is significantly higher in inner-city areas due to delays associated with permitting, planning groups, architectural review boards, negotiations with community groups, building codes and minimum minority contracting requirements. A strong trade union presence in many of America's cities can drive up the cost of development compared to the suburbs. To secure project approval, developers sometimes need to agree to set aside a certain percentage of contracts on the project to MBE or WBE firms (minority-owned business enterprise, women-owned business enterprise). These contractors may not be the lowest cost alternative, but the project requirements require the developer to use them, driving up development costs.

Urban sites tend to be space constrained, making construction more complicated and expensive. Delivery of materials and staging of work becomes a daily choreography routine for developers and construction managers due to limited space for storage of building materials, tight streets and uncooperative neighbors. In suburban sites, the huge parking field of a big box store can serve as a staging area for construction trailers, materials receiving and excess soil storage. The only mitigating factor that can keep construction costs relatively lower in cities is that sites and stores can be smaller which

translates into lower gross construction costs. The cost per square foot however will almost always be higher at the urban site.

### *Higher Operating Costs*

Security, shrinkage (shoplifting), worker's compensation, utility fees, general liability insurance and real estate taxes are all factors that increase the cost of operating a retail establishment in an urban area. According to Jeff Doss, a Wal-Mart real estate executive, "where you might be paying \$1 per square foot in taxes in the suburbs, an inner-city location could be \$3 or \$4. Labor costs are higher, rent is higher and Wal-Mart doesn't adjust prices for the inner-city [stores]."<sup>26</sup> Doss also commented, "ten years ago we wouldn't have given it a second thought [developing an inner-city store]. Even if the real estate looked good and the numbers worked, our operations guys would say forget it." Insurance, taxes and utilities are generally fixed costs that are difficult to reduce, but shrinkage is a controllable problem through effective store management.

Both the perception and reality of crime in inner cities is a major impediment to retail development. Crime prevention increases operating costs significantly in the form of police officers, security guards, additional lighting and regular cleaning.

### *Parking*

The inner-city's densely built environment presents additional challenges for big box retail's huge parking requirements (usually 3 to 5 parking spaces per 1,000 square feet of retail space, depending on the type of store). The cost of creating parking in the suburbs is usually limited to clearing and grading the land and then paving over it. Tight urban sites rarely have sufficient land for surface parking and either rely on public transportation or some type of structured parking. An exception to this are the "grayfield" sites mentioned above which often look very much like a suburban

development and have sufficient space for surface parking. Structured parking is extremely expensive and can cost anywhere from \$15,000 to \$50,000 per parking space depending on the location and if the parking is above or below grade.

### *Environmental Concerns*

Suburban retail sites are often located on prior retail sites or previously undeveloped land. The risks of environmental contamination in these areas are relatively low compared to their urban counterparts. Inner-city retail sites can be found on sites of previous factories, warehouses, manufacturing firms, dry cleaners and gas stations. Once land parcels are assembled, an urban site often requires environmental remediation, expensive demolition and litigation. The unknowns regarding contamination with these sites are large, and often discourage development because of the potential for the huge remediation costs associated with removing contaminated soils, asbestos, etc. Environmental remediation costs add risk to project and make it harder to attract outside investors.

### *Investment Concerns*

An inner-city retail project needs to make sense for equity and debt investors before it can move forward. Uncertainty in the regulatory and permitting process discourages investors who are unwilling to take a risk on a project that might never get off the ground. Government incentives, public/private partnerships, guarantees on permit speed and environmental liability greatly reduce risk and promote investment.<sup>27</sup> Public/private deals usually involve more participants and result in a more complicated deal structure that uses multiple sources of debt and equity and specialized public/private finance, ultimately resulting in a longer and more expensive development timeframe.<sup>28</sup>

Most investors are not interested financing one building if the rest of the neighborhood is struggling. Investors look to areas with signs of promise and sound underlying fundamentals such as an effective local government, good schools and transportation systems. Attractive areas for investors include those where population density is high and potential for competition is low. It is often difficult for developers to convince big box retailers to be the first one in on a new project where the big box retail format is essentially untested. If a developer is unable to convince a credit retail tenant to join a project, there is a good chance the project will not obtain the necessary financing.<sup>29</sup>

The economic downturn of 2001 through 2003 has increased investor's flight to quality and has potentially hurt opportunities for inner-city retail projects to be financed. Investors are looking for deals with fair returns and low levels of risk and uncertainty. Inner-city retail investment is usually classified as high risk or opportunistic, requiring a much higher return (typically 20% or higher) to compensate for the additional risk. National retail chains are opening new stores very selectively and are less prone to jump at an opportunity in an untested location. A preference remains for higher value locations and secure bets. This is seen not only in the retail sector but across other property types as well. The past year has seen an excess of investors looking to invest in Class A office properties having long-term leases with credit tenants. Retail tenants will pay premiums for proven, high traffic locations over potential big opportunities in untested markets.<sup>30</sup> In times of economic uncertainty, less capital will be invested in inner-city retail projects.

