



European Retail Property School

ICSC European Retail Property School 2014

Leasing Shopping Centers: The Overview

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Leasing Overview

- Retail & Leasing Professionals- **The Teams**
- The Basic Lease and It's Language
- Making the Deal: Salesmanship & Special Deals
- Research & Selection of Tenants – **Tenant Mix**
- **Demographics & Psychographics**
- Temporary, Specialty Leasing & Kiosks
- Tenant **Qualification** Process
- Lease Management, Administration & **Change**
- Maximizing Value & Managing Risk



Leasing Team – All The Players

- **In-House Employees/Contract 3rd Party**
- **Tenant Agents/Landlord Agents**
- **Lawyers/Landlord & Tenant Authorities**
- **Architects/Tenant Coordinators/Store Planning**
- **Asset Manager/Center Manager/Marketing Manager**
- **Retailer Merchandising/ Center Operations**
- **What's Special about Retail Leasing?**



The Lease & It's Language

- **The Lease is the Legal Relationship**
 - **Parties to the Lease**
 - **Description of the Leased Premises**
 - **Term or length of the Lease**
 - **Consideration or amounts paid by Tenant**
 - **Execution of the Lease**
 - **Rights and obligations are often lengthy and in detail**



The Lease & It's Language

- **Primary Consideration** is the **Base or Fixed Minimum Rent**
- **Secondary Consideration**” is the potential to earn future **Turnover/Sales/Percentage Rent**
- **Tertiary Consideration** is the **reimbursements to the Landlord** of Operating Expenses often called Common Area Expenses or Service Charges. These usually include Maintenance, Real Estate Taxes and Insurance costs plus any appropriate Administrative Management Costs to keep the individual return level over the lease



The Lease & It's Language

•Retail Leases Are Different Than All Other Commercial Leases – Why?

- There is an implied partnership between the parties but not a legal one
- Actions by the Landlord **can directly affect** the Tenant's business in ways that are not present in office or residential real estate
- Opportunity to do **multiple leases** with same retailer
- Carries a responsibility for the shopping center professional to embrace and learn as much as possible about the **retail world**



The Lease & It's Language

•Continued

- In addition to the Primary, Secondary and Tertiary sources of income for the Landlord, the retail lease carries considerable number of **lease clauses not found in other Commercial Leases**. Let's quickly review these today and later in the week there will a more in-depth coverage on the clauses
- I have also provided to you a special handout on **Leasing Strategies, Lease Terms, Valuation & Risk** which I hope will be a valuable resource for you



The Lease & It's Language - Clauses

•Retail Clauses

•*Note in my handout, I separate those clauses that **Create Revenue**, that **Preserve Revenue** and that **Hurt Revenue** and go against the **Triple Net Concept***

•**Use Clause**

•**Exclusive Use**

•**Restrictive Use**

•**Continuous Occupancy**

•**Continuous Operation (including Hours of Operation)**

•**Diversion of Sales (Radius)**

•**Advertising, Signs & Graphics**



The Lease & It's Language - Clauses

•Retail Clauses

- Merchant's Associations/Marketing Funds/Grand Openings
- Co-Tenancy
- Parking
- Insurance, Indemnification & Damages
- Assignment
- Subletting
- Landlord Relocation Right



The Lease & It's Language - Clauses

•Retail Clauses

- Allocation of Common Area or Service Charges (Pro Rata Share)
- Timing and Methods of Reconciling Service Charges
- Base Rents indexed for CPI and Service Charges either full pro rata share or at minimal, indexed
- Recovery of all other reimbursable expenses
- Turnover/Percentage Rents
- Reporting of Sales Turnover even if not paying turnover rents
- Default Provisions
- Specific Operational Guidelines for Retail Properties



