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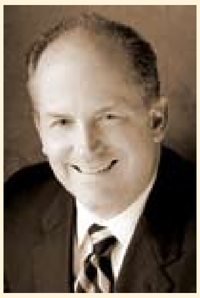
Outlet execs discuss industry challenges

Seven outlet veterans talk about what lies ahead, even for an industry reported to be counter-cyclical in economic downturns.

RICK CORDES is managing partner of Northwest Outlets LLC, a real estate investment company based in Walnut Creek, Calif. The company owns five outlet centers in the Pacific Northwest, as well as conventional retail, industrial, office and residential properties throughout Northern California.

DAVID OBER is VP-leasing for Outlets at Hershey (Pa.) and a general partner in the ownership of Rockvale Outlets in Lancaster, Pa., and Belz Outlets in Pigeon Forge, Tenn. In addition, he serves as president of the industry trade organization, Developers of Outlet Centers & Retailers (DOC&R), and serves on the board of the Pennsylvania Retailers Association.

JOSHUA PODELL is VP of real estate for Jones Retail Corp. a division of Jones Apparel Group, where he handles its Nine West, Nine West Outlet, Easy Spirit, Easy Spirit Outlet, Anne Klein, Jones New York, Bandolino, Bannister and Shoe Woo stores. In all, Jones operates 975 stores, of which about 600 are outlet units.



MARK MCCARTHY is managing director-leasing and marketing of Ariel Preferred Retail Group, which operates seven outlet centers coast-to-coast.

CHARLIE DEVINE has worked as a leasing consultant to many national and local retailers, most notably Dress Barn. He is president of Devine Realty Consultants and a partner in Devine, Lerner, Serwer, two outlet-related consultancies.

LISA QUIER WAGNER is a partner of EWB Development, which is helping to develop The Outlets at Corpus Christi Bay in Texas. She is also president of Quier Target Marketing, which provides strategic planning to outlet-center developers.

JEFFREY T. WAS is director of leasing for Felenstein Was & Associates, a consultancy that services outlet and full-price tenants and outlet-center property owners.

In this most unusual of times, VRN talked with several key outlet executives about the challenges their companies face in the coming months, as well as the trends they believe will shape the industry's future.

VRN: What are the most pressing challenges facing your company in particular, and the outlet sector in general, in the next year or so?

Cordes: Maintaining center occupancy is our biggest challenge amidst today's store closings and bankruptcies. Specifically, maintaining tenant consistency and not straying from the outlet theme is our biggest challenge. As of late, we have interjected lifestyle components such as restaurants and theaters in a few of our centers and this has proven to be an ideal support for outlet retail. The longer we can retain a customer within a center, the higher the shopping probability. Security is another challenge in declining economic times. We try to maintain and encourage a local police presence at our centers, and have active merchant groups who are very aware and pro-active to this extent.

Devine: The most pressing challenge for Dress Barn is retaining our sales and profits, while at the same time attempting to keep all of our associates, and closing as few stores as possible. We recognize how important our tenancy is to many of the challenged centers and we make every effort to maintain profitability in those centers. In many cases, our closing could affect the whole center and ultimately the outlet industry. We try to be good citizens and do our part.

McCarthy: The loss of highly recognizable brand names and their respective retail chains – and the lack of store openings generally available – will obviously hurt occupancy and income levels at most centers. Clearly, the overall

Among Dress Barn's strengths for withstanding the current economy is its family-business mentality, which leads to a tight rein on business practices and staying true to its roots.

economy is a major concern.

Ober: Building and maintaining sales is our most pressing challenge. We are committed to aggressively promoting the great values outlets provide the consumer. Sales and profit must be the starting point in any recovery. Without question, keeping tenants both at the shopping center level and within the industry will be a challenge in the next year. Thankfully, the outlet industry has been more resilient than regular retail. We have just signed three new leases at Rockvale Outlets in Lancaster this last month. Our industry can prove to retailers that the outlet sector is the place to be in terms of retail operations. It offers what today's consumers seek most – value – and the best overall package for success and profitability. The last recession in 1991 was when the designers found outlets to be a safe harbor and a profitable distribution channel.

Podell: The overall retail environment is still a challenge for those in the apparel category. Fortunately, our company and brands are strong, and we're confident that we'll endure this difficult period. The outlet sector clearly appears to be weathering the storm better than the full-price sector. Jones Apparel Group is a diverse company that provides us opportunities in full-price, outlet and wholesale. This can be an advantage over our retail-only competitors.

