MORE AND more of America's malls are going vacant, elevating property exposures.

Hope for America's Malls?

Mall vacancies elevate property and general liability risks, but offer opportunities for revitalization.

BY KATIE SIEGEL

Mall operators and real estate investors have some extra challenges to face — both man-made and weather driven — when stores become underutilized due to shrinking foot traffic or become vacant altogether.

The last new enclosed shopping mall in America opened in 2006. In the years since, oversaturation, a stagnant economy, and online shopping have beaten malls soundly into submission.

"Monolithic enclosed malls are being challenged," said Alexandra Glickman, managing director of insurance and risk management with Arthur J. Gallagher & Co.'s real estate division in North America.

Photos of "dead malls" depict weed-ridden parking lots, rotting ceilings, filthy floors and long-defunct escalators. Since their boom in the '60s and '70s, America's malls have dwindled in number and economic strength. Though most have yet to reach that state of decay, the struggling health of big box anchor stores like Sears and J.C. Penney suggests it won't be long before more of these massive retail centers slip down the same slope.

According to Reis Inc., a real estate research firm, the rate of retail vacancy has not budged from 7.9 percent over the past year, but is expected to grow in traditional, enclosed malls.

About half of America's malls are anchored by Sears and Penney's, both of which have been rapidly closing stores. Sears has shut down more than 300 locations since 2010. J.C. Penney announced plans in January of this year to close 33 stores and lay off about 2,000 workers. When heavyweight anchors go out of business, decreased foot traffic affects the entire mall.

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ELEVATED EXPOSURE

Empty properties invite vandalism and theft, and can serve as backdrops for other criminal activities from illegal dumping to robberies, assaults and drug dealing, according to Glickman.

"Boarded up shops are going to change the type of person that's walking into those malls," said Henry Felix, senior vice president and Bermuda branch manager of Allied World's property division.

"It's going to potentially introduce a high level of crime, if you have a high level of vacancy and low level of security."

According to "Managing Risks in Vacant and Idle Buildings," a 2010 Willis report, "90 percent of theft in idle and vacant facilities involves copper electrical or plumbing materials." The practice, referred to as "urban mining," had been on an upward trend for three years.

Property damage can also stem from an owner's neglect. Upkeep of empty properties tends to fall off the radar, making them susceptible to things like collapsed roofs and burst pipes.

"Every winter, I get calls about pipes bursting," said Steve Sallen, president and CEO of Maddin Hauser Roth & Heller PC, where he focuses on business, environmental and real estate law.

"The longer it takes to discover damage and get it repaired can be the difference between a manageable loss and a total loss, because water is so destructive when it's left to sit in a vacant or abandoned building."

Mold resulting from stagnant water can render a property "uninhabitable" and require a complete tear down, Sallen said.

Roof leaks can also snowball from a small issue into a catastrophic loss should water damage lead to a collapse.

"Just because no one is there to complain doesn't mean damage isn't being done," Sallen said.

However, lack of maintenance doesn't present the biggest threat.

"General liability incidences for malls are high frequency but relatively low dollar amount claims," said Jeff Alpaugh, global real estate practice leader at Marsh. The truly catastrophic claims arise out of Mother Nature's mood swings. Wind, fire and flood damage cause the biggest losses.

The Willis report stated that fire is "the most prominent and costly peril facing an idle or vacant building." The U.S. Fire Administration estimated that between 2003 and 2006, fire caused $642 million in property damages each year. One reason for that is fire's speed.

"Materials such as metal can absorb heat and transmit it to other rooms by conduction, where it can cause new fires to break out," said Scott Wolf, executive vice president of AmWINS Brokerage of Texas.

David Bailey, vice president of claims, added, "Radiation transfers heat in the air, until it too sets off secondary fires, spreading the danger away from its original location."

Summary

- **Struggling anchor stores are leaving more malls vacant.**
- **Vacancies increase risk for vandalism, theft, water and fire damage.**
- **Developers are replacing empty stores with non-retail attractions to increase foot traffic.**

AN OUNCE OF PREVENTION

Owners of under-used or empty properties can take several steps to minimize the risk of fire damage, including maintenance of automatic sprinklers and alarm systems. According to the Willis report, temperatures inside a building need to remain above 40 degrees Fahrenheit to prevent pipes from freezing, and sprinklers must stay connected to adequate water supply.

"You need to be careful to economize both maintenance and security," said Eamonn Cunningham, risk manager for Scentre Group, a real estate management company.

"Reducing those will not only have an impact at that particular location, but put your brand at large at risk. You need a certain level of operating expenditure to maintain the standard consistent with customer expectations."

"We had one client develop multi-family space above a mall — condos and apartments."