The Lease & It's Language - Negotiation

•Basics Of Lease Negotiation

- Understand your center and the **available spaces** (combinations)
- Understand the retailer's needs/history in the market; **qualification**
- Make a **realistic offer** that balances the retailer's ability to have appropriate **Occupancy Costs** and related Turnover Rents
- Know your bottom line and hold to it. Its **OK to "walk away"**
- Look for creative ways to **"trade"** on business and legal points
- Follow up all meetings with **written confirmations**
- Understand that the **first well done deal** can lead to many more



Tenant Mix – Why It Is Important

•Definition of Tenant Mix

Tenant Mix is simply the selection and location of retail tenants to maximize the sales of all of the respective retailers, stimulate business and excitement in general and maximize the income of the Landlord hopefully via Turnover Rents and maximum Market Base Rents

Developing the proper Tenant Mix for each center requires:

- Determining the right **location** in a market area
- Determining the right scope or **size** of the center
- Understanding the market **demographics & psychographics**
- Developing the right mix of **unit sizes** for Anchors, middle & small
- Placement** of the various categories of retailers and service tenants where a synergy will create the best possible experience for shoppers



Tenant Mix - Demographics

•Definition of Demographics

- Demographics are the current statistical characteristics of a population. These types of data are used widely in Sociology and Marketing
- Commonly examined demographics are gender, race, age, disabilities, mobility, home ownership, employment and location of sub-groups
- Shopping Center Owners and Retailers have used this type of information for years to seek new locations and develop and deliver merchandise to target communities



Tenant Mix - Demographics

•Demographic Profile Types (Cohorts)

- **Lost Generation** (1883-1900) Fought in WWI
- **Greatest Generation** (1901-1924) Fought in WWII
- **Silent Generation** (1925-1945) Not old enough for WWII
- **Baby Boomers** (1946-1964) Post WWII
- **Generation X** or Baby Busters (1961-1981)
- **Generation Y** or Millennial (Mid-1970s to early 2000s)
- **Generation Z** or Internet Generation (early 1990s to present)
- **Generation AO** or Always-On Generation (early 2000s through 2020?)



Tenant Mix - Psychographics

• Definition of Psychographics

Psychographics is not to be confused with Demographics but it is complementary. Psychographics deals with the attributes relating to personality, values, attitudes, interests or lifestyles

While Demographics pools groups (cohorts) into say gender and age, it will not determine whether older men prefer wine, beer or whiskey. Psychographics is the leading tool used in developing market strategy once the “Generation Cohorts” have been considered



Tenant Mix - Psychographics

- **Psychographic Profile Types** *(Source: The North Crossing.com)*
 - **Belonger** – 40%, Average person with strong values
 - **Achiever** – **5-7%, Serious business person chasing more**
 - **Emulator/"Wanna be"** – 15%, Wants to be an Achiever, but isn't
 - **Socially Conscious Type A** – **25%, Want to make the world a better place**
 - **Socially Conscious Type B** – Isolationist/Idealists
 - **Balanced/Totally Integrated** – 1-2%, Mixture of Achiever and Socially Conscious Type A
 - **Needs Driven** – 15%, Impulsive, and buy at the moment



Tenant Mix – The Center Environment

•The Typical Center Profile Types:

- | | |
|--|--------------------|
| •Super-Regional – US | 100,000 m2 plus |
| •The Regional – US / Europe* | 40000 - 100,000 m2 |
| •Super Community – US | 15000 – 450000 m2 |
| •Community – US | 10000 – 35000 m2 |
| •Neighborhood –US | 3000 – 15000 m2 |
| •Retail Parks – Europe / US* | 5000 – 15000 m2 |
| •Power –US / Europe | 25000 – 60000 m2 |
| •Specialty / Entertainment – US / Europe | 10000 – 25000 m2 |



