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## **Tarnished Gold**

**New York's luxury corridor loses its luster, but less expensive areas hold their own.**

**By Elaine Misonzhnik**

The stretch of Madison Avenue starting at 57th Street and continuing through the upper 60s has not historically been associated with hard times. Yet the current downturn has hammered the corridor, making it one of the hardest-hit areas in New York City.

In the past year, the Gold Coast, as local retail brokers have come to call it, witnessed the exit of long-time neighborhood stalwart and linens seller E. Braun & Co. and fashion designer boutiques Alessandro Dell'Acqua and Miu Miu, among others. Some of the retailers have closed shop altogether, while others opted to move into smaller stores.

In one case, Vornado Realty Trust alleges that a tenant, Krizia S.p.A., pulled a "midnight move" at 769 Madison, leaving without notice and without paying back rent for more than four months. (Vornado is now suing the retailer for approximately \$350,000.)

The problem for Madison Avenue, according to local brokers, is twofold. First, Madison is defined by opulence and luxury retailers have suffered more than any other sector from the drop in consumer spending. Year-to-date same-store sales in the luxury category have declined 16.3%, according to the International Council of Shopping Centers, while total same-store sales are down only 0.5%.

Shoppers who in the past indulged in high-ticket purchases no longer have the money to do so, while wealthier consumers are embarrassed to be seen as frivolous spendthrifts, says Susan Kurland, executive vice president of retail services in the New York office of CB Richard Ellis, a real estate services firm.

In fact, upscale retailers including Bergdorf Goodman and Saks Fifth Avenue now offer customers the option of taking their purchases home in plain shopping bags to hide the appearance of conspicuous consumption. "I know lots of people who have money and are just not spending," notes Kurland. "If they go to an upscale department store, they don't want anybody to know they've spent money there."

The drop-off in demand for luxury goods and the resulting difficulties faced by high-end retailers account for only part of the problem on Madison Avenue, however. Many retailers leasing space on the avenue also agreed to ridiculously expensive terms at the peak of the cycle and now can't afford their rental rates.

“The rental rates they were paying [at \$1,400 per sq. ft.] were priced into the perfect market, and instead they met the perfect storm,” says Henry Goldfarb, vice chairman of Grubb & Ellis Co., a commercial real estate services firm.

As a consequence, the vacancy rate in the Madison Avenue submarket reached 16.1% at the end of the third quarter, an increase of 70 basis points from mid 2008, reports Cushman & Wakefield.

That's higher than the vacancy rate for neighborhood and community shopping centers, which reached 10.3% in the third quarter. It's also higher than vacancies for regional malls, which hit 8.6%, reports Reis, a New York-based research firm. Meanwhile, effective rents in the area have dropped by as much as 40% over the past two years, adds Goldfarb.

The rents on upper Madison Avenue officially averaged \$1,005 per sq. ft. at the end of the third quarter. Unofficially, rents range from \$800 per sq. ft. to \$900 per sq. ft., says Goldfarb, still out of many retailers' price range.

That makes it difficult to turn over vacant space to tenants outside the luxury sector. They simply can't afford it, says Bill Miller, vice president and director of real estate with the retail services outsourcing group of Jones Lang LaSalle, a Chicago-based brokerage.

### **Nordstrom Rack on the move**

Considering Madison Avenue alone, observers might understandably conclude that New York City's retail market is devastated. But New York is a city of neighborhoods and Madison Avenue represents only small part of its retail universe, brokers say.

Upper Fifth Avenue has also seen a 40% drop-off in rental rates in the past year, but because it has less available inventory than Madison, it has not experienced as much vacancy, according to Faith Hope Consolo, chairman of the retail leasing, marketing and sales division with Prudential Douglas Elliman, a New York-based real estate services firm.

Meanwhile, Manhattan's less ritzy retail areas, including Times Square, Union Square, Herald Square, lower Fifth Avenue and SoHo welcome new tenants.

This summer, Nordstrom announced that Nordstrom Rack, an off-price version of the luxury department store, would take a 32,136 sq. ft. space at the former Virgin Megastore in Union Square. JCPenney elected to move into the repositioned Manhattan Mall.

Meanwhile, arts and crafts retailer Michaels opened its first Manhattan store on the Upper West Side. In short, the recession has affected leasing fundamentals — both occupancy rates and effective rents have suffered — but New York continues to attract interest from prospective tenants even during a difficult time.

“New York City has always been a very, very strong urban market,” says Stanley Lindenfeld, senior managing director with Grubb & Ellis. “The other thing you have to take into consideration is that [nationally] in order to save money, people have not been driving and they've stopped going to the mall. New York is a walking city, so there is more of an opportunity here than in the outer-lying areas.”

## **Branding works**

Most of the retail properties in the city's central locations, including Times Square, Union Square and Fifth Avenue have maintained near-full occupancy rates, according to Benjamin Fox, president of Winick Realty Group, a New York City-based retail brokerage firm.

In some areas, New York's continued success is a function of branding. For example, many retailers take locations in Times Square to gain exposure in an iconic and hugely trafficked part of the city, not necessarily because merchants believe stores at the "Crossroads of the World" will be boffo contributors to their bottom lines. Times Square's vacancy rate actually declined in the third quarter to 9.3% from 10% at midyear.

Another part of the equation is rents. Class-A retail space in Union Square leases for about \$354 per sq. ft. compared with \$239 per sq. ft. in the area south of Houston Street, according to Cushman & Wakefield. That's less than half of what retailers would pay for similar space in the luxe environs of Madison Avenue.