Although it is difficult to quantify, limited capital is moving to inner-city urban areas, transforming communities in the process. Investors are finding opportunities in underserved markets that are generally off the radar screen of other investors. The areas receiving this investment capital usually have high levels of public participation, public

incentives and proactive local governments. Most investors are targeting areas with the fewest obstacles and generally ignoring severely distressed areas.<sup>31</sup>

### *The Target Market is not Homogenous*

One of the major challenges for retailers is that the inner-city shopper is not homogenous. According to the U.S. Census Bureau in 2000, African-Americans represent 42% of the inner-city population and 36% of inner-city households, Hispanics 31% and 19%, Whites 23% and 32%, other segments represent 4% of the population and 13% of households.<sup>32</sup> This heterogeneity in the inner-city represents a unique challenge to retailers in product mix selection. Stores customizing their product selection to individual submarkets often results in a pricing premium. Convincing different neighborhoods and ethnicities to come together and use the same store can also be a challenge to a successful retail operation.

### *Conclusion*

Despite some false perceptions about the inner-city, the reality remains that developing urban sites is harder than developing suburban ones. Sites are tighter, there are more stakeholders involved and buildings are more expensive to build and operate. To answer the question of why retailers have avoided the inner cities, one must look to the excess of prime development sites that existed in the suburbs over the past ten years. According to Mike Litwin, Director of Corporate Real Estate at Target, “land was so plentiful in the suburbs, there was so much low hanging fruit, that moving to urban locations didn’t make sense.”<sup>33</sup> With so many sites with strong demographics to support them, it is no surprise that retailers chose to develop there. As prime space in the suburbs becomes more supply constrained, retail firms should become more adept at locating and developing inner-city sites. Gary Rappaport of The Rappaport Companies, a retail



developer in the Washington DC area, summarized the benefits and challenges of urban big box development saying, “big boxes are recognizing that even with all the additional costs of security, shrink and other costs, they can still make money.”<sup>4</sup>

## **Chapter 5: Changing the Rules to Make it Happen**

Developers and retailers cannot enter inner-city retail markets with the same agenda that they have successfully used in the suburbs. Success in inner-city markets requires a more sophisticated and well thought out plan that is more labor intensive than suburban development. This section of the thesis focuses on strategies retailers and developers can use to be successful in inner-city retail development projects.

### *Community Involvement*

A critical element in an inner-city retail development is gaining the support of the local community, including neighborhood groups, community development corporations (CDC's) and local governments. A new big box retail store might represent the first major investment a neighborhood has seen in many years and with it brings improved product selection and job opportunities. Not only will the surrounding community be the store's customers, but also its employees, so developing positive community relations is essential from both a buying and selling perspective.

Inner-city residents are often skeptical of outsiders coming into their neighborhoods promising great things as they have seen this happen in the past where projects never materialized. A new retail establishment will also challenge the viability of other stores run by local merchants and could be accompanied by a negative community backlash. Measures need to be taken to ensure these negative attitudes are quickly dispelled. The community needs to be given a sense of ownership in the project

so that they feel they are working with the retailer and developer, not against them.

Kenneth Lombard, co-founder of the Johnson Development Corp. spoke about community involvement at an Urban Land Institute conference last spring saying, “Part of our philosophy on securing projects is community outreach. They (the residents) have to feel like you are part of their community. Everyone is welcome at our projects, as long as they are not there to disrupt the experience of others. If you want to maximize your success, you need to figure out how you can do something to include all the customers available to you. It’s about going in with an attitude of inclusiveness, not an attitude of gentrification.”<sup>35</sup> Retailers report that community involvement, of all types, help reduce security problems for stores. Community involvement gives residents a sense of ownership in a project and the sense that it should be valued and protected.

Community-based organizations (CBO’s) and CDC’s can play an invaluable role assisting a retailer entering a neighborhood. CDC’s can be instrumental in the development process due to their ability to attract subsidies, facilitate governmental approvals, assemble sites and eliminate zoning conflicts. Acting as a liaison between the community and the retailer/developer, CDC’s can keep vital lines of communication open and keep a project moving forward. Lou Collier, an urban development consultant, discussed the importance of community involvement by saying, “[Y]ou need to have someone facilitate the process, because if you go in with a typical management attitude, the community will assume you view them as a commodity to make money off.”<sup>36</sup> CDC’s have successfully acted as the role of land assembler for projects, clearing sites and preparing them for development (see Skyland case study). A goal of CDC’s should be to create building-ready sites at market prices by handling land assemblage, remediation,

clearing and other initial costs.<sup>37</sup> This would facilitate developers to move forward quickly with projects and have an easier time attracting outside capital.

#### *Reuse of Old Stores to Gain Market Share*

For a big box retailer looking to enter a new market, locating a desirable development site for a store and then gaining regulatory approvals can take several years. To avoid these situations, big box retailers (supermarkets included) can take over the lease of a struggling chain or move into a vacant store of a previous retailer. Although the store might not meet the retailer's prototype format, it gives them an opportunity to enter a market in a relatively short period of time. Instead of taking years to open a new store, it could be as little as several months. This can be seen as two major players in the big box market, Wal-Mart and Target, have gained considerable market share over other national and regional competitors such as K-Mart (currently closing 326 of its 1,830 stores nationwide), Ames (closed 327 stores in 2002)<sup>38</sup>, Caldor (closed 145 stores in 1999)<sup>39</sup> and Bradlees (closed 105 stores in 2001).<sup>40</sup> Former low price stores such as Ames, Caldor and Bradlees have smaller floor plates than the typical prototypes for Target and Wal-Mart (120,000 to 180,000 sf). They make a better fit for grocery stores looking to quickly enter a market which can be seen by Shaw's Supermarkets \$75.5 million purchase of 18 former Ames Stores in the New England area. One of the challenges of retrofitting a discount retailer into a grocery store involves the large refrigeration requirements with a substantial portion of the piping typically run through the slab and stubbed up into the freezer boxes.

