U.S. Shopping Center Classifications: Challenges and Opportunities

*James R. DeLisle**

BACKGROUND

Over the years, shopping center formats have taken on a confusing array of identities, with names that include such descriptors as centers, commons, crossings, hybrids, lifestyle centers, calls, markets, marts, mega-malls, mixed-use, outlets, parkways, places, plazas, promenades, shops, strips, squares, super centers, town centers, urban retail, vertical, and villages.

Unfortunately, there is no agreement as to how many distinct types of shopping center formats there really are, nor how individual centers should be assigned to the various categories. Adding to the confusion is the fact that shopping centers can be further differentiated by a variety of marketing and management strategies including: convenience, entertainment, ethnicity, festival, lifestyle, luxury, off-price, theme (e.g., home improvement and furniture), tourist, urban and value. When considering the possible combinations of these types of differentiating, it is understandable that some consider the retail sector inherently complex and difficult to understand.

To address this situation and help provide some insight into the major components of the retail market, the International Council of Shopping Centers (ICSC) developed a classification of shopping center formats. This typology has undergone a number of modifications over the years, as new formats have emerged and variations of existing formats have become more significant. ICSC is at an important crossroads with respect to the reassessment of current shopping center definitions as it considers how to respond to the introduction of new formats, the blurring of lines among existing categories, and the resurgence in mixed-use and other urban projects in which retail is a component of a larger development. While the current typology, or classification scheme, has come under attack by some who argue they are imprecise, the organization's standard has contributed to a greater understanding of the structure and performance of the overall shopping center industry. However, given the dynamic, competitive nature of retail real estate and increased interest in the role of retail has in revitalizing urban centers, managing growth and responding to market demand, *the timing is right to step back and revisit the current classifications*. This review process can benefit from the application of "rules of classification," as well as efforts to expand the market's acceptance and use of ICSC's shopping center classification.

EVOLUTION OF SHOPPING CENTER CLASSIFICATIONS

To provide a frame of reference for revisiting shopping center classifications and to develop some perspective on current issues, it is necessary to explore the evolution of shopping centers and shopping center classifications. There have been three major waves of shopping center development that have triggered changes in retail classifications. During the ***first wave***, shopping centers were classified into several basic categories, including community centers, neighborhood centers and strip centers. These shopping center formats were distinct from free-standing retail and urban retail with respect to integrated design and unified storefronts, provision of on-site parking, strategic blending of tenants, emphasis on convenience and basic goods and coordinated management. Early shopping centers also tended to be fairly uniform, designed to satisfy more of the mass merchandise demands while offering the convenience of one-stop shopping. In the ***second wave***, which began with Southdale Mall in Minneapolis, the age of regional malls was born. This

*Director, Runstad Center for Real Estate Studies, University of Washington

wave took the form of a shift from urban to suburban shopping, spawning a spate of new malls. The major distinguishing elements of malls over shopping centers was the fact that most were enclosed centers with a common corridor connecting tenants, and sheer increases in the aggregate size and number of tenants, both anchor and in-line.[1] The ***third wave*** was a period of product differentiation in which the two core categories were further subdivided. For example, with the emergence of "category killers," the shopping center category spawned a new genre of centers known as power centers.[2] Similarly, super regional malls became dwarfed by even larger formats known as mega-malls such as the West Edmonton Mall and the Mall of America. During this period, the market also began recognizing various positioning strategies, which emerged as developers and operators sought to differentiate their properties and firm up their market niches (e.g., entertainment, festival, lifestyle, mixed-use, open-air, premium, and tourist).

