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Retail Tenanting Techniques

by Jennifer Norbut

These fundamental strategies can help to revitalize neighborhood centers.

Upticks in consumer spending and hints at economic improvement are fueling some long-awaited positive momentum in the retail sector. Despite the mild industry buzz, the latest data reports offer the view many property owners see when they look around their markets: Vacancy for strip centers rose to 11.0 percent nationwide in 2Q11 — just 10

basis points below the two-decade high of 11.1 percent vacancy in 1990, according to Reis.

Nowhere is the impact of vacancy felt more than in small retail centers, which rely on the health of not only their tenants, but the surrounding community. However, CCIMs say there is some good news: “All is not lost for neighborhood shopping centers,” accord-

ing to James J. Dunphy, CCIM, of Dunphy Properties in Tampa, Fla. “There are plenty of service-oriented users and restaurants out there requiring space. If you can provide convenience and service with the traditional attributes of a good location, you will be successful long term.”

To make the best of the current market, owners and landlords of small retail centers must be flexible, focused, and creative. But the one thing landlords don’t have to be is rocket scientists. In fact, CCIM retail experts around the country say that the formula for remaining viable under these conditions is rooted in fundamental marketing and tenanting techniques.

Negotiate, Negotiate, Negotiate

Similar to the sluggish and uneven nature of the commercial real estate market’s recovery, leasing strategies for small retail centers vary depending on a variety of localized

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factors. While tenants in one center may be motivated by free rent, another may want tenant improvement dollars, while another may seek early occupancy. Regardless of the location or center, the key to securing new leases in this environment is flexibility.

In some markets, time is on the tenant's side. "We have offered early occupancy in lieu of free rent, allowing the tenant to take possession 30 to 90 days prior to lease commencement," says William W. Hyatt, CCIM, of LanDel Realty in Fairhope, Ala. "In some cases that allows the tenant to rehab the existing space or build out new space."

Common incentives in strong markets, TI allowances can help tenants ink the lease. In the current market, Hyatt says he's offering TI allowances in the \$10 per square foot to \$30 psf range, depending on whether the property is being rehabbed or if it's a new build-out.

With economic uncertainties weighing heavily, cash-strapped property owners may

not have the luxury of offering TI allowances. "I've found lately that landlords do not have the capacity to provide TI allowances due to market constraints or lack of financing," says Jorge A. Rodriguez, CCIM, director of retail at Colliers International in Orlando, Fla. To help move deals forward in these situations, Rodriguez has opted to secure rent abatement periods that are equal to "market" TI amounts.

For instance, in a recent transaction, "I represented a national retail chain on an 86-month lease where the landlord provided a rent abatement period of 26 months in lieu of providing the typical TI allowance." This arrangement resulted in five years of rental income to the landlord, and the tenant was pleased with the concession. The abatement period only applied to base rent, requiring the tenant to pay operational expenses at occupancy, he adds.

Offering shorter lease terms, free rent, and graduated rent structures also may help to secure tenants in small centers. In fact, "many landlords prefer to offer free rent over tenant improvement money these days," says Alaina H. McGlothlin, CCIM, sales associate at CB Richard Ellis in Oklahoma City. "Offering a period of six to 12 months of 50 percent rent is another way to meet the needs of both landlords and tenants."

Specifying and spreading out the rent-free months provides landlords with another negotiating tactic. "Offer additional free rent if tenants will take it in months 12, 24, 36, and 48 instead of during 60 days on the front end of the lease," says A. David Zoller of The Weitzman Group in Dallas.

Ultimately, before going to extreme lengths to lease up vacant spaces, landlords must conduct thorough due diligence. "The most important thing to evaluate in this market — and what the deal you offer is dependent on — is the credit and financial stability of the tenant," says Gary W. Lyons, CCIM, SIOR, vice president of Investment Sales and Corporate Services at Lincoln Harris in Raleigh, N.C. "It's important to understand the operating history and experience of who you are getting into your center."

Target Service Tenants

"Service tenants are ideal for smaller centers," Lyons says. Financial and insurance

companies, dry cleaners, hair and nail salons, restaurants, convenience stores, and special medical service providers, such as dentists and chiropractors, all benefit from the easy access, parking ratios, and complementary tenant mix of neighborhood centers. And, these localized service businesses generally are looking for the same things when choosing a location: "Good visibility, strong traffic counts, and high foot traffic areas," Lyons adds.

In centers that can support larger, national tenants, "it is helpful to have an anchor that has some name or brand recognition," says Christopher Baj, CCIM, a commercial specialist with Michael Baxter & Associates Commercial Real Estate and Property Management in Stroudsburg, Pa. "The tenant can be national, regional, or even local as long as there is some name recognition," which makes the center attractive to both customers and other tenants.

However, for many smaller neighborhood retail centers, high-profile anchors are not a standard component of the tenant mix. A range of franchisees as well as local mom-and-pop businesses generally fill the storefronts of these properties. As a result, these centers present a prime opportunity for CCIMs to lend their expertise. "As CCIMs, we need to help the owners of these centers understand what tenants can afford to pay each month," says Charles A. "Mac" McClure, CCIM, chairman of McClure Partners in Dallas. "In this age of \$24 to \$30 triple-net rents, it can be impossible for a hair or nail salon to create sufficient income to pay the rent." In some cases, landlords must "reduce the rent to where a tenant can make a living" while making sure the pro forma for the income of the business moving into the space makes sense, McClure adds.