An example of a big box retailer moving into the shell of another store is Target's acquisition of a former K-Mart store in Boston's South Bay Center (see case study). Although the 150,000 sf K-Mart generated the highest revenue of all the chain's

Massachusetts stores, the company's January 2002 Chapter 11 filing forced it to reduce its number of locations. Boston Mayor Thomas Menino was able to convince Target to locate to the South Bay Center site while attending the International Council of Shopping Centers' convention in Las Vegas in 2003 (35 mayors attend the conference in 2003).<sup>41</sup> Menino reported that he "cut a deal with Target, that's 200 jobs."<sup>42</sup> Construction renovation started in the summer of 2003 and a March 2004 opening is scheduled. Moving into a proven successful inner-city site without dealing with issues of land assemblage and neighborhood opposition made this move an easy decision for Target.

As big boxes get bigger and bigger, retrofitting old stores is seen less frequently. Challenges of moving into another store's box include different column spacing, ceiling heights and floor loading. According to John Pascione, a real estate executive at Home Depot, "of Home Depot's 1,600 stores, I'd be shocked if more than 100 were in an old store's shell. . . Moving into another store's box might be feasible from a real estate development perspective, but might not work for the store's operational requirements." There have been a few occasions where Home Depot has moved into former Caldor and Bradlees stores, but those were "very unique situations" and usually only happen if all possibilities of doing a traditional store have been exhausted.<sup>43</sup> Mike Litwin of Target noted that old K-Mart stores are typically 80,000 to 90,000 sf. Target has determined that stores need to be at least 100,000 sf to be sufficiently profitable and provide "guests" (Target customers) with adequate product selection. Big boxes tend to make exceptions and move into a less desirable box if the market they are targeting is strong enough to compensate for lost efficiency. Tom Gallagher of Home Depot noted "We've enlarged old stores in an attempt to avoid a long entitlement and zoning process. This allows us to get the registers ringing faster."

### *Adjusting Store Formats/Layouts*

Wal-Mart supercenter (department store and supermarket combined) stores are typically 180,000 sf or larger. In an effort to increase market share, Wal-Mart is promoting its Neighborhood Markets chain of smaller grocery stores which tend to be about 40,000 sf and are being developed for the “convenience of shoppers”<sup>44</sup> that might otherwise have to travel long distances to a supercenter. These smaller store formats have the ability to reach urban development sites. Home Depot has developed a similar approach with its home improvement stores. In Mill Basin, Brooklyn, Home Depot launched an experimental venture with an explicitly urban store called Villager’s Hardware. The urban format is smaller (about 40,000 sf) offers less parking and is geared toward the needs of city residents. The store includes 37,000 products, about half of which are also available at Home Depot. It carries less lumber, floorcovering and lawn and garden supplies. Villager's Hardware is designed to draw customers from a number of competitors, including independent and chain hardware stores, discounter and home-decor stores such as Bed Bath & Beyond.<sup>45</sup> In speaking with Home Depot officials, it is unclear whether the Villager’s Hardware store will be actively pursued in other markets as the suburban prototype store is more profitable than its urban counterpart. Neighborhood Markets and Villager's Hardware are concepts are aimed at getting the two giant retailers closer to consumers' homes. If they are successful and are able to get customers into stores more often, sales could justify their higher operating costs.

Target has started to develop stores on two levels in urban sites and now has over two-dozen multilevel stores operating. Target is hoping to build a 169,000 store on two levels in Washington DC’s Columbia Heights neighborhood (see DC USA case study).

According to Target's Mike Litwin, two level stores have been proven to work for Target and they are currently creating a two level prototype store. Two level stores are more costly to operate as staffing needs to be increased substantially. In addition to staffing, there are the added costs and planning complications associated with vertical transportation.

Big box retailers have become increasingly flexible with store formats in order to enter new markets. According to Michael Beyard, senior resident fellow at the Urban Land Institute, "Five years ago, for the stores, it was my way or no way. The stores want a single level, with wide parking lots out front, to fit their standard formats. Now, there's enough competition for sites that they're willing to compromise. We've seen a fundamental change in the willingness of big box stores to accept compromises."<sup>46</sup>

## **Chapter 6: Important Factors for Success**

As with any retail store, finding a good location is just the beginning on the long road to success. A well thought out strategy and the execution of a carefully orchestrated plan are critical to ensuring the success of an inner-city retail location. Boston Consulting Group's 1998 study outlined three critical elements for success in inner-city retail: commitment and leadership, operational excellence and tailoring product types to local customers.<sup>47</sup> These three elements have been reoccurring themes throughout the research of this thesis.

### *Commitment and Leadership*

Commitment to inner-city markets must start from the top of an organization. Commitment to success needs to be instilled in all employees, from managers to cashiers. Being profitable is management's number one task, and without a strong commitment to

it, inner-city stores are destined for failure. Store managers are critical in determining the success of a store.<sup>48</sup>

### *Operational Excellence*

Operational excellence is critical for inner-city stores. Some of the biggest challenges stores face is external crime, or the perception of an unsafe environment. A store with this image is destined to fail as customers will seek out other stores with a better environment.