Meanwhile, some of the best performing areas of the city tend to cater to value-oriented tenants, a group that has withstood this recession better than luxury and mid-price retailers.

The Union Square submarket houses national discounters such as Filene's Basement, DSW and cheap chic retailer Forever 21, in addition to a Barnes & Noble and a Babies "R" Us. Smaller and more affordable apparel shops, including Strawberry's and American Eagle round out the tenant list along with a bevy of local discount chains.

The area's emphasis on affordable fashion, along with its heavy foot traffic, made it the logical choice for Nordstrom Rack's first Manhattan location, according to a statement from Scott Meden, the brand's president. Nordstrom Rack sells Nordstrom merchandise at discounts of up to 60%. The brand's Union Square location is set to open in spring 2010.

Union Square's heavy foot traffic also means that vacancies don't last long, even in a downturn. Bankrupt Circuit City left a 48,000 sq. ft. space earlier this year. In November, Best Buy opened its first 24-hour store in that same spot.

## **SoHo is so healthy**

Further downtown, SoHo has benefitted from a steady influx of tourists and its affordable rental rates, according to Fox. The area gets an added boost because of the variety of its retail offerings. Walking down Broadway between Houston and Canal streets, one sees a broad spectrum of national and international chains, ranging from the all-American Levi's store at 536 Broadway to the Japanese transplant Uniqlo a few doors down.

"SoHo has remained extraordinarily healthy and there are hardly any availabilities along that stretch," says Fox. "Every brand you can think of is represented there. It's almost like going to the mall."

New tenants have swiftly picked up vacant SoHo slots. When Ann Taylor left a 7,000 sq. ft. space at 560 Broadway, in moved Escada. When Staples exited 488 Broadway, fashion retailer Bebe picked up the 8,700 sq. ft. store.

The drop-off in demand for new space has hit some of Manhattan's outlying retailing areas harder, including the Upper East and Upper West Sides. In those zones, however, mom and pop shops have provided a stabilizing force, says Goldfarb. Necessity retailers — delis, dry cleaners, liquor stores — that have inhabited their locations for years tend to pay affordable rents and have largely avoided the carnage in the retail sector.

“They provide needed services for the community and are not as affected in a recession as the national chains that overpaid for the space and for whom the slightest quiver is death,” Goldfarb notes. Larger chains that tried to grow their bottom line through store growth have been heavily affected, he says.

### **Some retailers are shopping**

That's not to say that retailers are flooding New York City with demands for space. Retailers no longer feel pressure to expand, so unless a new location makes sense financially, they won't take it, Fox explains. In a lot of cases landlords are more concerned about getting a stable tenant than making a top buck on the deal, adds Goldfarb.

Instead, a select cadre of retailers are actively shopping around. They include drugstores CVS and Duane Reade, Subway, video game seller GameStop and regional beauty supplies store Ricky's NYC, says Goldfarb.

Jones Lang LaSalle's Miller has also been working with larger tenants, including TJ Maxx, Marshalls and Dollar Tree on taking over empty big boxes left by Circuit City at more than 30 sites in New York City. Apparel retailers, however, the bread and butter of the local retail scene, are holding off on new store openings.

“Even if there is a rent reduction on a prime piece of space, the apparel tenants aren't biting [because] they don't know what kind of sales volume they will do. It costs \$1 million to build a store and the banks aren't lending,” says Fox. Along with apparel shops, banks are sitting on the sidelines.

Recent leasing activity involves significant concessions from landlords. So far, the latter have resisted lowering asking rents and that's why official statistics have held up so well, says Fox. But the effective rents at which deals are being signed have come down by anywhere from 25% to 40%. In many instances, the tenants are pushing hard for free rent and tenant improvement allowances, says Miller, a tenant representative. A tenant looking for a Manhattan storefront might get up to \$100,000 more from a landlord through concessions than two years ago.

The difficulty in filling vacancies has had the unintended consequence of making pop-up store leases — short-term leases ranging from several months to two years — more common, Miller notes.

In the past, Grubb & Ellis would field a few calls each season from retailers seeking pop-up locations. Today, Goldfarb's phone is ringing off the hook. Gucci, Toys ‘R’ Us, Rachael Ray and Ricky's have signed pop-up leases in Manhattan.

The pop-up lease rates in New York generally are 50% lower than permanent leases and require little to no build-out investment from the retailer, says Consolo. Earlier this year, apparel seller Lisa Perry opened a pop-up store in SoHo. The brand is now in the process of signing a permanent lease on the Upper East Side, says Consolo.

Landlords have become less finicky about letting “wet use” tenants such as restaurants and fast-food joints take spaces formerly used by hard goods retailers, notes Miller. In the past, “a lot of landlords put a line in the sand and said, ‘We only want a dry use.’ They are now allowing food uses into some of these spaces just so they can fill them up,” he says.

### **Will the holiday help?**

The newfound flexibility could help New York landlords recoup some of the losses resulting from increased vacancies.

Goldfarb and Lindenfeld say the Manhattan market has bottomed out, but Kurland notes that leasing activity will pick up only if the retail sector has a good holiday shopping season. Most industry sources project that same-store sales growth through January will be flat.

Kurland, who handles national retail leasing, says the last deal she closed in New York City was seven months ago. At the peak of the real estate boom, she closed at least one Manhattan lease a month. She's working on four potential transactions in the city, but remains cautious about the short-term prognosis.

“Unfortunately, our business is very tied into consumer confidence,” she says. “And except for the things that you absolutely need,” including food and drugs, people are not shopping.