While the idea of doing good for the inner city has merit, there is growing evidence that—when the deal is right—retail development in troubled neighborhoods also can be profitable.

Inner-City Retail Opportunities

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For more than two decades, inner-city revitalization efforts have focused primarily on the development and rehabilitation of housing. Over the past few years, however, the momentum has begun to shift to retail and other forms of commercial development as a way to bring services, jobs, and economic growth to communities in need.

At a session held during last fall’s ULI meeting in Los Angeles, Sneesles York, cochair of the Institute’s Inner-City Task Force, noted: “Inner-city issues are building momentum within the Institute and ULI members are looking at the inner city as a significant development opportunity.” With retail opportunities in suburbs exhausted for the foreseeable future, the inner city is being given more consideration by retailers hoping to expand their market areas—and by developers hoping to stay in business.

Many developers and retailers perceive that doing business in the inner city is risky and unprofitable. Their mindset has contributed to the basic lack of services available to residents of these communities. Is there really a market here? If so, can money be made?

Motive

Retailers ask themselves: Why do business where land and business costs are high? Why expose employees to crime and assume liability for customers? Why go through a permitting bureaucracy with more red tape than in the suburbs? According to Curtis Backlow, vice president of real estate for The VONS Company, retailers do those things because they believe there is profit to be made and because they feel a social responsibility to provide the community with jobs and needed services.

VONS—the largest supermarket chain in southern California—has recently committed to spend more than $100 million over the next two years to build ten to 12 new stores in the inner-city communities of metropolitan Los Angeles. The VONS program is driven by both profit and social agendas. Recognizing that suburban development has
and that the urban fringe is saturated with supermarkets. VONS is looking to the inner city as the best way to expand its regional market share.

The VONS program also has a social objective. Besides bringing foods and related goods to neighborhoods that were previously underserved, it is expected to create between 1,500 and 2,000 new jobs. VONS has agreed to hire and train community residents to fill many of these new positions.

According to Patrick Barber, vice president of real estate for Food 4 Less Supermarkets, Inc.—also based in southern California—inner-city retail development is a matter of simple demand and supply. "Population densities are much higher than can be found anywhere else and competition is much lower—therein lies the opportunity." Residents of most inner-city communities, as Sandy Aqar, cochair of ULI's Inner-City Task Force notes, "have a substantial discretionary income that often is not recognized."

According to Suzanne Sunshine ("The Economics of Retail Centers in Inner-City Neighborhoods," The Real Estate Finance Journal, Spring 1992), inner-city neighborhoods often contain up to 400,000 people within a three-mile trade area. Even if the lower-renting third of the population is excluded, these trade areas would still have 250,000 people with a median family income in the $25,000 range. Many of these trade areas are unserved by retailers, especially grocery stores.

A simple understanding of the population and household incomes within an inner-city community, however, is not enough to guarantee success. Aqar recommends that developers take a hard look at the demographics of the local market: "The localized focus is essential; developers and operators must look at the micromarket for success factors."

Barber agrees: "Operators should design a store to reflect the community in which it is to be located." Food 4 Less is a $1 billion per year business, of which $1 billion is generated from inner-city operations. The company operates several store chains, each with a special market niche. Its Viva supermarket chain, for example, is geared primarily to Hispanic communities in L.A.

**Opportunity**

Barber warns developers and operators that inner-city neighborhoods can change quickly—in terms of both of ethnicity and income. Retailers need to monitor the market and adjust with it as it changes. He advises developers and operators to "start small and do your homework by talking to those with previous experience before starting an inner-city venture."

Inner-city stores and shopping centers operate quite differently from their suburban counterparts. As Barber points out, most of their customers operate on a strict cash basis. Operating costs—are especially those associated with providing security—are many times greater. Sales volumes also can vary wildly throughout the month, according to when public subsidy checks are received. Operators need to be prepared to handle the peaks and valleys.

The developer must acknowledge these kinds of operational differences in the design of the center. For example, parking lots must be able to accommodate the peak shopping days of the month. Most important is designing a center that will make retailers and customers feel safe.

