THE INCONVENIENT TRUTH ABOUT MIXED USE

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As far as trends in retail real estate development go, none during my 30-years in the industry has been more counter-productive or government-driven than residential over retail mixed-use development (RRMU).

Pick just about any Bay Area city and you will easily identify any number of RRMU projects that have been proposed, entitled and/or developed over the past ten years. And with rare exception, these projects suffer the same ills…relatively high vacancy rates, substantially below market rents, poor credit tenancies and a high turnover rate of the brokerage firms that try, with little success, to lease what is un-leasable.

Don't get me wrong – as a design concept RRMU works beautifully…in Paris. And in Manhattan. And therein lies a big part of the problem. City planners and city councils across Northern California have revealed an inferiority complex to major urban markets around the world and tried to force feed this utterly urban product type into sprawling suburbs from Concord to Novato to San Jose. Only guess what, the most important ingredient is missing – concentrated, massive, pedestrian populations.

Retail developments thrive and enjoy competitive demand for their vacancies only when merchants and restaurants can succeed. The ingredients for the retailer's success are universally known and proven: easy access, convenient parking, strong co-tenants and proximity to a desirable trade area. In the Bay Area's primarily suburban sub markets, well over 90% of shoppers get to their shopping and dining destinations by car. Only one of the Bay Area's nine counties, San Francisco, can make a legitimate claim to having the kind of fundamentals that support RRMU, and even then only in select neighborhoods

But the retail landscape in every other Bay Area county is overwhelmingly suburban in nature and comprised of shopping centers, power centers and regional malls with abundant parking, or traditional downtowns that cater to auto-oriented shoppers via street parking and proximate parking structures. Against successful and entrenched assets like these, with their ease of parking, strong anchor tenants and broad offerings, RRMU projects seek vainly to attract tenants who soberly see futures with no parking, no reliable anchor tenants nor the traffic they generate, and above all, no customers.

The Bay Area's numerous submarkets fail to meet the fundamental criteria for RRMU for more reasons than lack of residential density. Remember that the European and east coast markets where RRMU has historically evolved are typically centuries old and have a far more restricted infrastructure of freeways, parking and roadways, which were all necessary factors in the natural growth of RRMU in those markets. RRMU worked in these markets because at the time that they developed, there was no alternative. Infrastructure in Northern California however is based on a 20th century standard, which gave rise to suburbs and the retail projects that serve them, thus eliminating the critical cause & effect chemistry needed for successful RRMU. Government elites have ignored these realities while advancing their Euro model for our communities.

Rapt by the dogma of New Urbanism, our municipal planners have uniformly ignored the fact that retail by its very nature likes to congregate. In retail lease planning, this reality is expressed through anchor tenants, larger formats and critical mass. Yet New Urbanism's RRMU designs plug its' ears and closes its' eyes to this essential truth.

Tragically, today's sophisticated residential developers have learned the game. The hot residential market allows them to build out projects where they can plug in zero income for the retail space they are forced by the municipality to build, knowing it will struggle at best. But strong returns on the residential pro forma compensate for the retail write offs, thus giving birth to another RRMU project whose ground floor is destined to lay vacant, or perhaps be leased by a start-up nail salon or martial arts operation with no credit or resume, if the landlord is lucky.

Of course there are a handful of exceptions. Santana Row and Bay Street among them (although projects like these have more regional mall DNA than RRMU). Also, an admirable niche is being developed by select firms like BHV Centerstreet Properties, that are delivering mixed use projects that seek to blend functional, first class retail with high quality residential. But for every smashing success, there are perhaps thirty train wrecks. City staffs who have no responsibility to finance, lease or manage the projects they conceive and require, are increasingly a class of folk with their hands on the gears of approval, yet with no boots on the ground understanding how retail leasing works or of the utterly flawed nature of their dreams.

Our city planners all seem to attend the same conferences and seminars – those hosted by an alphabet soup of trade organizations such as ULI, ICSC and BOMA. They bring back the trendy design concept du jour (e.g. Residential over retail mixed use, transit villages, adaptive re-use, etc.) back to Northern California's overwhelmingly suburban retail markets, and proceed to jam developers with un-leasable designs, if those developers hope to seek approval in that city.

So who exactly is campaigning for the RRMU design concept? Not the risk-savvy developers that have learned how this product type rarely succeeds. Clearly not the high quality retailers and first class dining establishments that consistently choose to avoid these projects, leaving them half vacant. Yet RRMU projects continue apace in a bizarro real estate world where the laws of supply and demand have been suspended by ivory tower planners who suffer none of the consequences of these failures, unlike the developers jammed with building them, the banks that might loan on them, or the brokerage firms charged with leasing them.

De-coupled from the financial realities of designing and building retail projects that will attract quality tenants and manage to stay leased in markets both good and bad, our bureaucrats appear more interested in how a project looks or if it comports with the latest fashion in the urban Meccas.

Brokerage firms like ours increasingly experience visits from exasperated multi-family developers who have realized that they have a mounting problem on their hands. With growing concern, they see how the vacancy problem in their commercial portfolios is getting bigger and has no apparent cure. Makeshift leasing solutions have become commonplace as sophisticated institutional developers populate their "retail" spaces with complimentary fitness and meeting rooms in order to shrink, if only slightly, their inventories of dead space.

While Adam Smith's "Invisible hand" would give the consumer, the merchant, the builder and the community at large what they want, namely, parking, convenience, anchor tenants, and projects that succeed, our bureaucrats have charted their own path. One that looks like Paris, but with empty buildings.

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About John Cumbelich & Associates
John Cumbelich & Associates is a San Francisco Bay Area based firm that provides commercial real estate services to Fortune 500 retailers and select owners and developers of retail commercial properties. The firm's expertise is in developing store networks for retailers seeking to penetrate the Northern California marketplace and the representation of premier Power Center and Lifestyle developments.

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