Another challenge for inner city stores is shrink, the industry term for shoplifting. Unchecked shrink is a huge drain on a store's profitability and strict measures need to be taken to control it. Similar to suburban markets, reducing shrink starts with competent store managers, effective employee incentives and hiring practices, store layout and security technology.<sup>49</sup>

A largely untrained labor force presents additional challenges to store managers. High employee turnover, historically common in inner-city markets, is a drain on a store's profitability. Effective training and incentives need to be established in order to retain the best employees. Partnerships with local community groups is an effective way to find and retain good employees.

### *Product Flexibility*

Product flexibility is also an important factor to the success of inner-city retail. Products that are designed for suburban families do not necessarily sell well in inner-city markets and national retailers need to customize their product mix to cater to the diverse ethnic needs of the inner-city. Giving store managers the flexibility to try different items is something retailers have been historically reluctant to do, but can be important to the success of the store. The standardized approach of some large retail chains often lacks

the flexibility required to successfully operate in the inner city.<sup>50</sup> Today's information technology allows national chains to monitor product success in certain stores and bring that product mix to stores with similar demographics. Retailers do not have to customize the entire store, 10% to 20% is often sufficient.<sup>51</sup>

## **Chapter 7: Benefits to Entering Underserved Markets**

“Why do we open stores in the city? Because that's where the people are.”<sup>52</sup>

(Harvey Gutman, Senior VP for Retail Development of Pathmark, a large northeastern supermarket chain. About one-half of Pathmark stores are located in low-income communities.<sup>53</sup>)

Potential urban development sites are often centrally located, have great visibility and underutilized infrastructure. Unlike their suburban counterparts, urban sites are more supply constrained, reducing the threat of competition opening up next door. As inner-city retail continues to grow and mature, retailers with an existing presence will be well positioned to profit from their good location now and in the future. The amount of gross leasable mall area mall area has ballooned from 7.3 feet per capita in 1970 to 20.0 feet per capita in 2001.<sup>54</sup> The great majority of this retail growth has occurred in the suburbs, resulting in increased competition. Retailers are realizing now is the time to take advantage of an opportunity that might become much more expensive in several years.

### *Jobs*

Filling unmet retail demand in inner cities could create up to 250,000 direct retail jobs and 50,000 indirect jobs in the inner-city.<sup>55</sup> While some people might argue that national retailers draw all of their profits from the community, the impact of new retail jobs has a very substantial impact on the community's economic well being. Wages paid to employees typically account for approximately 20% of sales.<sup>56</sup>



For residents who live in the inner-city, a large portion of their expenditures are now made outside their neighborhoods due to a lack of retail supply. This referred to as expenditure leakage or outshopping and it undermines the inner-city quality of life. Associated with this leakage are lost opportunities for unemployed or underemployed inner-city residents to get jobs.

### *The Inner-City Offers a Glimpse into the Future*

Retailers can take lessons learned in the inner cities and eventually apply them to stores in the suburbs. Minorities and immigrants represent the fastest growing portion of the U.S. population, and many of them live in the suburbs.<sup>97</sup> Racial and ethnic minorities make up 27% of the suburban population in America's 100 largest cities, an increase from 19% in 1990.<sup>98</sup> Understanding how to serve ethnically diverse markets will be a major benefit and lesson the inner-city experience can teach retailers. Retail is often the first viable sign of a community's connection to the wider economy and inner-city markets can become a proving ground for new product selection and marketing techniques in the suburbs as they become more ethnically diverse.

Creating successful retail opportunities in inner cities will result in a net gain for all parties involved. Businesses that move into neighborhoods hire local residents, and raise the resident's standard of living. This income allows residents to both save and spend more, creating greater demand for new businesses to move into the area. More businesses create more new jobs, which in turn increases consumer demand. The cycle feeds itself, creating sustainable economic development and allowing lower-income areas to have more assets, better services and a stronger tax base.<sup>99</sup>

## Chapter 8: Case Studies

### 1. Brentwood Road, Washington DC

Completed in the summer of 2002, the Brentwood Road shopping center in Northeast Washington DC contains a 53,000 sf Giant grocery store, a 118,000 sf Home Depot and an available development pad that was originally planned for a K-Mart store. Since their Chapter 11 filing, K-Mart has decided not to build a store on this site. DC officials estimate the new center has created upwards of 600 new jobs (half are reserved for DC residents) and \$5 million in annual tax revenue.<sup>60</sup> When completed in 2002, the Brentwood Road project represented the first major retail DC development in two decades.

The 22-acre project was developed by Graimark/Walker Urban Land Development from Detroit and is located in Ward 5 between Brentwood Road NE and Rhode Island Ave. NE. Prior to redevelopment, the site was home to DC services including a salt dome, a mountain of ground-up asphalt and a driver's testing facility. The fact that the site did not have personal attachment from local residents made it appealing from a development perspective as it would have been a much more complicated development if homes or parks needed to be condemned.