Wagner: The ability to get financing for new projects is limited by the credit crisis and the uncertainty of the underlying credit of the leases that are required for financing.

For new projects, there are two key issues: the credit crunch and the tenants' ability to make commitments at this time. Of course, those are tied to the availability of funding that is impacting both developers' ability to finance centers and also the tenants' ability to open stores, purchase inventory, etc. The customers are there – they are shopping outlet centers more than most other formats – and the tenants are seeing that surge in demand. While many have expressed the desire to open additional stores, at this time many of them have their hands tied. For existing centers, tenants are re-evaluating their percent of cost-of-occupancy ratios and lowering them. This will affect the ability to pay the mortgage and the value of the underlying projects.

Was: As with virtually all other sectors of the economy, our industry faces many obstacles. I feel that we are in a Catch-22 right now. Many developers continue to try to move forward on new centers, some of which under normal market conditions would have a very strong likelihood of succeeding. The problem is that many of the retailers today are simply on hold with new deals, or they are not able to move forward and sign leases at the various centers. Hence, the dilemma: Most of the planned centers today are either being delayed or simply disappearing. Look at the daily headlines and stories about the Dow Jones being at a 12-year low, unemployment at a 16-year high and the markets losing 50 percent in 15 months. Factor in reports that say over 20 percent of households now have negative equity in their homes.

Our firm has certainly seen the effects of this recession firsthand. It is much more difficult today to make deals with retailers in the existing centers that we lease. There simply is not an appetite for new deals. That said, we have been fortunate in our leasing efforts at The Shops of Grand River, set to open near Birmingham, Ala., in late 2010. We were

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Outlet execs say challenges include:

1. The overall economy
2. Obtaining financing
3. Tenants' credit worthiness
4. Tenants ability to make commitments
5. Occupancy costs
6. Occupancy levels
7. Maintaining outlet tenancy
8. Security
9. Sales and profits
10. Keeping employees
11. Keeping traffic up
12. Convincing retailers that outlets are the place to be

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Nine West's parent, Jones Apparel Group, is diversely positioned in full-price, wholesale and outlet channels, and the brand giant has low corporate debt.

fortunate to have been far enough in the leasing process that we weren't killed last October when the bottom fell out.

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***VRN:* What, in particular, is your company doing to meet those challenges?**

Cordes: We're doing everything possible to get customers to our centers. We're hosting weekend local events, enticing temporary tenants to activate vacant storefronts, and trimming expenses, to the extent we can, while fully delivering our responsibilities as property owners. We are also soliciting help from local, regional and national leasing brokers to make them aware of our leasing opportunities, as well as staying in constant contact with our current retailers to let them know we're taking a very direct and proactive approach to this market challenge.

Devine: We are constantly searching for creative ways to cut costs and to increase comparable-store business. This is a significant challenge in today's economy as it dictates that we must have competitive margins to maintain our market share. We have implemented many green initiatives for long-term savings. We keep a watchful eye on all of our expenses.

McCarthy: Ariel Preferred has decided to approach 2009 and 2010 in an aggressive manner focusing on expanding and improving our leasing and marketing teams. Ariel recently hired four industry veterans: three senior leasing reps and a seasoned marketing director. We're focused on recognizing opportunities in this market as well as implementing a strategy to take full advantage of these opportunities. We also reorganized and re-staffed our center manger positions with professionals more interested in leasing, marketing and entrepreneurial responsibilities than care-taking and operational responsibilities.

Ober: Two fold: We're increasing the amount of paid advertising during prime time to reach more consumers, and, secondly, we're running new weekly specials supported by aggressive advertising that will cut through the fog of everyone else's liquidation sales.

Podell: Over the past year, we've started several new initiatives, including the launch of our multi-branded shoe/accessory concept Shoe Woo, which has been very well received thus far. In addition, Jones has started several exciting programs with New Balance (JV with our Nine West brand), Wal Mart (l.e.i. apparel), and substantially grown our e-commerce business.

Wagner: We're actively sourcing partners who have cash reserves and who have a longer-term view to the industry. I have been in this industry long enough to have been through two recessionary periods – the one in the early '90's really ushered in the golden era of outlet development – but credit was not the problem then that it is now. Maintaining the perspective that the economy will cycle around again – and it will – is key.

Was: Unlike many companies today, our firm has actually added members to our leasing team over the last six months.

