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Shopping-Center REITs Are on Many Investors' Lists

Limited supply causes retailers to show steady demand for existing properties



Crossroads Plaza, a shopping center in Cary, N.C., is owned by Kimco Realty Corp. There is 'a waiting list' to get into the firm's properties, says CEO Conor Flynn. *PHOTO: KIMCO REALTY CORP.*

By **LIAM PLEVEN**

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Downtown may be trendy, but landlords are thriving with properties often seen as suburban eyesores: strip malls and shopping centers.

The main reason: safety.

While economic uncertainty clouds the outlook for many businesses, owners of open-air retail space have gotten a relative boost because their tenants often include grocers, discount-clothing stores and pharmacies—stores that consumers shop at in good times and bad.

“They’ll cut back on food a little bit. They’ll buy hamburger instead of filet mignon,” said Drew Alexander, chief executive of Weingarten Realty Investors, a Houston-based shopping-center landlord whose major tenants include grocers such as Kroger Co. and Whole Foods Market Inc. “But the important thing is they still come to the center.”

At the same time, the tepid economy is limiting construction of new space, according to real-estate executives and analysts. As a result, retailers are showing steady demand for many existing properties, and

occupancy is running high, they said.

“There’s an argument that this good-enough environment is ideal,” said Jason White, a senior analyst at Green Street Advisors, a real-estate research firm.

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Share prices of real-estate investment trusts that own billions of dollars’ worth of strip malls and shopping centers reflect the favorable conditions. In many cases, they fared better than the broader market when fears of a recession rattled investors early this year and then logged gains as the market rebounded in recent weeks.

Office landlords have gotten hit in 2016 by investor concerns about weak tenant demand if the economy slows, while apartment REITs have suffered from worries that construction of new multifamily buildings will lead to a glut.

By contrast, many shopping-center REITs are up roughly 2% to 4% this year through Monday’s close. The S&P 500 is down slightly more than 2% over the same period, and the MSCI US REIT Index, which tracks owners of various types of properties, is down 0.1%.

On Sunday, analysts at Evercore ISI downgraded the shopping-center sector to “hold” because the companies’ stock-market valuations “seem a bit stretched.”

Nonetheless, “from a fundamental standpoint,” they said in a report, the outlook for the sector is positive “due to the limited supply and the ability to push rents.”

Regional malls get much of the attention from shoppers and retailers, but open-air shopping centers make up a far greater share of America’s total retail square footage, Mr. White said. They can range from small properties with two or three local merchants to large properties occupied by national brands.

New space at such centers has been growing less than 1% annually in recent years, according to the International Council of Shopping Centers, a trade group. By comparison, the amount of space grew by 3.3% in 2006 alone, before the recession hit.

“New supply is at historically low levels,” said Hap Stein, CEO of

Regency Centers Corp., which owns more than 300 properties from Massachusetts to California. Mr. Stein said the firm's properties are about 96% occupied and rents grew by more than 9% on average in 2015.

Developers also are wary of building new shopping centers because new homes aren't being built at a rapid clip in suburban areas where this kind of retail space thrives, said Paul Morgan, an analyst at Canaccord Genuity. Real estate in densely populated urban areas is in fashion.

To take the risk of building in a slow-growth economy, developers and lenders generally need a commitment from an anchor tenant to occupy the new space, Mr. Morgan said. And "the anchor tenants are not expanding at the same rate they have in the past," Mr. Stein said.

The scarcity of new space can put owners of existing properties in desirable locations in a relatively strong position if vacancies arise. Analysts at Cowen & Co. called the recent bankruptcy filing by Sports Authority Inc., a retailer that has stores in many strip malls and shopping centers, an opportunity for REIT landlords.

Conor Flynn, CEO of Kimco Realty Corp., one of the largest shopping-center REITs, said there is "a waiting list" to get into the firm's properties and he said anchor stores are more than 98% occupied.

When vacancies do occur, the company can often command a higher rent, Mr. Flynn said. On average, current rents at Kimco's properties are 37% below the prevailing market rate. "We can't wait to get boxes [enclosed spaces] back," he said. "Many times, there's a higher, better use for that box."

Still, shopping centers and strip malls also face risks. Many of their tenants must contend with stiff competition and other challenges. Kroger warned investors last week that sales growth could be among the weakest the company has seen in more than a decade.

With occupancy high already, "there's really not a lot of room to run," Mr. White said. In addition, leases often include renewal options with predetermined increases, which can "act somewhat as an anchor" on rent growth for a landlord, he said.

Still, "the underlying climate is healthy," Mr. Morgan said. In the near term, he said, only an accelerating economy would cause shopping-center REITs to lag far behind other types of real estate.

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