The major catalyst for this project was DC Mayor Anthony Williams who has made annual trips to the Las Vegas ICSC convention to promote Washington DC to national retail chains since taking office in 1999. Encouraging national retailers in 2001, Williams said, "I'm here to convey the message that the District is open for business."<sup>61</sup>

Mayor Williams met with Graimark/Walker President Rick Walker at the ICSC convention in 1999 and for month prior to their meeting, Walker had been studying DC for an appropriate site for the project. By the fall of 2000, Graimark/Walker and the city had signed a deal for the site, which Mayor Williams announced on September 28. The land was sold for \$3 million and official groundbreaking on the site took place on July 11, 2001. K-Mart was the first major tenant to commit to the project and Home Depot came in after negotiations were well underway between DC, Graimark/Walker and K-Mart. After contemplating and ultimately rejecting the idea of moving into a former two-level Hechinger's store in Northwest DC, Home Depot was eager to get involved in the Brentwood project. According to Tom Gallagher of Home Depot in July, 2003, "we're doing very well there."

Mayor Williams made this shopping center in an underserved Washington DC area a major priority. Walker says he was amazed at the rapid pace at which the shopping center progressed saying "I have done lots of similar projects [and] they typically take us anywhere from three to four years, sometimes even five. We have basically completed this one in less than two years. . .the Washington DC, site has moved much more quickly than anything else we have been working on, primarily as a result of the mayor's aggressive program." The appeal of this site from the developer's perspective is simple, "The density is extremely high," said Walker, "and we were able to sign letters of intent for over 80 percent of the space even before the project was approved."<sup>2</sup>

DC's project manager for the development, Cyril Crocker, discussed the benefits of this site for a retailer looking to enter an underserved market, "For Kmart, the urban market is going to be key. They've been getting their brains beaten out of them in the

suburbs by their competitors. So they've become more willing to go into urban markets, especially in areas like [Brentwood] where there effectively hasn't been any retail services for years."<sup>63</sup>

Despite its success as a retail center, the project has been widely criticized for its foreboding presence and lack of connection to the surrounding neighborhood. Before construction on the project began, the DC Office of Planning hired outside consultants to review the site plan and make recommendations for design improvements. The consultant's study reported that the Brentwood project had "no sense of place" and exhibited "poor integration [with the] neighborhood" and included over thirty pages of suggestions how to improve the design. The consultant's recommendations were never implemented. Don Shillington of Columbia Engineering, who served as the lead engineer on the Brentwood project, said that nobody wanted to slow progress and risk stalling the project. "It would have put the project back at least a year if we had tried to implement their suggestions," said Shillington. Furthermore, Shillington says that the consultant's vision was not entirely realistic for the site and surrounding neighborhood. "Some of the recommendations were kind of what we considered ivory-tower stuff," said Shillington. "They didn't take into consideration the people that we were bringing in. These big boxes have pretty specific criteria in order for them to go ahead with the project. They are big enough and powerful enough that if we say, 'We want you to do this,' they'll say, 'Well, we just won't go there.'"<sup>64</sup>

Some urban design experts argue that huge parking lots and sprawling big box buildings set back from the street that are common in suburban areas do not work in dense urban neighborhoods. Some feel that big box retail is so divergent from urban neighborhoods that they could bring enough unwelcome side effects to make those areas

less prosperous and less desirable places to live. "In an ideal world, the big box stores would be integrated with existing retail development, and that often isn't happening now," said Michael Beyard of the Urban Land Institute.<sup>65</sup>

This project challenged the DC government's need to attract the big retailers and the desire to create neighborhoods where people can walk between stores and restaurants without being cut off by huge parking lots.<sup>66</sup> DC's recent history of being abandoned by retailers made it difficult to push the issue too hard as nobody involved in the project wanted to risk the retailers walking away.

Despite some complaints about design issues, nearly everyone agrees the new retail development is better than what preceded it. A key lesson to be learned from the Brentwood site is that when a city mayor and local government puts their reputation on the line to support a project, there is an excellent chance the project will be successful. The government's commitment allowed developers and investors to be willing to take a chance on a previously untested area.

## **2. Shaw's Lower Mills, Dorchester MA**

Opening a prototypical suburban store in the inner-city is something that rarely happens if the retailer is unwilling to adapt to the urban environment. Prior to the July 25, 2003 opening of a new Shaw's supermarket in the Lower Mills section of Dorchester Massachusetts, this area was in serious need of a new supermarket. The new store is unique in that it is 40,000 sf instead of Shaw's standard 58,000 sf and is built in a historic warehouse that used to be a chocolate factory. This project is much different from supermarket retailer's typical suburban prototype. According to Jim Keefe, President of Trinity Financial, the developer of the site, "In the inner city, you don't select the site; the

site selects you.”<sup>57</sup> After another large retailer (Stop & Shop) failed to get community approval for a 65,000 sf suburban prototype store, Trinity Financial was brought in by Shaw’s to work with local community groups and town officials to make the renovation project work both for Shaw’s as well as the local community.

The \$25 million store is the result of a long contested battle between Shaw’s and Stop & Shop to gain control of the supermarket site. Stop & Shop had assembled parcels of land for what it planned would be a perfect location for a superstore at the corner of River and Washington streets. The local community opposed the plan and Stop & Shop’s option on the key piece of land expired in late 1997 and was acquired by Star Market, which was purchased by Shaw’s two years later. Stop & Shop claimed its option was still valid in court, but when that failed, it used its ownership of adjacent parcels in an apparent attempt to stop Shaw’s from acquiring enough land for adequate parking and delivery space.