CURRENT ICSC SHOPPING CENTER CLASSIFICATIONS

The current ICSC shopping center classifications consist of two major categories: malls and open-air centers, each of which is divided into sub-categories. Within these broad categories, the sub-classifications hinge on several key attributes, including:

- Concept. The underlying business strategy or model that distinguishes the REIT (real estate investment trust) or helps characterize its overall operations. The defined "concept" captures the theme or market positioning offered by centers within the broader categories, including such characteristics as convenience, customer-orientation, entertainment, merchandise lines, and price points.
- Size. The massing of the center, including both anchor tenants and other tenants.
- Acreage. The typical land assemblage required to house the retail space, along with parking and ancillary services necessary to the operation of the respective types of centers.
- Typical Anchors. A profile of the type, size, and business orientation of the major anchor tenants that are typically housed in the centers.
- Anchor Ratios. The mix of anchor and non-anchor tenants, including in-line retail tenants.
- Primary Trade Areas. The typical size of the primary trade area from which the respective centers draw the bulk (i.e., 60%-80%) of their customer sales.

Table 22-1 presents the core concepts and size ranges of the eight sub-types of retail in the current ICSC classification system. As

Table 22-1

SUMMARY OF ICSC SHOPPING CENTER CLASSIFICATIONS

TYPE	SUB-TYPE	CONCEPT	SIZE RANGE (square feet)
Malls			
	Regional Center	General merchandise, fashion	400-800,000
	Super Regional Center	Same as regional; more variety & assortment	Over 800,000
Open-air Centers			
	Neighborhood Center	Convenience	30-150,000
	Community Center	General merchandise; convenience	100-350,000
	Lifestyle Center	Upscale; national specialty; entertainment, outdoor	150-500,000
	Power Center	Category-dominant anchors, few small tenants	250-600,000
	Theme/Festival Center	Leisure; tourist-oriented; retail & service	80-250,000
	Outlet Center	Manufacturer's Outlet stores	50-400,000

Sources: Runstad Center; ICSC.

[1] Over time, further increases in the size and number of tenants created the need to further differentiate malls, resulting in the addition of Super-Regional Malls to the lexicon. In some circles, rather than differentiating among types of formats, retail properties were simply referred to as Shopping Centers, which referred to smaller format centers, and Regional Malls, which referred to larger format centers.

[2] Another example was the introduction of Outlet Centers, which were positioned somewhere between traditional shopping centers and regional malls. Although large enough in sheer square footage and the number of tenants and trade area draw to be considered Regional Malls, Outlet Centers lacked the presence of department store anchors, and thus were not enfolded into that category. At the same time, Outlet Centers were too large to be included with Community Centers and Power Centers, thus leading to another classification.

noted, there are some overlaps in the various attributes across several retail classes. Thus, in order to properly classify a center, the combination of other attributes must also be considered.

CURRENT INDUSTRY USAGE OF SHOPPING CENTER CLASSIFICATIONS

An important consideration in efforts to enhance the classification system for shopping centers is an assessment of the degree to which the current classifications have penetrated the industry. Several key potential users of the existing typology of centers are noteworthy:

- NCREIF. The National Council of Real Estate Investment Fiduciaries is the main source of private, institutional real estate performance data. The NCREIF Index, launched in 1978 to provide institutional investors with meaningful benchmarks for real estate, is broken down into a number of classes including regions, property types, and sub-property types.[3] As of mid-2005, the retail component of the NCREIF Index included $37.3 billion of retail assigned to the super-regional, regional, community, power and fashion categories. The remaining $370 million that was unclassified fits into the outlet centers, theme/festival centers, single tenant facilities, and "unknown" categories for which the number of centers fails to meet the masking criteria.
- NAREIT. The National Association of Real Estate Investment Trusts has not established a classification system for retail properties, although it groups REITs into several general retail classes: shopping centers, regional malls, and free standing. These three categories accounted for a market cap of some $85 billion, which translated to 25% of the total REIT market cap. Actual retail holdings exceed that amount, since diversified REITs and other categories include some retail investments. Within REITs, the use of ICSC shopping center classes for individual holdings is somewhat limited, with some 38% falling into the major classes, and 58% either unclassified or falling under a generic label, including some of the major shopping center REITs that do not classify individual properties. Some REITs do report new formats (e.g., lifestyle, mixed-use, specialty, street, and other) although these account for only 4% of all designated holdings.
- Vendors. A number of vendors track the shopping center industry, reporting on market structure and performance. In general, information providers do not embrace the ICSC definitions beyond the major classes of malls and shopping centers, or by using size designations. For example, the National Research Bureau (NRB), which focuses on the retail industry recognizes some 18 formats, but uses six size categories when breaking down the census of centers into aggregate groups.

