

**MEMORANDUM**

**Date:** December 19, 2018

**To:** Katherine King, Assistant Director, Community & Economic Development, City of Kalispell, MT

**From:** Jesse Silverstein, Director-Real Estate Economics, Development Research Partners, Inc.

**CC:** Blase Leven, Technical Assistance to Brownfields (TAB), Kansas State University

**RE:** Retail Business Opportunities and Absorption Analysis for Kalispell, Montana

---

The following research and analysis evaluate household supply and demand for retail goods and services in the City of Kalispell, Montana. The relevant trade area in this evaluation includes Kalispell and the surrounding Flathead County. Retail goods and household services demand and supply are evaluated to identify both undersupplies and oversupplies. Finally, business opportunities are evaluated regarding potential commercial real estate absorption.

**The Market for Retail Goods**

According to data provided by ESRI, Kalispell’s median household disposable income was about \$36,000 in 2017 and household demand for retail goods totaled about \$260 million annually.

**Figure 1. Number of Businesses by Category in Kalispell, Montana**



*Source: ESRI Retail Marketplace Profile; Development Research Partners, Inc.*

Figure 1 above details the types and number of businesses in the City. In Flathead County, a much larger surrounding region, median household disposable income was about \$40,000 in 2017 and household demand for retail goods totaled about \$1.4 billion annually. Within the City of Kalispell there were over 340 retail, food, and drink businesses in 2017.