With site constraints on all sides, Shaw’s made an expensive investment decision to go with underground parking. According to Trinity Financial, Shaw’s spent “a couple of million dollars more” building a 115-space garage beneath the new supermarket. Deliveries are being handled in a small space dedicated for trucks to turn around and back into the loading dock. The supermarket has no employee parking and Shaw’s executives hope it will not be necessary, but if it is, workers may be bused in from offsite.

There is limited surface parking (65 spaces) and most customers will have to park in the tight garage underneath the supermarket and use an elevator to get shopping carts down. The only other Shaw’s that uses elevators is in the Prudential building downtown.

Vince Droser, project manager for Trinity Financial, said he hoped Stop & Shop would have sold some or all of its parcels to Shaw’s after Shaw’s bought the main parcel

for \$2.1 million in December 1997. The intense competition between the two chains (Stop & Shop is owned by Royal Ahold of the Netherlands and Shaw's is owned by London-based J Sainsbury PLC) made that impossible. "It's a cutthroat business," Droser said. "These guys are after market share and they'll take any edge they can get."

Neighborhood residents are hoping the market will give the entire area a boost and act as a catalyst for additional development. The Shaw's case shows that retailers sometimes need to abandon prototype layouts to get community approval. Time will tell on this development if the higher development costs associated with the historic renovation and underground parking will pay for itself.

### **3. Skyland Shopping Center, Washington DC**

In Southeast Washington DC's Anacostia neighborhood, The Rappaport Companies has been selected to redevelop the Skyland Shopping Center, an existing outdated center with several small land owners. The Anacostia neighborhood has been historically underserved by retail and plagued by unemployment and crime.

The current site 17.5-acre site consists of a disjointed "hodgepodge" of retail with seventeen different landowners and most buildings on the property are forty to fifty years old. There is no cohesive pattern to the center as some of the buildings are attached while others are freestanding. The parking lot is poorly lighted and the center is not considered a safe place to be after dark. Despite its many drawbacks, the center is currently operating and generating rental income. Current tenants include a hair salon, a laundromat, a liquor store, a post office, etc.

Approximately 85,000 people live around the Skyland center, with a median household income of \$35,000. While it is definitely a low-income neighborhood, the city

estimates the neighborhood spends about \$470 million a year on retail purchases. There is significant outshopping in the neighborhood as only 33 percent of the \$470 million is spent in the community. Many purchases for local residents involve a long car ride to Virginia or Maryland. Speaking about the proposed Skyland center, Gary Rappaport said, "It will give to the community the other retail needs that right now force a lot of these people to drive into Maryland."<sup>68</sup>

The idea to redevelop the Skyland Shopping Center became a real possibility when a 100,000 sf shopping center opened across the street. That center is anchored by a 55,000 sf grocery store and 45,000 sf in ten other stores. A local CBO, the Anacostia Economic Development Corporation, was instrumental in making that deal happen.

The Skyland site had been studied for ten years as a prime location for a neighborhood shopping center, but nothing ever materialized. In 2001, National Capital Revitalization Corporation (NCRC), the quasi-public organization that is overseeing several redevelopment projects around the city, issued a request for proposal to redevelop the site. "I think the mayor has really made this a clear top priority, in terms of making certain that east of the river sees its fair share of redevelopment, as the west of the river has seen," said Greg Jeffries, senior development director of the NCRC.<sup>69</sup> Gary Rappaport of The Rappaport Companies was selected in May 2002 over a team of nationally known developers with experience in urban markets including, Forest City Ratner, Johnson Development Corporation (Magic Johnson) and Graimark/Walker who recently completed the Brentwood Road project in Northeast DC.

Without assistance from the government or a CDC, it would be nearly impossible for an individual developer to make this project a reality. The site assemblage, with 17 different landowners, would take years to complete and would quickly become



financially unfeasible. NCRC will take on the role of land assembler and will do so by purchasing the land parcels or condemning them through the power of eminent domain. Jeffries said the city will negotiate to buy out the owners, but an individual's refusal to sell will not stop the project. "Clearly our organization does have the ability to exercise eminent domain," Jeffries said. "That is not something we're looking at this present time. But as a last-ditch effort it may be something that we would consider."<sup>70</sup>

The Rappaport Companies have planned a 230,000 sf center with two major anchors and one minor anchor. Gary Rappaport indicated the initial phases of a project like this are challenging as you do not know how much tenants will pay in rent and you do not know how much environmental remediation will be required on the site. He indicated the negotiating game with the retailers is tricky, "you don't negotiate what they will pay until you determine that they want to be there."<sup>71</sup> "The most important thing they need to believe it's real," Rappaport said of the retailers that are interested. Several potential tenants, including Shoppers Food Warehouse, Harris Teeter, Giant Food, Target, Wal-Mart, TJ Maxx, Marshalls, Home Depot and Lowe's are doing sophisticated analyses of the market to determine whether they want to be in Skyland.

The current plan for the site includes a big box retailer on two levels. Rappaport commented that the more desirable the site, the easier it is for developer to put a store on two levels. Tom Gallagher of Home Depot noted that "the site [Skyland] does not allow us to build a traditional store [site constraints] but there is a chance a neighborhood store format could work there."