Tenant Mix

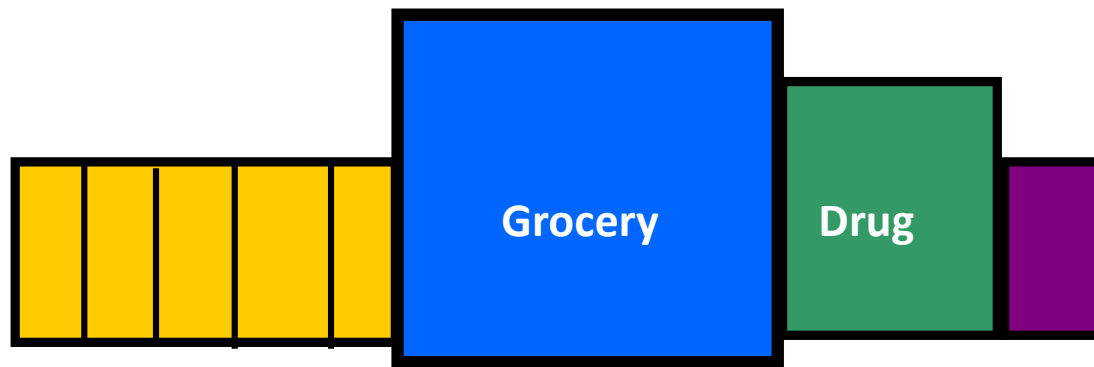
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•Center Profile Types (continued)

- | | |
|---|---------------------|
| •Outlet – US / Europe | 5000-40000 m2 |
| •Hypermarket Center – Europe | 30000-60000 m2 |
| •High Street – Europe / US | Street Level/DS |
| •Mixed-Use – US / Europe | Office/Hotel/Retail |
| •Street Level Retail – Europe | 25-1000 m2 |
| •Convenience Retail – US / Europe | 1000-3000 m2 |
| •Downtown Urban Development – US / Europe | 5000-20000 m2 |
| •A Comment on Mexico | Department Stores |