In addition to these major industry players, a number of other parties also classify shopping centers. Examples of these parties include: appraisers who value centers and use classifications in picking comparables, lenders who underwrite commercial mortgages, rating agencies who rate CMBS issuances and trade associations which track the retail industry as part of their overall coverage. In general, while recognizing the leadership role of ICSC, there is little evidence that these and other market participants and information providers strictly adhere to the current ICSC classifications.

POTENTIAL USERS OF SHOPPING CENTER CLASSIFICATIONS

In addition to recognizing the needs of current users of shopping center classes, a number of other parties should be considered in revising the classification system. The key user groups and perspectives to consider include:

- Capital Markets. The convergence of real estate and the capital markets, and the dependency of the retail industry on adequate capital flows elevates the capital

[4] To increase standardization for institutional investing, NCREIF, National Association of Real Estate Investment Managers (NAREIM), and the Pension Real Estate Association (PREA) created the Real Estate Information Standards (REIS) to provide greater information consistency for institutional real estate. As a part of those efforts, the REIS initiative turned to the ICSC for classifications of shopping centers, although the definitions focus on size, anchors and abbreviated concept definitions.

markets to an important constituency whose needs should be considered in revisiting shopping center definitions. In general, greater transparency for the sector will be critical to its ability to capture a fair share of capital flows relative to other property types. As such, it is particularly important that a new classification system for shopping center formats address the needs of key capital market players (e.g., NCREIF, NAREIT) as well as appraisers, lenders, and investors.

- Growth Management Community. The retail industry is facing a number of challenges as planners and governmental agencies seek to manage growth and to contain urban sprawl. To ensure that such policies are sensitive to the impact on consumers and the need to maintain market balance, it is important that these parties understand how different shopping center formats fit into the urban mosaic and what makes them successful. At the same time, cities are developing incentive programs to increase density, make neighborhoods more livable, and revitalize urban centers. In many cases, retail plays an important role in such efforts. Revised and enhanced shopping center classifications can help inform these efforts and create a foundation that can be used to negotiate optimal approaches that take advantage of the contribution that various shopping centers can make to developing socially responsible, ethical, and pro-actively managed communities.

- American Planning Association. The American Planning Association (APA) developed multidimensional Land-Based Classification Standards (LBCS) for classifying land uses. This classification system is based on five attributes: activity, function, structure, site development character, and ownership. LBCS covers shopping centers under "Structure 2500: Malls, shopping centers, or collections of shops." Although recognizing the importance of physical characteristics, APA stresses that for planning applications, knowing the type of trade area served by the shopping center (i.e., neighborhood or region) is more useful than knowing the basic configuration. Land-use classification systems have used a variety of categories in the past. Due to the increasing role that planners and the entitlement process play in approving new shopping centers, it is clear that efforts to enhance the shopping center classification system should contribute to more informed, market-based policies and practices.

- Retail Developers. The retail arena is extremely competitive, with developers seeking new solutions that will better satisfy consumer and tenant needs. Classifying centers into meaningful categories and tracking performance of various formats can go a long way to increase market efficiency and help focus development activity on viable product categories. This is particularly true in the case of new formats including mixed-use, lifestyle centers, market centers and urban infill development, that are receiving a lot of attention by cities and planners, but which have unproven track records. An enhanced classification system can help "educate" the market to the critical success factors underlying such innovations, to help rationalize new activity and maintain market balance. At the same time, it can help developers avoid the risk of creating a slew of new product that fails to satisfy retail needs in terms of size, configuration, loading docks, parking and other elements critical to retail success.