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***VRN:* How are your company's particular strengths helping to stay the course?**

Cordes: Our biggest strength is that we are a small, private company, with only a handful of decision makers. Between the partners and the mall general managers, decisions are made quickly and aggressively, without the layer of bureaucracy found in larger public firms. We are hands-on owners and our company structure is lean and efficient. We have also been fortunate to maintain a low debt ratio throughout our portfolio, allowing us to make necessary deals in difficult times, and to remain highly competitive in the market.

Devine: Dress Barn started as a family business and we've always maintained that small family business mentality. In spite of being a major public company, we've never strayed too far from our roots. Our co-founder and chairman, Elliot Jaffe, still must place his seal of approval on every real estate transaction. Our seasoned operations, marketing and merchandise executives hold a tight rein on how we transact business. Our regional store managers, district store managers and store managers are responsible for outreach, fashion shows, VIP parties and the like to drive business.

McCarthy: While the challenges appear to be significant, we have an experienced, professional

Outlet challenges are met by:

1. Aggressive marketing
2. Expanded leasing teams
3. Expanded leasing efforts
4. Trimmed expenses
5. New store concepts
6. Brand partnerships
7. Expanded e-commerce business
8. Partners with cash
9. Temp tenants
10. Close relationships with tenants
11. Accelerated green initiatives
12. Maintaining a positive perspective

Outlet execs say trends include:

1. Opportunities for chain expansion
2. Opportunities to increase market share
3. Outlet centers continue to migrate toward major markets
4. Return to the basic value message
5. Casinos and Mexican border sites continue to be hot
6. Increase in retailer clearance concepts
7. More recognition of outlets as a distribution channel
8. More recognition of outlet centers as development opportunities
9. Shake out of dead wood
10. Smaller first phases
11. Rent reductions
12. Growing green movement

and optimistic corporate and center-based staff that is interested in beating the odds and coming out of this period on the winners' list.

Ober: One of our key strengths has always been marketing, and we continue to work with our merchants on a daily basis to promote value to consumers. Customers are not only seeking sales these days, they are seeking sales on top of sales – the biggest values out there. Outlet shopping is all about value, so as an industry, this message is nothing new. It's more about how we promote that concept to our key stakeholders – shoppers. For example, at Rockvale Outlets we are pushing a weekly Steal of a Deal campaign that integrates broadcast and web placements with email marketing to place weekly deals in front of our customers. In a sense, we are treating each week almost like a Black Friday, making sure shoppers are aware of the best deals of the week as they evaluate all of their shopping options.

Podell: The diversity and strength of our brands gives us the ability to take advantage of opportunities like those previously mentioned. In addition, our low corporate debt and advanced inventory management systems are an advantage over our competition.

Wagner: We have a strong positive reputation that allows us to work with worthy partners, be they tenants or investors. We also have the depth and diversity to be able to work on existing centers, new centers and other formats – and all over the world. And our experience of having seen some challenging cycles before certainly helps.

Was: Our partners Marshall Felenstein and Frank Was have been in this industry since its inception, giving our company unmatched experience and positioning us strongly for the future. We also have a record of getting the job done. Currently, we lease nine outlet centers, including one in development. On several occasions, we have taken center occupancy from less than 50 percent to more than 95 percent.

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***VRN:* How long do your expect challenges to affect how you operate your company?**

Cordes: I believe the challenges of today will be with us for at least four or five years, maybe longer. We're maintaining well so far, and we plan to continue on this path. We are prepared to do whatever is reasonably necessary to increase occupancy and keep existing tenants in place. We believe that the market we are experiencing and will be experiencing is not unlike the Great Depression, and such times tend to fine-tune business practices permanently. We're prepared for this.

Devine: Challenges will be with our industry forever. If it's not the economy, it will be the next retail venue that challenges our outlet strategies. I am confident that our industry is here for the long haul. DOC&R has shown great leadership under our president, David Ober, and our partnering with ICSC. We've received very favorable press over the last several years and the public believes that outlets are a legitimate place to purchase quality goods at great savings.

McCarthy: No business model can remain the same for very long without failing. We expect these current challenges are not short term.

Podell: It's difficult to say when the macro-environment will improve, however, I'm confident that we will be ready once it does.

Wagner: Because of the dynamic changes in the industry, these challenges will not go away, until the tenant community has the ability to expand and the lending community reduces the premium on their ability to lend.

Was: It is difficult to make a guess because the problems we're facing today are different and

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more complex than what we've previously faced.

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VRN: On a scale of 1 to 10, how do you rate today's challenges?

Cordes: Today is a 7. Summer will be an 8. Fall a 9, and 2010 will be a 10. Things should improve beyond then. I always try to plan for the worst and hope for the best.