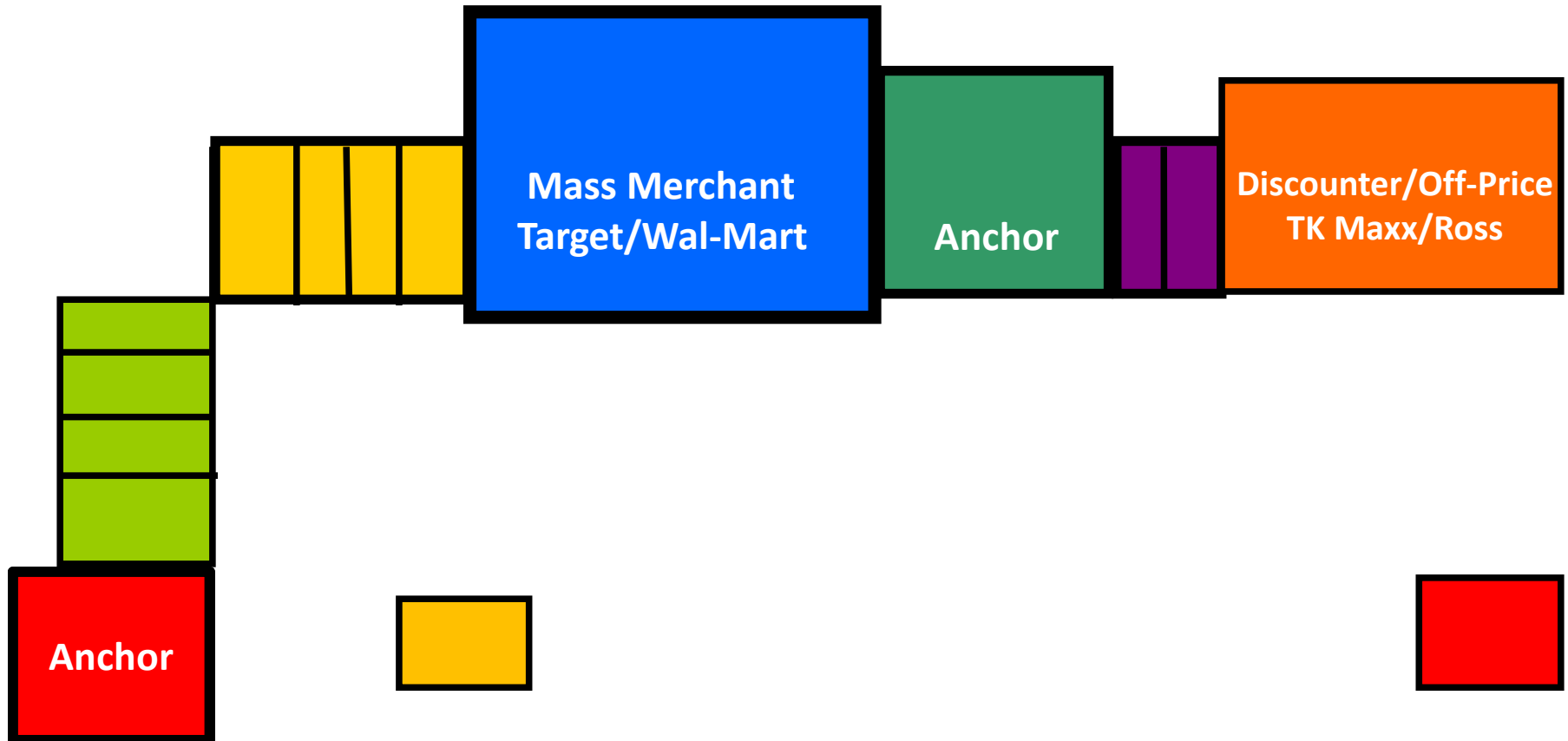


Tenant Mix – Typical US Neighborhood Center



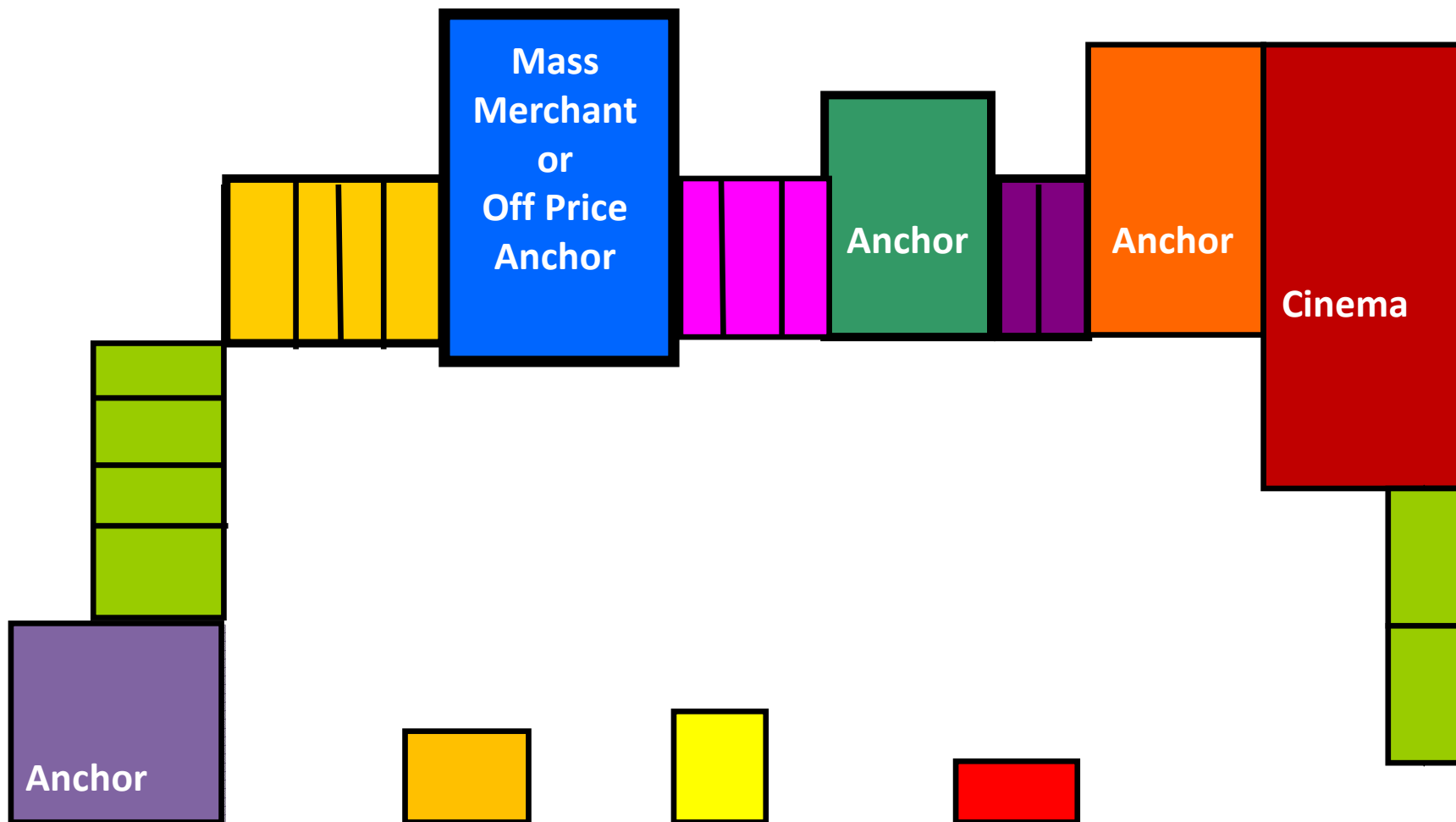