Landlords may not have to look too far to find prospective tenants. "Target in-market prospects and find out what it will take for them to move," Zoller says. Landlords who have a competitive edge should "consider buying out [a prospective tenant's] lease for a long-term deal at an above-market rate." While it may seem like a hard sell to lure a tenant across town at an above-market rate in the current climate, Zoller sees it as an opportunity. "Our goal as brokers is to show

them what they can accomplish in sales by asking them, ‘If you could do 14 percent more in sales, wouldn’t it be worth paying 4 percent more in rent?’”

Where competition is tight, attracting in-market tenants requires landlords to pay extra attention to details, such as the signage, landscaping, parking lot upkeep, and other aesthetic aspects of the property. To sway prospects, “we have to be cleaner, brighter, cheaper, and more in touch with tenants’ needs,” Hyatt says. As part of the deal, some relocating tenants may be looking for extra incentives, such as rent reductions and early occupancy. If a center can offer these things, “it gives you a competitive edge against other centers.”

However, tenant relocations may require an extra step in the due diligence process to ensure landlords are seeing the whole picture. “I usually contact the corporate office if they are franchised tenants to find out if they are relocating due to declining sales, problems at their current location, or corporate relocation mandates,” advises Samuel S. Fung, CCIM, principal with Oregon Commercial in Medford, Ore.

FINDING FRIENDS AND FOLLOWERS

Social media outreach has become an integral part of the marketing strategy for mega retailers such as Walmart and Target, which have amassed more than 7.7 million and 5.2 million fans on Facebook alone. Landlords and owners of small retail centers can quickly and affordably adapt a similar strategy on a smaller scale to create awareness for their property as well as for their tenants.

For instance, Samuel S. Fung, CCIM, principal of Oregon Commercial in Medford, Ore., recently helped a client create a Facebook presence that includes each tenant’s business. Instead of only relying on print advertising or snail mail, “if a tenant has a special promotion or discount sale, they can post it on Facebook in real time,” he says. Fung also helped a restaurant tenant maximize its presence on Facebook by uploading pictures of specialty dishes as well as a video about the restaurant.

“Internet marketing tools like Facebook and LinkedIn are free,” Fung notes. “Every retail center — large or small — should take advantage of these tools.”

Market on a Micro Budget

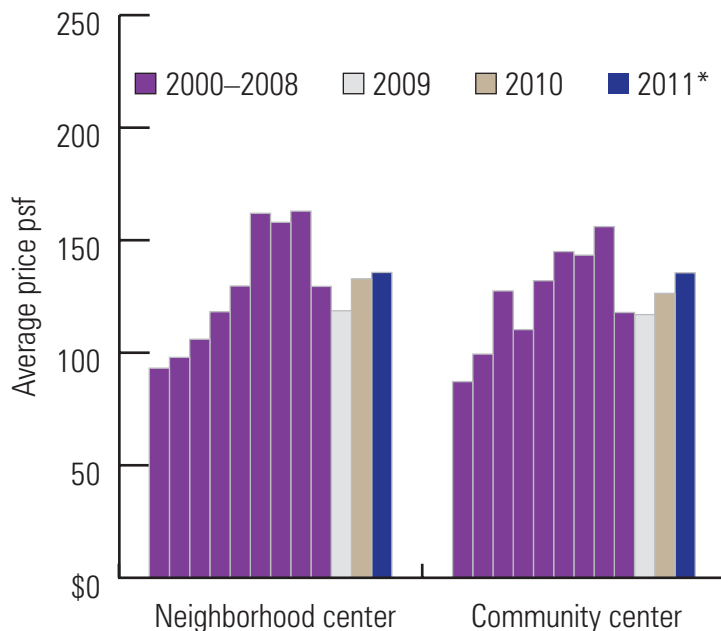
Marketing a challenged center — one that is in a poor location or has low traffic counts — requires tremendous creativity, Lyons says. “Most landlords of smaller centers are not capitalized well enough to spend large sums of money. The goal is to keep the capital outlay to a minimum but provide enough incentives to motivate the retailer to make a commitment.”

Creating co-tenancy arrangements can infuse new energy into centers as well as improve the overall tenant mix, CCIMs advise. “A doughnut shop has heavy morning traffic, sub shops are heavy at lunch, fitness centers are busy after normal work hours, yogurt shops are busy between 2 p.m. and 5 p.m. and after dinner hours,” Hyatt says. The revolving traffic restaurant tenants create benefits other service businesses such as medical-related services, convenience stores, and hair and nail salons.

With so much of the interest in small enters coming from local drive-by traffic, it’s critical to “effectively utilize any of the property’s on-site monument signage to promote awareness and availabilities,” Rodriguez says. Though contrary to the high-tech online marketing capabilities available today, old-fashioned techniques still have value: Posting banners, affixing marketing brochure boxes to the property’s exterior, and hanging window posters are effective ways to gain attention at very small centers, according to CCIM experts.

Tried-and-true, low-cost improvement projects, such as enhancing signage, updating landscaping, cleaning windows, and keeping the property litter-free can make an impression as well, Baj says. “And don’t forget to upgrade your image with existing tenants,” he adds. “Prospective new tenants frequently talk to existing tenants to see how happy they are in their location and space. Word of mouth still goes a long way today.”

NATIONAL RETAIL CENTER PRICING TRENDS



* Estimated through 1H11
Includes Sales \$1M+
Sources: Marcus & Millichap Research Services, CoStar Group, Inc.

Jennifer Norbut is senior editor of *Commercial Investment Real Estate*.