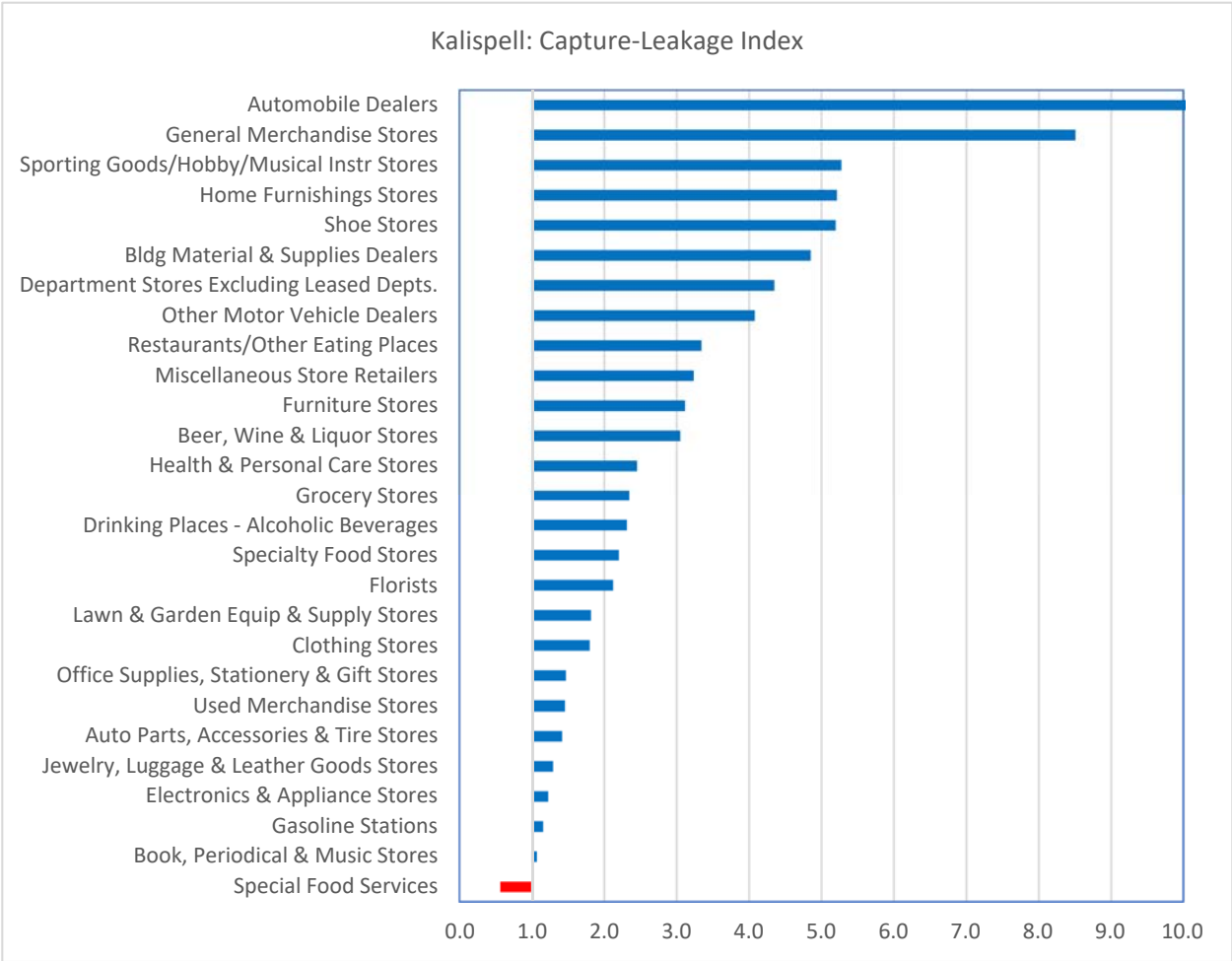
### ***Retail Leakage Analysis***

Retail leakage refers to goods that local consumers buy locally versus how much local consumers purchase outside their local market. If a retail category is selling more goods than local consumers can financially support, it is assumed that the local market is "capturing" consumer dollars from outside. Examples where retail capture occurs: tourism destinations; unique destination shopping; and products being shipped to outside buyers. Retail "leakage" occurs when local consumers are buying goods outside of their local market. Leakage can occur for many reasons including people traveling for work or pleasure, an undersupply or lack of choice in local products, and e-commerce.

Based on sales revenues versus local consumption, a capture-leakage index is developed. Figure 2 below illustrates the retail capture-leakage index by retail category in Kalispell. An index of "one" indicates local demand is exactly matched by local supply. An index greater than one indicates the local market is capturing outside consumer purchases; and an index less than one indicates local consumer dollars are leaving the local market as leakage.

As can be seen below in Figure 2, Kalispell's retail market is well-served in all retail categories but one. This is attributable to Kalispell being the largest population and commerce center for a very large, rural, geographic region. Kalispell retailers serve local residents, residents across Flathead County, and across the region including Canada.