Tenant Mix – Typical US Community Center



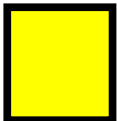
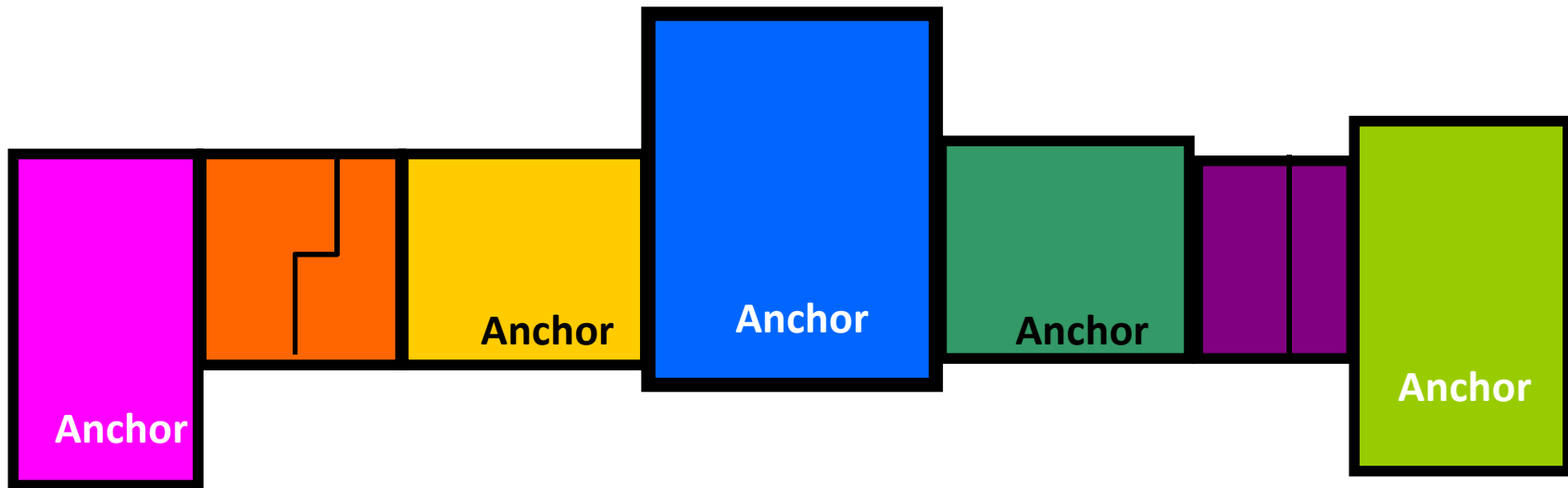