IMPORTANCE OF SHOPPING CENTER CLASSIFICATIONS

The lack of widespread reliance on ICSC classification of shopping centers and the resultant ambiguity surrounding retail formats has far-reaching impacts, affecting retail participants on both Main Street and Wall Street. On the Main Street side, efficient operation of the retail market depends on the fact that real estate developers, tenants, planners and other facilitators understand the underlying business models and drivers of value for the various types of retail. On the Wall Street side, investors and capital markets must be able to apply performance measurements and benchmarks to various types of retail to understand relative risk/return and price these investments. In addition, commercial vendors and trade associations depend on valid, reliable and credible classifications of retail properties to support their activities in data collection, research and education, particularly for the research firms and data purveyors who track occupancy, rents, absorption and other measures of market fundamentals.

Although specialists who concentrate exclusively on the retail industry may be able to operate without an industry consensus on shopping center classification, the same cannot be said for those for whom retail is only a part of their focus. This caveat is especially true when looking beyond the real estate market, to other affected parties who directly or indirectly affect the functioning of the retail market. To support the informational and educational needs of these parties, it is imperative that the market be offered a framework, and the tools to implement it, so that it can allow non-retail specialists to approach the retail sector with a greater understanding of its underlying structure. The bottom line is that greater market knowledge and insight can lead to the application of more proactive investment, management and regulatory strategies.

It should be noted that efforts to develop a valid and reliable shopping center classification system will always have to address the dynamic tension between over- and under-classification. The appropriate number of categories could be addressed through statistical tests of significance, but attention should also be paid to challenges associated with getting the market to embrace the classification system. The ultimate typology should also address the challenges that will be associated with the task of accurately assigning retail properties to the various sub-categories. To the extent possible, efforts should also be made to ensure that best practices and reporting requirements mandate their use. However, if a new typology of centers is unwieldy or cannot be translated to market knowledge, efforts to enhance the current classification system can backfire. The end result could be a situation in which the resulting complexity overwhelms the market, confounding market participants and leading to inappropriate allocations from the capital markets to the overall retail sector.

RULES OF CLASSIFICATION FOR SHOPPING CENTERS

Three major requirements must be addressed in attempt to enhance a shopping center classification system: it must be unambiguous, it must be meaningful and it must be capable of being measured.[4] ***Unambiguous*** means that the individual properties must be uniquely assigned to a single category by some systematic process that can be applied in an objective and dispassionate manner. The typology must also have stability and consistency that endures over time. This criterion is important in light of the longitudinal use of a classification system to code individual properties, track market structure, and calculate performance measures. At the same time, it should be anticipated that developers, investors and retailers will continually "push the envelope" with new innovations in an attempt to capture a competitive advantage. Since many of these "innovations" will not catch on, the decision to elevate them to the level of distinct categories should depend on their longevity or staying power rather than popular opinion that proves fleeting.

The ultimate classification system also must be ***meaningful***. While the related question of "to whom" should it should be meaningful should be debated (i.e., ICSC core members vs. broader constituencies), there are some objective measures to help resolve this issue. In general, whether a category is "meaningful" should be judged based on three dimensions. First, centers that are assigned to any particular class must have a degree of homogeneity or similarity with other members of the same class, and must be meaningfully different from properties in other classes. Second, to justify treatment as a distinct sub-category, there must be a sufficient number of candidate properties to warrant separation. This criterion must be carefully applied in the case of new trends, where

[4] If these criteria cannot be satisfied in the short term, some form of interim or transition program should be developed which can help move toward eventual market adoption. For example, ICSC could begin modifying its internal systems to track new or modified subclasses of retail and report the results in its own publications and industry benchmarks. Similarly, ICSC could develop educational and outreach programs to sensitize the market to the benefits of embracing such a typology. Individual member firms and interested parties could also begin to demand more precision in reporting from vendors, using the private sector and market share to drive innovation and expansion.

new classes of retail formats are likely to emerge over a reasonable period of time. Finally, to warrant treatment as a distinct shopping center class, the market must have the potential to capture some pay-off or ancillary benefits to justify the effort to create and track a new category of shopping centers.