Podell: I'm going to say 5, but that's a blended number between how challenging the environment is currently, coupled with the exciting opportunities that I believe it will bring to us. Because we have the size and strength to get through this, as opposed to some of our competitors, we could potentially increase our overall market share within our categories simply by being around when others aren't.

Devine: Today's challenges would rank as a 9 on a scale of 10. Unfortunately, we've seen some brands close their doors and that has weakened our industry. Of course, the silver lining to this cloud is that there are now spaces available in high quality centers where space has traditionally been difficult to find. These spaces are also available at much more affordable rentals. Dress Barn is evaluating several opportunities for expansion.

McCarthy:: Between 6 and 7. While these current challenges are significant and if not handled correctly our economy and society could deteriorate much further, national media and human nature tend to focus on the negative. Let's not forget that our country is still the leader of the free world, has a very high standard of living, is well protected by the best and bravest military, and many of our countrymen are the best in their respective fields. Provided our government's reforms don't hamper or limit the free market of ideas or commerce, I don't see why the 21st century cannot be another American Century.

Ober: A 7. We are optimists, and we continue to go back to the fact that the outlet industry is all about value. Always has been and always will be. The question isn't how long are we going to be in a down economy, it's how do we beat this? We must all look at every dollar we spend on marketing, leasing and operations and ask, "Given the economy, is this the right purchase or decision for us?"

Wagner: A 10.

Was: I would rate today's challenges at a 9 – very intense. That said, our society has faced many difficult times before and we have always prevailed. This time, while it may take a little more time, will be no different.

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VRN: What trends do you see for the outlet industry in the near future?

Cordes: There will always be people with money – some less, some more – who want or need to shop, and outlet stores and discount stores will offer the most value. We are fortunate to own moderate outlet centers that offer extreme discount and variety. This is the safest place to be in retail for the foreseeable future.

Low debt ratio and hands-on management give Northwest Outlets the flexibility to make necessary deals in its portfolio, which includes Bend (Ore.) Factory Stores *(above)*.

Devine: Outlet center real estate is getting closer to the same criteria used by traditional venues, closer to the population base and more accessible to the affluence of a major market. Border sites, tourism related sites and casino related sites will continue to be hot. Both of these trends are evidenced by the hot markets where several developers are working on sites: Dallas, Phoenix and Laredo.

McCarthy: A return to and a focus on providing value to the shopper: This appears to be paramount to shoppers during these times.

Ober: More and more stores will convert to clearance concepts – as Restoration Hardware recently did. In addition, I believe more concepts, including department stores, will consider the outlet division for clearance locations to help sell off overload and excess inventory. While retailers may be gloom and doom in the press, I look at this opportunity as one that is ripe for our sector.

Outlet companies' strengths include:

1. Hands-on owners
2. Low debt ratios
3. Family business mentality
4. Experienced staff
5. Ability to make aggressive decisions
6. Outlet value message
7. History of intense marketing
8. Brand depth
9. Advanced inventory management
10. Worldwide reputation
11. Positive press
12. "We've been through this before" attitude

Podell: This is a very exciting time for the outlet industry. More and more people are recognizing how outlets provide balance to a portfolio that is solely full-price. This is true whether you are a retailer or a landlord. We're seeing an increase in developers who have traditionally been involved only in full-price centers investigate and enter the value market. Simon started the trend several years ago with the Chelsea (and subsequent Mills) purchase, and now you have companies such as Cousins (through the Horizon and Dolphin JVs), General Growth (Reno project), and there was even a representative from Macerich registered for the VRN Spring Deal Making who was investigating opportunities.

Wagner: We'll be seeing smaller new-center phases and less extravagant building design to offset rent reductions. Secondarily will be the green movement for energy efficiency. For new centers, the better locations with development teams with strong credentials and a long-term view will be realized, while some of the others may never happen.

Some years ago when a lot of big chains were closing down, many people in the industry despaired that we couldn't live without those tenants – but who even remembers Bugle Boy, Gitano and IB Diffusion – to name a few – now? Some brands will surely go, but in time, others will replace them. It is actually healthy in the long term.

Ultimately, this shake-out is good for the industry's long-term prognosis – which I think continues to be brighter than other segments of retail – at least for the foreseeable future.

Was: Over the next year or two, I would expect to see limited growth but new opportunities in the outlet industry. I believe in this industry, and I believe in the people in this industry. I would not give up what I am doing for anything. We will get through this crisis and re-emerge stronger than before. V