Tenant Mix – Typical US Super Community Center





Tenant Mix – Typical US Power Center



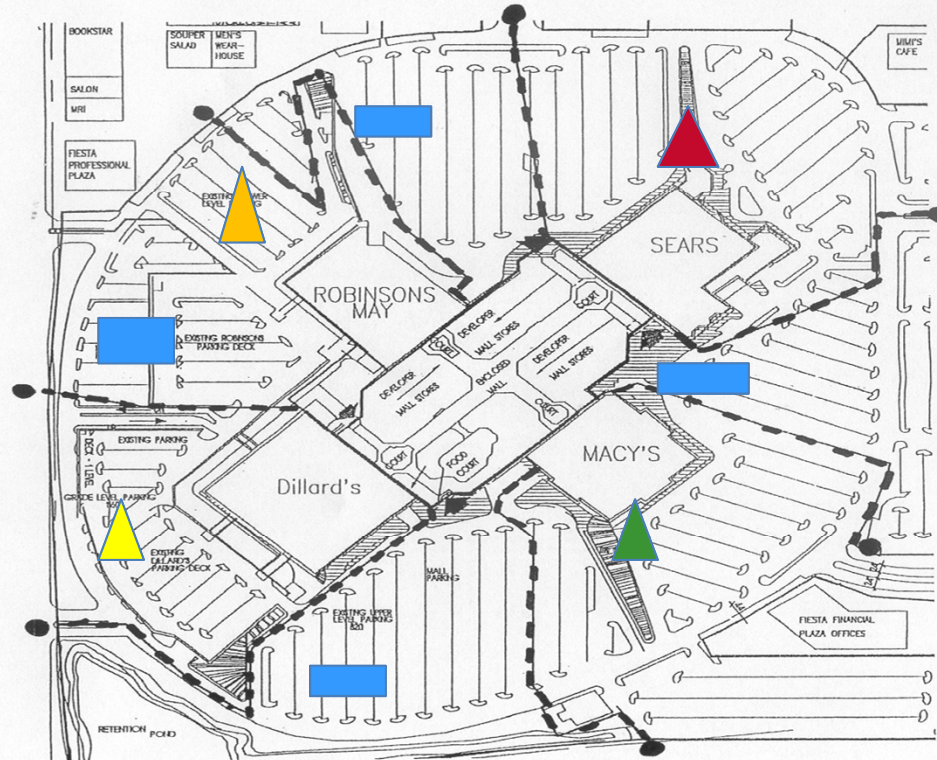


Tenant Mix – Typical US Super Regional Mall



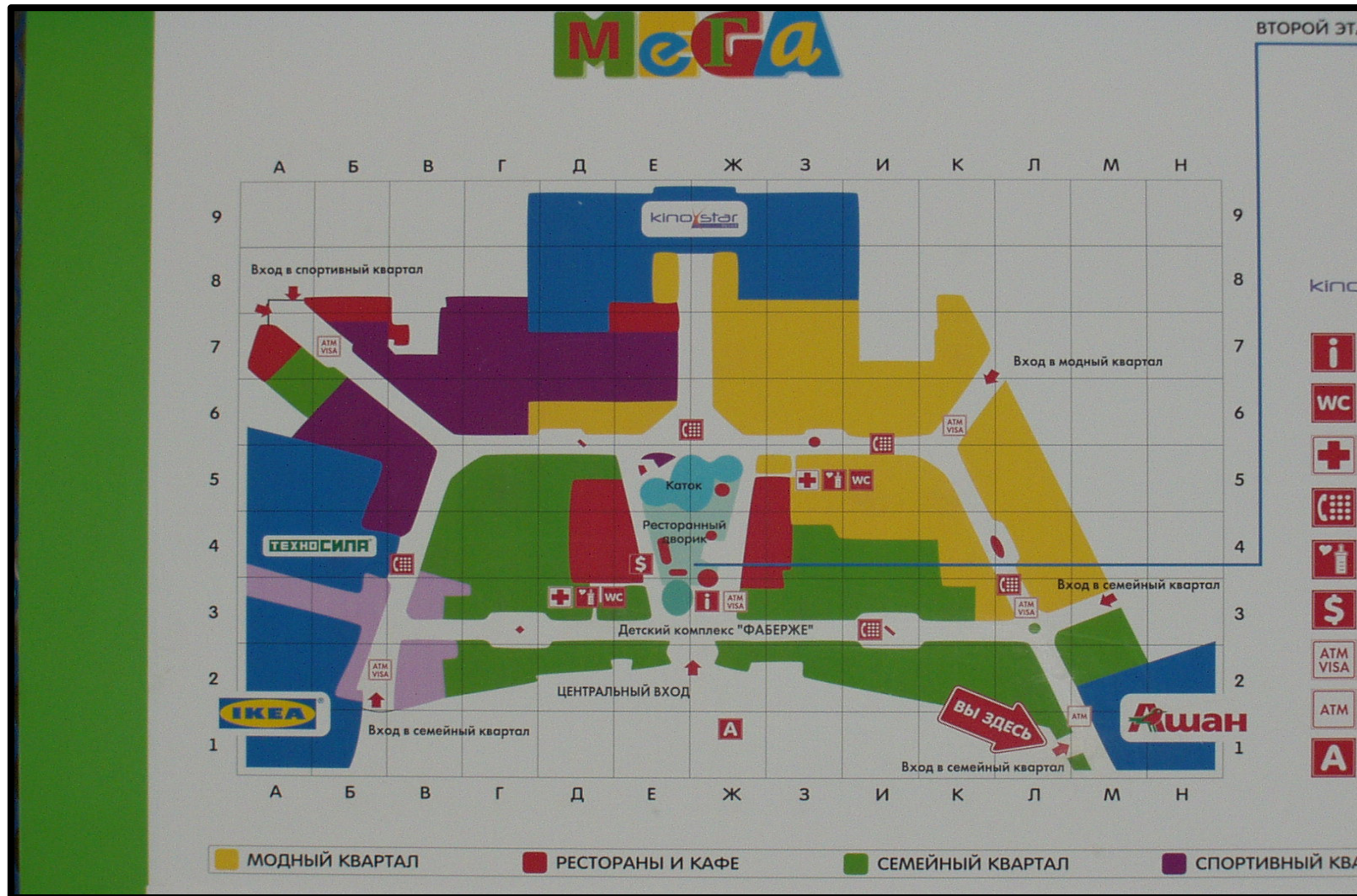
Fiesta Mall
Mesa, Arizona

site plan





Tenant Mix – Typical Moscow Regional Mall





Tenant Mix – Typical Moscow Regional Mall





Tenant Mix – Typical European Urban Mall





Tenant Mix – Typical Mexico City Mall/Mixed Use





Tenant Mix – Typical US Lifestyle/Mixed-Use Center





Tenant Mix – Typical US Theme/Lifestyle Center





Tenant Mix – Typical US Neighborhood Center



Corner Pad Site for Future



Tenant Mix – High Street Retail - Vienna





•Relevance of Merchandise Mix

- Types of Tenant Mix – **Use/Activity Clusters, Price-Point Positioning**
- Impact of Tenant Mix on Attracting Additional Tenants – **H&M, Zara, Grocery/Hypermarket, Family Fashion, “French Fashion”, Discount**
- Impact on Turnover Sales Volume
- Impact of Anchor Tenants – **Create Footfall, Co-dependency**
- Critical Mass /Size of Center