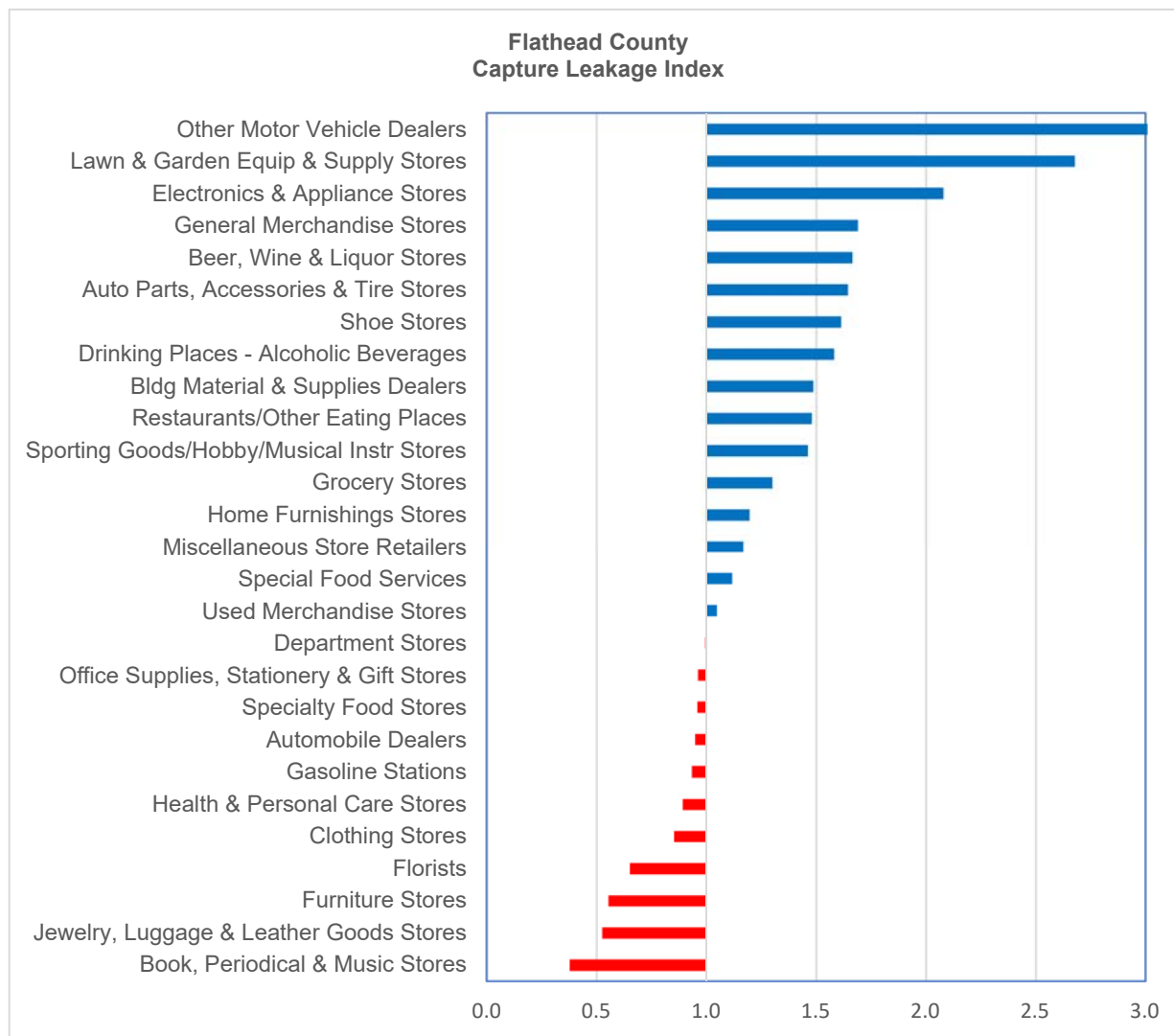
**Figure 2. Capture-Leakage Index in Kalispell, MT**



*Source: ESRI Retail Marketplace Profile; Development Research Partners, Inc.*

The only retail category that is underserved is Special Food Services which includes food service contractors, caterers, mobile food services, vendors for institutions, and food concessions at sports and similar facilities. However, special food service businesses in Flathead County as a whole, including the City of Kalispell, are meeting local demand. Because consumers and products are fluid and easily cross contiguous market borders, it is useful to evaluate the County’s market as a whole. Figure 3 below illustrates the retail capture-leakage index by retail category in Flathead County.

**Figure 3 Capture-Leakage Index in Flathead County, MT**



Source: ESRI Retail Marketplace Profile; Development Research Partners, Inc.

It is not surprising that The City of Kalispell does not capture all County resident spending and, as expected, the County shows more leakage than Kalispell. Retail categories that show county-wide leakage are generally businesses that lend themselves to small scale, single-proprietors; e-commerce; or in the case of furniture and clothing stores, destination shopping outside the County.

U.S. Census e-commerce data (2016 data released May 2018) shows online sales to account for about 8% of total retail sales nationally. Flathead County's (including Kalispell's) e-commerce sales would likely be above the national levels given its rural setting. With \$4.1 Billion in county-wide demand and assuming 10% ecommerce penetration indicates about \$140 million annually in e-commerce sales. Total leakage from the County is estimated at about \$55 million, leaving about \$85 million in consumer cash -equivalent purchases, 6% of total

demand, that is leaving the County. On a relative scale, this is a rather small amount and not atypical. There should be little concern that e-commerce will be detrimental to brick and mortar retailers.

Currently, the retail market in Kalispell seems to well-serve local market demand. In other words, there does not currently seem to be a local shortage of goods in any retail category. Bolstering local demand are households from surrounding Flathead County and the greater region that use Kalispell as a shopping destination. Kalispell's tourist economy further brings in consumer spending. Brand diversity and healthy competition is always good for a local economy and anecdotal data indicates that Kalispell would be very welcoming to additional women's clothes stores and small-footprint grocery stores such as Trader Joe's, Sprouts, or Aldi's for example.

