

WESTERN REAL ESTATE BUSINESS®

Connecting Real Estate in the West

KEEPING THE LIGHTS ON

WREB sat down with some of the West's top brokers, owners and legal eagles to discuss the impact of e-commerce, downsizing and the recent wave of store closures on this area's retail market.

By Nellie Day

WREB: It seems like we're hearing about more and more tenants, particularly anchor and junior anchors, vacating shopping centers over the past couple of years as entire industries change due to e-commerce and other factors. Is this the case?

Jeff Badstubner, Senior Vice President, JLL: I believe tenants both big and small are seeing their business models shift as e-commerce becomes more popular. Store sizes, for example, have gotten a bit smaller. Store layouts have changed as retailers try to re-engage the customer with more

interaction, using larger entrances and more lively displays.

In order to look ahead, you need to always be viewing new developments across the country to understand the new concepts and the new formats anchor tenants are using. To see some examples of the trends among changing users, look at tenants such as drug stores, which continue to downsize stores.

WREB: What type of due diligence can you execute as a landlord to ensure (to the best of your abilities) a tenant will be able to maintain occupancy for the duration of its lease?

see *RETAIL*, page 44



Sierra Vista Mall in Clovis, Calif., is anchored by Kohl's and Sierra Vista Cinemas 16. Notable nearby anchors include Target and Sears. The mall is managed by the Woodmont Company.

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RETAIL from page 1

Grant Gary, President of Brokerage Services, the Woodmont Company: From a leasing standpoint, continuous occupancy clauses and limited co-tenancy provisions are of utmost importance. Market and tenant due diligence is critical to ensure a tenant has the highest likelihood of maintaining occupancy in a project. A few due diligence items of importance include: knowing your competition; competitive rental rates; occupancies and competing landlord motivations; knowing your market; and knowing your tenant, their operating performance and history of default within your own portfolio.

WREB: Is there anything about the West's retail/shopping center environment in particular that makes this area more or less prone to backfill situations?

Brian Bielatowicz, Senior Vice President, Lee & Associates: Speaking to core markets in California, these markets have a big advantage due to strong tenant sales, strong demographic characteristics, low vacancy rates and the ability to release quickly as core markets are preferred expansion areas for tenants.

New growth, suburban and non-core markets are more prone to vacancies due to higher existing vacancy rates, being dependent upon future housing growth, demographic characteristics not meeting minimum tenant requirements in some cases and the reality that non-core markets are typically secondary in priority for tenant expansion plans.

WREB: What actions should a landlord take if he or she suspects a tenant may not be able to live out the duration of its lease?

Gary: Always have a Plan B. If a tenant has reported several quarters of declining comp store sales or given an indication of declining performance, begin working on the backfill plan for the space. This may include determining the costs to downsize and/or split the box, a merchandising plan and prospective tenant list, and communication with the tenant, your lender and partners to ensure a smooth transition if you must re-tenant the box. If this



The 735,000-square-foot Menifee Countryside Marketplace is the second largest shopping center in Southwest Riverside County. It contains one 4,026-square-foot available shop space for lease, which is being handled by Lee's Bielatowicz.

is a publicly traded retailer, be sure to read their 10-K. This report is arguably the single most important report specific to a complete health review of a tenant.

WREB: Are there specific, practical items a landlord can include in a lease that will protect them in the event an anchor needs to close?

Dan Villalpando, Partner, Cox, Castle & Nicholson: A landlord should request a recapture right if a tenant goes dark. That way, the landlord can regain control of the space. If the landlord recaptures, he or she should recover out-of-pocket tenant improvement costs, as well as brokerage commissions.

WREB: When is it most problematic, from a landlord's perspective, to have a tenant close?

Badstubner: If you as a landlord have a poorly kept center and the tenant mix has been ignored, the replacement tenant will know and use it against you for extensive concessions. The balance of the center should be in good condition and health. However, if you are proactive in discussions, maintain a good-looking center and maintain an attractive covenant lineup, the new tenant will have a bigger desire to get into your center as it has already proven to be successful.

WREB: How can a landlord navigate through this unpredictable time for the retail industry?

Bielatowicz: They can do this by watching sales of tenants to anticipate possible closures. Watching your tenant option term notification windows. Watching mergers. Know your tenant's market requirements. Monitoring media and financial reporting of retailers. Paying special attention to how co-tenancy and exclusive clauses are negotiated in new leases going forward. It's also important to have the ability to review a layout of a tenant's plans, and to pay attention to future repurposing, should this new tenant fail.

WREB: How can a landlord maintain the upper hand when negotiating with a new tenant to backfill space?

Villalpando: Staying positive about the value of the center, the local draw and the demographics would be key in trying to maintain an upper hand. Just because one type of core merchandise doesn't work doesn't mean that another will not. The landlord should expect to make some form of rent concessions to the backfill tenant. This may be in the form of reduced

rent for a short period of time, or a lower average rent over the course of the term of the lease. The backfill tenant may also look for a shorter lease term (five years versus 10 years) to make sure that its business is viable.

WREB: Can a tenant vacancy ever be a good thing?

Bielatowicz: Landlords sometimes look forward to these opportunities to potentially upgrade a tenancy. It can be a possible windfall economically relating to the lease terms, which adds value to the overall asset. It can also improve the financial modeling for lenders and investors, making it much easier to undertake backfilling opportunities.

WREB: What are some of the difficulties landlords should expect to encounter once an announcement has been made that a store is closing?

Villalpando: Negative publicity is probably the biggest difficulty a landlord can expect once an announcement has been made that a store is closing. Ideally, the impact on the rest of the center will not be catastrophic, but a negative buzz can impact whether customers come to the center.

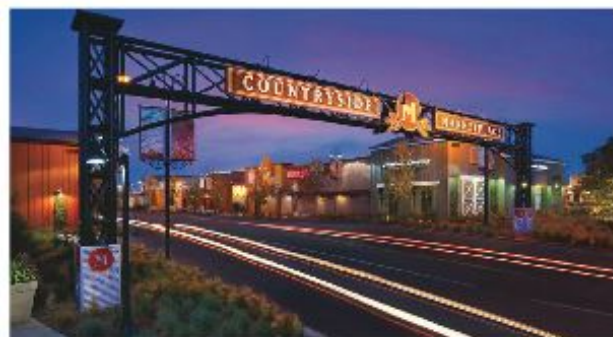
A careful review of a landlord's leases to check whether the closure will impact any co-tenancy provisions is also recommended, sooner rather than later. The closing of an anchor may trigger the rights of other tenants to pay modified rent or even close themselves. As soon as the landlord can announce that it has a backfill tenant, or tenants, to replace an anchor tenant, they should do so — particularly if the new tenant is in any way better than the previous one. ■



Bielatowicz



Villalpando



Tenants at Menifee Countryside Marketplace in Riverside County, Calif., enjoy an anchor presence that includes Super Target, Lowe's and Kohl's.