The impact this center will have on the surrounding neighborhood will be substantial. Local officials calculate the project would triple employment of the existing

center, to almost 400 people. Sales tax receipts could also triple and property taxes revenue will increase substantially.

While it is still in the planning stages, Skyland is a good example of how a developer can partner with a CDC to achieve excellent results. Neither party would be capable of succeeding alone, but by working together the project has an excellent chance for success.

#### **4. South Bay Center, Boston MA**

In 1994, Samuels & Associates, a Boston development firm, developed a power center in Boston's Dorchester neighborhood for \$65 million. This center has been widely successful since its opening with current tenants including Old Navy, Home Depot, Toys "R" Us, Marshalls, Super Stop & Shop, Fleet Bank and OfficeMax. While being an urban shopping center, South Bay Center has a decidedly suburban feel with 2,200 surface parking spaces. The 70,000 sf Super Stop & Shop is the highest grossing store in the 186 store chain.<sup>22</sup> Samuels & Associates sold the project in 1998 to Edens & Avant of South Carolina.

Built on site of former Sears' distribution facility, the land was previously owned by Congress Group Ventures who had a permit to build a research and development facility on the site. When an agreement with Boston University never materialized, Congress Group sold the land to Samuels & Associates. In the early 1990's, the office market was still in a depression and the highest and best use for the land was retail.

Site preparation was expensive because of the need to drive piles as that section of Boston was built on landfill. Some of the biggest challenges were handling security concerns and bringing together two neighborhoods that had previously been separated

both by geographic and psychological barriers. South Bay Center was a pioneering project when it was developed over ten years ago.

##### **5. DC USA, Washington DC**

DC USA is a planned 540,000 sf retail and entertainment complex located in Columbia Heights neighborhood of Washington DC. The 4.89 acre site encompasses most of a full city block with dimensions of 500 feet by 225 feet. This is a very appealing development site to retailers because of its high population density as almost 200,000 people live within a two-mile radius of the site. "We have 80,000 people within a half mile," says Robert Moore, president of the Development Corp. of Columbia Heights, a member of the DC USA development team. "If that's going to bring 1,600 jobs and 30 to 40 businesses, it seems to me to be a worthwhile investment." In addition to permanent retail jobs, DC USA is projected to generate 700 construction jobs.

Grid Properties is the developer of the project and has worked closely with the Washington DC government to develop a program that will provide maximum benefits to the residents of Columbia Heights and the surrounding neighborhoods. The multilevel development will include a Target store, specialty retailers, food establishments and entertainment options. 15,000 sf in the development will be designated to local and minority-owned tenants with rents set at 33% below-market.

DC USA will be modeled after Harlem USA, another project developed by Grid Properties known for its high quality tenant mix and commitment to urban design. Unlike the Brentwood Road project, DC USA will be uniquely urban in scale and density with most of the retail spaces entered directly from the street. The 168,000 sf Target store will be located on the second and third levels and will be accessed from the ground

level where “guests will be swept up by the escalator to the second level.” Enclosed parking for 1,364 cars will be in three below-grade levels.

DC USA is intended to appeal to a diverse population through vertically integrated multi-generational themes (education, the arts, health and fitness, style and fashion) combining retail, entertainment and recreation.<sup>24</sup> The project will also offer an number of special marketing opportunities that will link corporate sponsors to the community-based educational, recreational and cultural organizations, and will provide these corporations with access to a greatly underserved population. The project has minority contracting requirements set at 35% for subcontracting dollar percentage and hiring goals of 75% for district residents and minorities.

Total cost for the project is estimated to be \$140 million. The sources of funding include TIF financing of \$50 million, a permanent loan of \$47 million and an equity investment of \$43 million. The need for TIF financing is driven by the size and cost of the parking facility, the allocation of below market rents for local businesses and lower rent generated from Target due to their location on the second and third level. “TIF levels the playing field for these retailers to come into the city,” says Drew Greenwald, President of Grid Properties. “Until you create a structure to get them in, there's no reason for them to be here.”

The financial benefits to Washington DC from this project are great and include the following: increased real estate taxes on the development (TIF only utilizes 25% of real estate taxes), increased real estate taxes from property values in the surrounding area, increased income taxes (corporate and individual) and public utility taxes.

Drew Greenwald says interest in the project is high and lease negotiations are progressing with a number of national tenants: Marshall's, Office Depot, Sports

Authority, Ann Taylor Loft and Cost Plus World Market, among others. Bed, Bath & Beyond and Whole Foods Market have signed letters of intent.

DC USA is an example of a developer with a proven track record in inner-city retail projects working with a local government to make the project a reality. The large amount of TIF financing makes this project unique and forces DC to balance the needs of economic development with a subsidy that is necessary, sufficient but not excessive.

## **6. Wal-Mart Philadelphia**

Suburban retail developer Wolfson Verrichia Group Inc. is taking its first attempt to develop an inner city Wal-Mart in Philadelphia. The proposed 135,000 sf store has all surface parking and will be located on the polluted and abandoned G.B Goldman paper factory. Proponents of the project say that it will bring 300 new jobs to a economically depressed area and clean up a polluted site that has become a neighborhood eyesore. The following interview was conducted with Daniel Bleznak of Wolfson Verrichia Group Inc.