Retail trends in products, physical formats, and interactive experiences are everchanging. It should be noted that during the course of this study the Herbergers department store chain closed, including an 80,000 square foot location in Kalispell. The data analyzed in this report does not reflect that closure but the market impact can be imputed based on anecdotal analysis. The Herbergers store was very successful and its absence will be missed; this indicates a strong source of retail demand that is now not being met. Stated alternatively, there is now additional unmet demand that should strengthen sales at all other retailers in town and create opportunities for new retailers to offer items and services no longer available.

Big box and department stores are struggling and currently a smaller footprint is better suited to today's retailers. While the now vacant 80,000 square foot Herbergers store does represent additional space for the market to absorb, its size and functional utility places it in a category of special-use property that can be re-occupied, or more likely adaptively reused for large footprint users such as a climbing gym, banquet hall, community space, or other special purpose tenant. In today's market this space is in a class of its own and is not expected to significantly impact the need for well located, smaller, functional space for today's retailers.

This discussion above should not imply there are not opportunities to add and grow retail businesses, quite the opposite. This high-level analysis only examines how well served the local Kalispell market is. There is business growth opportunity from at least two other sources: (1) local population growth; and (2) regional population growth and tourism growth, both generating additional destination shoppers. Employment growth will drive population growth and is assumed to already be captured in the broader measure of population change: population growth is assumed to include people moving to Kalispell for a job.

### ***Demand from Tourism Growth***

There is abundant evidence of the impact of visitor spending. Tourism is a significant basic industry in Kalispell's local economy. The Kalispell Chamber of Commerce, notes that 60% of Flathead County's workforce is employed by businesses that depend on outdoor recreation. In turn, much of Kalispell's outdoor recreation businesses cater to tourists.

The University of Montana's Institute of Tourism & Recreation Research (ITRR) reports an estimated 12 million tourists spent \$3.16 billion across Montana in 2016. The Northwest Montana region attracted 32% of all nonresident dollars spent in the State, or about \$1 billion in direct spending, the report says. The study further estimates that Flathead County benefited from the second-highest amount of that spending, about \$506 million in tourist spending. The Kalispell Chamber of Commerce/Convention & Visitor Bureau estimates Nonresident Travel is 20% (the largest single category) of Flathead County's economic base. Glacier National Park saw a record

3.3 million visitors in 2017, a 10% increase over the approximately 3 million visitors who came to the park in 2016, and marked the sixth consecutive year visitation has increased at the park.

Kalispell's Glacier Park International Airport had a record number of passengers in 2017: 539,588 total passengers, compared to 492,522 the previous year. Kalispell participates in this visitor market and is known as the "outfitters" for the region, and also serves as a base camp for many visitors to the larger region. The Kalispell Convention and Visitors Bureau reports that 803,645 nonresident visitors (including an estimated 21,000+ international visitors) spent at least one night in Kalispell during 2016, a 12% increase from the previous year.

ITRR's 2018 2017 Nonresident Visitation, Expenditures & Economic Impact Estimates states that visitor groups to Montana spends about \$75 daily on retail goods including gasoline, diesel, restaurants, bars, groceries, and other retail goods. Visitor groups are groups traveling together which average about 2.2 persons per group. This implies that if 803,645 people stayed a day in Kalispell, then about 365,300 groups spent \$75 each while there, totaling \$27.4 million per year. The estimated contribution from overnight groups staying in Kalispell is about 10.5% of the City's \$260 million in annual retail demand.

While tourism in the region has been experiencing a positive trend in recent years, it can fluctuate from year to year for many reasons. A University of Montana ITRR "2017 Trends & 2018 Outlook" Tourism Business Survey (January 2018) reports: about half of Montana tourism businesses had an increase of visitor volume in 2017 compared to 2016; a little over a quarter of business had a decrease; and slightly less than a quarter experienced the same volume. Additionally, compared to 2016, 10% fewer businesses expect to see an increase in 2018 and only 47% are expecting an increase.