— JEFFREY ALPAUGH, GLOBAL REAL ESTATE PRACTICE LEADER, MARSH

Other prevention strategies include "eliminating unnecessary combustibles in the building as well as ignition sources," including trash and overgrown grass or weeds. A clean appearance also doubles as a security measure, deterring vandals and thieves.

"We insist on the same if not heightened level of security," said Felix of Allied World.

"We expect insureds to maintain a consistent level of risk management practices, that shouldn't be impaired by one of their locations deteriorating in their financial performance."

Mall owners tend to cut down on security personnel when stores struggle, but adequate lighting and 24-hour closed-circuit cameras can take their place, along with alarm systems and regular inspections to check for physical damage.

Wolf and Bailey also recommended securing roof access to air conditioning units or other machinery that has copper wiring.

"An ounce of prevention is worth a thousand pounds of cure," Sallen said. "[Property] is an asset and it needs to be looked after. If you ignore it, it will go away."

Maintenance also pays off in attracting prospective tenants and maintaining carriers' confidence. It can be "nearly impossible" to place insurance on a vacant property, but exclusions can sometimes be granted for strong security systems and good loss history.

TRANSFORMATION AS RISK MANAGEMENT

The best risk mitigation practice a mall owner can undertake, however, is to completely redevelop an empty space into a non-retail attraction. According to Cunningham "good quality data flow based on the mall's financial operations leaves mall operators well-placed to intervene early and reduce the likelihood or impact of poor operating conditions."

"You have to look at ways to replace anchor stores with something that will provide consistent, week-in, week-out foot traffic, and transform shopping malls into experiences," Felix said.

"You need to offer something different from the overall shopping experience for the customer."

Many turn to movie theaters and upscale restaurants to fill the void, but some developers are also building gyms, office space and residential buildings.

"We had one client develop multi-family space above a mall — condos and apartments," Alpaugh said.

"Others are looking for theme attractions that would bring more families to malls as a destination."

Upscale malls, which have always provided higher-end amenities, prove that this model works. They seem not to have been touched by the same economic woes of mid-level malls.

"The space of mall operators has become bifurcated between malls that are essentially servicing affluent, urban areas and the more mid-level malls which are suburban in their locality," Felix said.

"Those are the ones that are struggling more. The upper level malls' anchor stores are typically going to be a Saks or a Neiman Marcus rather than a Sears or J.C. Penney."

In addition to offering more expensive wares and targeting the wealthy, high-end malls have been ahead of the curve in adjusting to consumers' shopping habits and desire for a fuller experience. More shoppers, for example, want to browse and order products online, but then pick them up in-store for convenience and the ability to ask questions.

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"It keeps people coming in, without losing customers to online shopping," Felix said.

Open-air mall designs also drive foot traffic, providing a better visual experience and ease of navigation for consumers.

Adopting open designs, which allow entry to any store from a parking lot or outdoor walkway, also eliminates some property risk associated with internal infrastructure. It means less ceiling to inspect and maintain, less space to heat and air condition, and smaller surface area susceptible to water and wind damage.

Retail Store Closings and Planned Closings

Abercrombie & Fitch — 180 stores by 2015
Aeropostale — 175 stores over next few years
American Eagle — 150 stores by 2017
Barnes & Noble — 223 stores by 2023
Brown Shoes/Famous Footwear — 145 stores in 2014
Build-A-Bear — 88 stores by 2015
Children's Place — 125 stores in 2014
Coldwater Creek — 365 stores in 2014
Express — 50 stores by 2017
Game Stop — 128 stores in 2014
Golf Galaxy — 54 stores by 2016
J.C. Penney — 33 stores in 2014
Jones Group (Easy Spirit/Jones NY/Nine West) — 170 stores in 2014
Juicy Couture — 70 stores in 2014
Kmart — 80 stores in 2014
Office Depot/Max — 400 stores by 2016
P.S. from Aeropostale — 125 stores in 2014
RadioShack — 200 stores by 2017
Sears — 300 stores in 2014
Staples — 225 stores by end of 2015
Target — 12 stores in 2014
Toys "R" Us — 100 stores, no timeline

Sources: 24/7 Wall St. and About.com

ADAPTATION AND GROWTH

In the suburban town of Media, Pa., the Granite Run Mall opened to fanfare in 1974 but has been in steady decline for years. While it has maintained its major anchor stores, other popular retailers have jumped ship, rendering the mall an enclosed ghost town.

BET Investments, a real estate investment and development company, bought the property in 2013 with prospective plans for a movie theater, bowling alley and four-story luxury condominiums. The core of the mall would also be demolished to create an open-air structure.

While the plans remain tentative, Granite Run's transformation could provide other real estate investors with a blueprint to revive America's dilapidated malls.

"I believe people will always want to go to a store and have immediate assistance and purchasing power," Sallen said. "Good properties in good locations that are well-maintained will always do well."

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