Q - Is the Allegheny Ave. Wal-Mart your first inner-city development?

A - Yes. It is our first truly inner-city redevelopment, however, we did do a semi-urban redevelopment of the former Baldwin Locomotive facility in Eddystone Pennsylvania, Delaware County. The project had many attributes that inner city-projects have such as environmental issues due to prior industrial uses at the site, dense population close to the site and a lower economic base compared to suburban projects.

Q - When working with a client like Wal-Mart, who typically locates the sites and opportunities. Do you bring them to Wal-Mart or does Wal-Mart find them and tell you guys to develop it?

A - It depends. So far on our project we have located the sites as the Developer. We have worked with Wal-Mart for a while and have a pretty good feel for the type of sites that they are looking for. Of course in the inner-city locating parcels that meet the size requirements of a Wal-Mart store is a limiting factor that reduces the number of sites available for development. In Philadelphia as in other cities redevelopment of sites for large retail has tended to occur on former industrial sites in outlying areas where there are sizeable parcels. For instance, in Philadelphia, a lot of the commercial redevelopment is occurring along the Delaware River, and area dominated by industrial uses due to access to the river and the former navy yard.

Q - What are the biggest challenges for developers with inner-city, infill sites?

A - As I mentioned before, finding parcels of substantial size (at least for the type of projects that we do) is probably the biggest hurdle. Land costs, environmental issues and access are also hurdles. Due to the nature of most eastern cities - built out / narrow roads / no room to expand - access is a large issue. For a Wal-Mart store as well as other retail, large trucks need to be able to get to the store easily for it to work as do customers require clear access. You are also mixing a greater number of vehicles in area that have largely had pedestrian foot traffic, which can be a sticking point.

Q - Does the permit process generally take longer?

A - It really depends on the project I would guess. I am not familiar with other cities and how they operate. In Philadelphia there are few if any sites that would permit a project like ours "by right" due to the size of the project and the frequency with which

zoning classifications change across a single city block. Therefore, you either require a use variance or zoning change. The city is under no obligation to grant either, so the project really depends on the support of the local councilman, which in turn, relies on the support of his/her constituents. Typically, you will meet with civic groups in the community to present the project and garner support. All that being said, in urban areas today there is pressure to redevelop vacant industrial sites that do not produce revenue for the city coffers. There are also environmental and blight issues that a good redevelopment project can positively address. All these issues together mean that permitting, at least in Philadelphia is not cut and dry. Timing will depend on all of these factors.

Q –Is it more expensive to build in an urban location (unions labor, higher workers comp, higher insurance premiums)

A - Yes. Union labor will add to construction costs in the city as will demo, environmental clean-up issues and insurance costs. Also, given the age of eastern cities you are bound to hit something underground you did not know was there - old trolleys, old building foundations, etc. Recently, during the construction of the National Constitution Center in Philadelphia graves (I think) and artifacts were found dating back to the revolution. This delayed work until archeologists could catalog everything in accordance with the standards of the Pennsylvania Historic and Museum Commission.

Big bucks!

Q - Do you (or does Wal-Mart) look for incentives form the city/town to make the project financially feasible (land write-downs, property tax abatements, operating expense subsidies)?

A - It depends on what incentives are available. For instance, certain area of the city are designated "empowerment Zones" and "urban enterprise zones" that have particular incentives that are aimed at encouraging redevelopment. Such incentives are very important due to the higher costs of redeveloping in the city for all of the reasons I have stated above. Cities with good planning will target these programs in area that they want to see redeveloped. I am aware that some low-income housing developers target areas where these programs exist since such incentives are what make their projects profitable. I imagine for most commercial developers it comes down to their "all in" land costs. If incentive programs help to reduce your costs, profitability will increase and the city helps reduce blight, clean-up environmental issues and attract business and at some point generate tax revenue (I say "at some point" b/c there tax abatement is often an incentive). Operating expense subsidies are valuable to retailers and other business operators, but generally do not help developers.

## **Chapter 9: Conclusion**

Inner-city retail markets are becoming a new land of opportunity for national big box retailers. By looking at different types of market data where income density is placed at a premium, retailers are learning that inner-city markets are stronger than they once believed and can be highly profitable ventures if properly managed. The reasons why retailers have avoided inner cities in the past lies somewhere between perceptions and realities, but the fact remains that inner-city retail development is more difficult than suburban development and big box retailers have historically chosen the suburbs. The challenges to successfully develop in the inner-city are becoming increasingly well known by all the required parties: retailers, developers, local governments and



community groups; all of which should promote more development in these underserved markets.

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- <sup>52</sup> HUD 1.
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#### **Retailers**

Mike Litwin – Target, Director of Corporate Real Estate

Jeff Doss – Wal-Mart

Tom Gallagher – Home Depot

John Pascione – Home Depot

Bernie Schacter – Staples, Inc ., Senior VP Real Estate

#### **Developers**

Joel Sklar – Samuels & Associates

Gary Rappaport – The Rappaport Companies

Vince Droser – Trinity Financial

Robert Frazier – W/S Development

John Courmoyer – Forest City Ratner

David Hill – Jeffrey M. Brown Associates

Greg Alderfer – Jeffrey M. Brown Associates

Kevin Cleary – ORIX Real Estate Equities

Brian Gordon – ORIX Real Estate Equities