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WHAT RETAIL APOCALYPSE? SHOPPING CENTERS ARE MAKING A COMEBACK.

Vacancy is the lowest it has been in two decades, at 5.4 percent, according to a recent report. The properties are thriving even as retailers like Macy's and Express shutter many stores.

By Joe Gose

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The Westfield UTC shopping center in San Diego. As large department stores have withered, developers have built shopping centers with diverse offerings like restaurants, fitness operators and medical facilities.Credit...Ariana Drehsler for The New York Times

Shopping center landlords have found themselves in a wholly unfamiliar position: For the first time in 20 years, demand for retail space outstrips supply.

That demand has soared recently and, after years of muted construction and a purge of weak-performing properties, met a retail market with less available space. Properties that survived the purge signed up tenants that would draw more shoppers and give them more reason to linger. That meant more restaurants and venues that promote recreational experiences, like ax throwing and, more recently, pickleball. It also meant less space for traditional retailers that weren't performing as well, like bookstores and apparel brands.

Because of those moves, "there's not as much redundancy from tenants, and landlords are creating much more robust tenant mixes," said Barrie Scardina, president of Americas retail services, agency leasing and alliances for Cushman & Wakefield, a real estate firm. "We are seeing some of the most productive occupancy recorded in the last 10 years."

Shopping center vacancy is the lowest it has been in two decades, at 5.4 percent, Cushman & Wakefield said in a recent report, and the edge in lease negotiations has shifted from tenants back to landlords.

To meet demand, developers are on the hunt for distressed and failed properties — or even locations where retail would be a better fit than the current use. Partners Capital is converting a 100,000-square-foot office complex near Las Vegas into a $30 million project, called the Cliff, that will include restaurants, boutiques, health-and-wellness operators, entertainment space and a central bar. This is a shift from what the developer was doing just a few years ago, when it was selling off much of its retail-center portfolio and pivoting to industrial buildings that housed tenants such as logistics providers, said Bobby Khorshidi, president of the firm.

Partners Capital's move is an apt representation of how the fates of office properties and shopping centers have switched places.

David Larcher, chief executive of Vestar, a developer in Phoenix that is planning several projects, including the second phase of Vineyard Towne Center, a 260,000-square-foot shopping center in Queen Creek, Ariz., said the pandemic had been "good for retail."

"There was a lot of derelict space converted into other uses, and retailers with too much debt who had been hanging on by their fingertips were wiped out," he said.

While the pandemic may have hastened the rebound, it is underpinned by a shift that began more than a decade ago. After the financial crisis and 2009 recession and amid the growth of e-commerce, retailer bankruptcies led to a glut of space that prompted many investors to sell or convert shopping centers and embrace offices, apartments and warehouses. Shopping center space, which had surged from 2006 through 2009, began to shrink — primarily in two waves, first from 2009 to 2016 and then again during the pandemic.

The shopping centers that were still around shifted strategy to meet changing consumer taste, and landlords brought in high-traffic-driving tenants including restaurants and entertainment centers, fitness operators, boutique services, public gathering areas and medical facilities.

In some cases, developers are adding apartments, grocery stores, hotels and offices, while still scaling back excess store space.

Trademark Property Company is planning to redevelop a 470,000-square-foot center in Arlington, Texas, by reducing the retail space by about half and adding office, residential, hotel and entertainment uses.

Similarly, Shopoff Realty Investments plans to turn a Macy’s and vacant Sears that bookend Westminster Mall, south of Los Angeles, into housing and about 25,000 square feet of food retail space, like restaurants. The project is part of the firm’s strategy to buy and convert distressed retail properties. It typically reduces shop space 60 to 90 percent, said Bill Shopoff, founder of the company, which is in Irvine, Calif.

“There’s a sufficient number of these opportunities to keep our pipeline well stocked for a number of years to come,” he said.

Open-air centers in high-growth markets such as Phoenix, Nashville and Austin, Texas, are leading the resurgence, said Ms. Scardina of Cushman and other industry experts. High-end malls have tight vacancies as well, she added.

Shoppers at Vineyard Towne Center, a 260,000-square-foot shopping center in Queen Creek, Ariz.Credit...Adam Riding for The New York Times

The industry also experienced an uptick in demand in recent years as shopping in person enjoyed a mild resurgence and more retailers began using stores as distribution points. Nationally, the average rental rate of nearly $24 per square foot in the first quarter of this year was almost 4 percent higher than it was a year earlier. In some cases, landlords are able to raise rates on new leases by more than 30 percent from the previous lease, said Terry Montesi, founder of Trademark Property Company, a retail and mixed-use property developer in Fort Worth.

The current environment is reigniting investor interest. Because retail properties were out of favor, their values in general did not rise as much as apartments and warehouses over the past several years. As a result, shopping centers can generate an attractive yield compared with those pricier assets in a time of stubbornly high interest rates.

“Retail real estate fundamentals are the strongest they’ve been in my career,” said Mr. Montesi, who started Trademark in 1992. “The capital markets haven’t completely come around to retail, but they’re warming up.”

But a handful of threats could derail the good times. Most notably, industry experts say, consumers are feeling squeezed by inflation and have pulled back on discretionary spending, as recently reported in Walmart’s and Target’s quarterly earnings. Shopping center owners and retailers alike are being pressed by higher interest rates as well as the increasing cost of construction and insurance, all of which are elevating occupancy expenses.

Investors are also keeping an eye on troubled retailers, as more apparel stores like Express and Rue21 file for bankruptcy and major retailers like Macy’s and Walmart close low-performing locations.

In the meantime, shopping centers are looking better than they have in a long time, and spaces that become vacant are often snapped up quickly by other tenants.

During the pandemic, the developer NewMark Merrill secured pre-lease commitments for 100 percent of its Rialto Village project, a 96,000-square-foot center that opened last year in California’s Inland Empire region, said Sanford Sigal, chief executive of the group. A decade ago, pre-leasing commitments typically filled 65 to 70 percent of a center, he said.

“Every time I went to a party of any sort and would tell someone I was in the shopping center business, people would say, ‘Oh, you poor thing!’” said Mr. Sigal, who bought four shopping centers in Chicago for roughly $100 million this year. “So the idea of getting calls from brokers the day after a store announces closings is very unusual. Maybe we’re the cockroaches of the earth-extinction event.”