The third important factor for classification is that individual properties or projects that make up a category must be measurable. That is, the relevant characteristics of individual properties or projects that make up a category must be capable of being identified and quantified in a public, objective, and verifiable manner. Moreover, the individual classes and overall typology must be palatable to key players in the market to ensure industry acceptance. Without sufficient buy-in, the development of new classes of retail that do not supplant other classifications will merely add to confusion and thwart efforts to increase understanding and market transparency. Thus, it is imperative that current industry leaders and market participants (e.g., investors, rating agencies, trade associations, and companies) must embrace the new classification).[5]

RECOMMENDED APPROACH

The goal of revisiting ICSC's classification of shopping centers should be to produce a system that can satisfy the rules of classification discussed earlier: unambiguous, meaningful, and measurable and lead to greater transparency and efficiency for direct players. At a higher level, though, efforts should also be extended to ensure the resultant typology leads to a greater understanding of the retail industry, and the important role that it plays in our market-based economy. By highlighting the distinguishing elements and identifying the fundamental drivers of the various retail formats, the classification system can be used to support greater collaboration in which the retail sector can be seen as a partner in solving challenges surrounding the management of growth and the revitalization of our cities.

Going forward, one can envision some form of hierarchical typology that breaks retail categories down into functional or locational groupings, with major and minor classes. At the same time, the typology would address various positioning strategies that might further differentiate products in terms of price points or other factors. Finally, the classification system should address the types of challenges that need to be resolved to add more transparency to the retail scene and avoid some of the ambiguity that could emerge if the issues of classification are not adequately addressed. In developing and promulgating its expanded classifications, the ICSC could help the market avoid some of the mistakes that are looming on the horizon as inexperienced parties and vested interest groups move into the retail arena without an understanding of the need for the coordination that is necessary to create sustainable retail solutions that enhance the quality of life for current and future generations.

James R. DeLisle, Ph.D. is Director of the Runstad Center for Real Estate Studies at the University of Washington. For more information, contact him at jdelisle@u.washington.edu.

Editor's Note: *This is an excerpt from a much longer white paper by James DeLisle, which is available on ICSC's Web site.*

[5] This market acceptance is especially true from an industry perspective, where implementation of new categories will require significant resource commitments and market pressure to ensure successful implementation.

[6] There are a number of approaches to classification that could be applied to shopping center classifications. For example, in a quantitative sense, it would be possible to apply multivariate statistical models (e.g., discriminate analysis, cluster analysis) to arrive at a taxonomy that is statistically significant and can be objectively applied. While this has some appeal in terms of reducing some of the ambiguity, it suffers from the fact that it would comprise the face validity, or industry acceptance of the schemata. Another approach would be to turn to theory to isolate the major factors that should be incorporated into such a classification model, as well as how such a model should be constructed. Again, such an approach has tremendous appeal on the surface, but suffers from the general dearth of relevant theory related to real estate and retail markets. Thus, analysts would be left to borrow theory and principles from other disciplines or applications, and then merely extend them to real estate. This approach would fail in terms of industry acceptance, due to the low likelihood that it could provide sufficient insight and understanding of market structure to gain acceptance from industry professionals and other users. The reality is that the real estate market is largely decentralized, unregulated and inefficient in terms of industry oversight and "best practices." To gain acceptance, any approaches to quantify the process must be blended with more pragmatic, applied methods that benefit from market knowledge, and insights into how the market actually operates. However, that is not to say that quantitative and theoretical approaches should be ignored, rather that they should be used strategically to empirically test the ultimate schemata and to develop classification tools that can help the industry apply such techniques.