There is considerable debate about the degree to which inner-city centers should be made secure. Andrew Natkin, partner with the Alexander Haagen Company in Manhattan Beach, believes that, "without security, most inner-city retail centers would not be feasible." Haagen has developed several such centers, including the Vermont-Slauson Shopping Center in south central Los Angeles and the Martin Luther King Center in Watts. Both projects feature six-foot-high fencing with heavy landscaping around their perimeters; both are heavily guarded. Natkin notes that a typical neighborhood center built and operated by Haagen will employ 17 armed security staff, including two to three whose only job is to monitor video from security cameras placed extensively throughout the project.

Other developers and operators believe such extensive security features are unwarranted. Ted J. Simon, vice president of real estate for Borman's, Inc.—a Detroit-based grocery chain—says that his firm's inner-city stores are not staffed with armed guards. Martin Debowner, president of Weingarten Realty Management Company in Houston, which operates dozens of inner-city stores, believes that armed guards are sometimes necessary, but they should be kept outside of the store itself to minimize the company's liabilities risk.

All agree, however, that whether or not armed guards are present, it is important for these centers not to look like fortresses. As Barber notes, "It is essential to make the customers feel welcome and to treat them with respect—is something few inner-city residents get very often."
The costs of developing and doing business in the inner city can turn pro formas red before the project gets past the feasibility analysis stage. Land costs, in particular, tend to be very high. Sites of the right size at the right location are few and far between. Design and construction costs can be inflated by security provisions such as fencing and surveillance equipment. And operating costs can greatly exceed similarly sized suburban centers because of security, shrinkage, taxes, and insurance.

Also, equity requirements are more stringent because conventional lenders perceive these projects as being a higher risk. On the other hand, commercial banks are likely to become more interested in investing in inner-city retail projects with the coming stricter enforcement of the nondiscrimination mandates set forth in the Community Reinvestment Act of 1977.

So how can a private developer keep the numbers in the black? The economic solution lies mostly with the public sector. Without some form of government assistance or incentive, developers may find it impossible to break into the inner-city market. According to Nakre, “All of Haagen’s inner-city centers have major public sector participation and investment.” Haagen’s projects are typically structured as joint ventures with a city, redevelopment agency, or nonprofit corporation, in which a public interest has about a 50 percent share of the deal.

Barlow notes that without public sector participation, VONN’s $100 million inner-city program would not be possible. In L.A., for example, enterprise zones allow tax credits on employee wages. Other important public incentives include sales and use tax deductions; first-year business deductions; sales tax rebates; tax increment financing for infrastructure; land cost write-downs; and reduced fees for permits. Private developers with eyes on the inner city need to be prepared to negotiate with public agencies on these kinds of incentives. They also should be prepared to walk away from a deal if the public sector proves reluctant to put on the table enough incentives to make a tough retail project feasible.

**Capitalizing on the Ethnic Marketplace**

At a ULI 1992 fall meeting workshop moderated by Nina J. Green, executive vice president and principal sociologist for San Francisco–based Grant Green + Associates, panel members discussed the increasing importance of America’s ethnicity for retail and residential developers.

Meeting the rapidly shrinking share of the white non-Hispanic population in cities such as Los Angeles, Miami, New York, Washington, and San Francisco, Green said that “learning how to take advantage of cultural change is mandatory for developers hoping to stay in business.” She suggested the first step be to stop believing the myth that “minority” is synonymous with “poor” and that serving a large minority population is not profitable.

Pointing out that African-Americans, Latinos, and Asians represent just under 30 percent of the U.S. population have and have a combined purchasing power of over $1.4 trillion annually, Tara L. Dubbs, director of asset management for1

The Marabella Town Center, a Donahue Schriber–managed center on the edge of east L.A., serves a market area that is 90 percent ethnic minorities. Its sales average over $300 per square foot. Its average shopper spends more than $100 per visit.

Dubbs suggested that the successful development and operation of retail centers serving primarily ethnic populations require close study of the particular market areas, an understanding of the nature of the market, retailers who understand the ethnic market and will meet their buying and merchandising programs to local considerations, working with and learning from local ethnic merchants and community leaders, and letting go of assumptions based on experience with different markets.