Today's development decisions are based on projected market conditions. It is assumed that \$27.4 million in annual tourist spending in Kalispell will grow 5% annually. For the purposes of this analysis growth is estimated at \$1.4 million annually or \$7.2 million over five years. Assuming this growth rate holds, and applying a \$300 per square foot in average retail sales, implies a demand for about 5,000 square feet of new retail space each year. Over five years it is projected that 25,000 square feet of new space will be demanded by retailers.

### ***Demand from Local and Regional Population Growth***

Flathead County saw a 6.6% population growth from 2011 to 2018<sup>1</sup>. During this period annual growth rates ranged from 0.3% to 1.1% (excluding 2013 which experienced an atypical 1.5% growth rate). The most recent trend since 2016 illustrates a 1% annual population growth. Similarly, REMI forecasts a County growth rate averaging about 1.1% for each of the next five years.

Kalispell is the largest city in Flathead County (and the largest city in northwest Montana), and ranks as the third fastest growing city in the state after Bozeman. The city of Kalispell has seen a total 15.7% population growth between 2010 and 2017 according to Census and American Community Survey data. During this time annual growth rates have varied from 0.9% to 3.2% and averaged 2.1% annually. The most recent years, 2016 and 2017, have had the highest rates trending around 3%.

---

<sup>1</sup> Montanan Department of Commerce; REMI; Development Research Partners, Inc.

Weighing estimated annual population growth rates from the County and City, this study assumes that regional population, and Kalispell retail demand, will increase about 2.5% annually over the next five years.

With \$260 million total in net demand for retail goods in Kalispell, and deducting \$27.4 million attributable to tourist spending, means local and regional residents spent about \$232.6 million annually in Kalispell during 2017. A 2.5% increase in population and household demand equate to about \$5.8 million in additional retail demand in 2018. Assuming this growth rate holds, and applying a \$300 per square foot in average retail sales, implies a demand for about 19,400 square feet of new retail space each year. A five-year projection totals 97,000 square feet of space demanded from retailers over the next five years.

### Retail Opportunities in Kalispell

The above discussion highlights several observations regarding the City of Kalispell:

- It is well-served by retailers to meet the needs of its residents
- Both the City and Flathead County are experiencing positive population growth
- Kalispell is growing at a higher rate than the overall County as the trend of migration to more urbanized areas continues.
- Despite being well-served in retail categories, there is growing unmet demand being driven by population growth and tourism

In evaluating current market conditions, a five-year construction cycle is used as the projection period to estimate market demand. Demand for new retail space in Kalispell during the period 2108 through 2022 is estimated to be:

#### **Kalispell: Total Projected Retail Absorption: 2019 through 2023**

	<u>Annual Demand</u>	<u>5-Year Demand</u>
New Local & Regional Population Growth	19,400	96,500
New Tourism Growth	<u>5,000</u>	<u>25,000</u>
<b>Total Square Foot Demand:</b>	<b>24,400</b>	<b>122,000</b>

## Summary and Conclusions

The preceding analysis estimates the current state of Kalispell's retail market and forecasts demand growth and real estate absorption over a five-year term. Short-term projections are important to translating growing demand into square feet of space absorption. It is the growth outlook in the short-term that drives real estate development today.

Estimating unmet retail demand is challenging in Kalispell in that it is the largest City in a large region, with destination shoppers coming from as far as 100 miles away or more, and a tourist stop and destination for many visitors. Capture-leakage analysis shows a local market that is well-served with existing retailers. However, exploring sources of demand shows that regional demand and tourism are behind growing the demand for retail goods and services. Assuming that current local supply and demand from all sources are in balance, population and tourism growth will drive demand for even more retailers, and in turn, demand for new retail space.

It is estimated that near-term growth in demand (up to 5 years out) can support the absorption of an estimated 122,000 square feet of retail and commercial space. Overall, the retail market outlook is positive and should support development.

Development feasibility is highly dependent on site specific and business specific characteristics. Due to the nature and limitations of the high-level analysis presented herein, it is recommended that specific development projects evaluate feasibility for that project as proposed and at that point in time.

###