The fast growing Asian population can be especially difficult for mainstream real estate developers to attract. Martha Colopero, real estate consultant for Coldwell Banker in Alhambra, California, suggested that a basic understanding of the ancient Chinese concept of feng shui, a complex concept that “relates to all of the natural elements in the physical universe,” is a good place to begin.

The principles of feng shui influence how many Asian groups perceive their immediate environment, from shopping centers to houses. Not only residential projects but also shopping centers with buildings oriented, lot configuration, or landscaping that fails to conform to the principles of feng shui will not appeal to many Asians.

1. The Rowe Company of Columbia, Maryland, operates 70 retail centers around the United States. Eight of those are located in primarily African-American or Latino market areas. Said John Ragland, assistant director of research for Rowe, “no residential community is still being driven by many old preconceptions about the ethnic marketplace that are simply no longer true.” He noted that Rowe’s ethnic-serving centers tend to outperform the company’s other centers.

The key to success, in Ragland’s view, is finding retailers who understand the local market. Other important roles are to base marketing, tenanting, and operating decisions on research and not on stereotypes or preconceptions, and to keep the merchandising mainstream.

Understanding the consumer is basic common sense retailing. As Wayne Rothkoff, president of Los Angeles–based The Rothkoff Companies concluded at this workshop, “Serving the ethnic marketplace builds on classic capitalism—trying to please consumers and provide them with what they need.”
Increasingly, community development corporations (CDCs) are helping to fill the negotiating and financing gap between private and public interests. In recent years, not-for-profit, locally based CDCs have taken a strong interest in inner-city retail development as a way of providing communities with needed services and helping to build the local economy. CDCs can play an essential role in putting together deals and providing equity; typically, they will become joint ventures in the project. A note of caution: the community development objectives of CDCs may go beyond the retail project at hand; developers will need to scrutinize carefully the condition that CDCs bring to the deal.

Even with public incentives factored in, private developers may find it difficult to obtain financing from cautious lenders. To bridge the financing gap, the Local Initiatives Support Corporation (LISC) has created an affiliated national fund, The Retail Initiative, Inc. (TRI), to invest in CDC-sponsored, supermarket-anchored, inner-city retail centers (see "The Retail Initiative, Inc.").

Through programs such as TRI, and with the assistance of locally based CDCs, developers may be able to get over some of the financing hurdles that have thus far discouraged retail development in the inner city.

Bringing Retail Back

How can retail be brought back to the inner city? Barlow believes that, first, developers and operators must create an atmosphere of safety for both retailers and customers. Local police must commit to being a visible presence and local prosecutors must aggressively go after criminals. Second, government agencies must create and grant investment incentives to lower the cost of doing business. The third, and often underestimated, means of attracting retail to the inner city rents with local governments. According to Barlow, "An aggressive pro-development attitude with an acute sense of urgency needs to be instilled in government agencies and officials." He calls for streamlining permit processing, removing regulatory roadblocks, and eliminating private agendas often held by local officials that tend to discourage private investment.

Based on his experiences in the effort to rebuild a 20-block south central Los Angeles, Peter Ueberroth, cochair of Rebuild L.A., agrees that "government has to change." Specifically, government needs to regulate less, stop taxing inner-city residents proportionately higher than others, and start creating incentives for businesses to locate in the inner city. Furthermore, inner-city residents must be empowered—involvement in decisions making and made part of the solution. Ueberroth stresses that the private sector also must become part of the solution, by putting pressure where it is needed to bring about governmental changes.

Is there a market for retail development in the inner city? The answer clearly seems to be yes. Suburbs may offer retail developers lower costs, easier operations, and more predictable financing. But most urban markets are now saturated with retail space. For the foreseeable future, the inner city offers developers and retailers some of the best opportunities for growth.

Is there money to be made? Based on the experience of developers and operators who have already made a commitment to the inner city, the private sector can find a profitable position within which to operate. However, it will not be business as usual. Almost everything will be tougher—negotiations, design, operations, financial structuring, and property management. For the faint of spirit, doing business in the inner city may prove overwhelming. For those willing to make the long-term commitment—and sort through the maze of promising and shaky opportunities—the inner city can open doors to both income and professional growth.

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