Determining Rental Rates & Creating Value

- **Comparables / Competitors**
- **Benchmark Rent / Development of Minimum Rents**
 - **Location in Center**
 - **Size of Space**
 - **Competition Within Center**
 - **Clusters of Categories**
 - **Occupancy Cost Ratio / Effort Ratio**
- **Percentage / Turnover Rent**
- **Tenants Who Generate Highest and Lowest Volume**
- **Function of Turnover Sales Volume Potential**



Determining Rental Rates & Creating Value

- **Definition of Comparable**
 - Capable of being compared; having features in common with something else to permit or suggest comparison
- **Definition of Competitor**
 - Competitive- well suited for competition; having a feature that makes for successful competition
- **As Market Studies are prepared, keep in mind a brick and mortar building with retailers may not be a Competitor but only a Market Comparable**
- **Comparison Grid (Of Competition)**



Determining Rental Rates & Creating Value

• **Benchmark Rent / Development of Minimum Rents**

- **Principals of Economics** (see my Leasing Handout)
- Location of and in the Center
- Size of Space
- **Frontage & Depth – 1:3 maximum as a general rule**
- Clusters of Categories – **Activity, Use, Price-Point**
- Competition Within Center of Similar Segments
- Competition Outside the Center with Competitive Centers
- Comparison Grid for Market Rents
- **Market Rents versus Pro Forma Rents**
- **Occupancy Cost Ratio**



Determining Rental Rates & Creating Value

•Occupancy Cost

•Occupancy Cost **represent the ability to cover the directly allocated expenses of the lease such as minimum rents, service charges, utilities and any associated marketing costs**

•The Ratio is calculated by taking the expenses above divided by the total sales for the period. This produces a ratio (percentage) of expenses to sales. For example, as small retailer has **\$450,000** in sales for a period and the minimum rent and other costs they pay is **\$28,000**, **$28,000/450,000=.06$ or 6%**. That is a average to low occupancy cost.



Determining Rental Rates & Creating Value

Occupancy Costs

•Occupancy Costs

•**Occupancy costs** are a direct indicator of a Tenant's ability to pay their lease expenses and remain in business. As a general rule the following apply:

- Costs that are less than **6%** are **very positive** in most cases. This has a natural relationship why most Landlords see a 6% Turnover Rent Factor being reasonable
- Costs that range between **7% and 10%** are **viable** on a case by case basis but might be on the Landlord's Tenant watch list, case-by case
- Costs that are between **12% and 18%** represent **concern** for the retailer and is associated with poor rental payment history
- Costs exceeding **18%** represent a tenant that will **likely fail** in the near term



Determining Rental Rates & Creating Value Typical Turnover Breakpoint % Factors

•Although there can be, and are variances in the market to those below listed **Break-Even Sales/Turnover Rent Factors**, these can be used as a guideline for most leasing activities:

•1.5% to 2.5% (maximum 4%) for High Volume Sales Turnover / Low Margins such as **Grocery Stores**

•5% to 8% average retailer volumes on balance such as **Fashion**

•8% to 10% represents tenants that have low volume sales but high margins such as **Jewelry Stores**

•Ultimately there is a relationship between **Occupancy Cost and a normal, functioning Turnover Rent Factor**



Determining Rental Rates & Creating Value Turnover Rent Calculation Example I

- **Turnover Rent Only Scenario**
- **Turnover Rent With a Natural Break Point**
- **Turnover Rent With an Arbitrary Breakpoint**
- **Turnover Rent With a Spilt Breakpoint Scale**
- **Reporting of Turnover Without Turnover Rent Due**



Determining Rental Rates & Creating Value

Valuation of Real Estate – The Three Methods

•Cost Approach:

The value estimate based upon the reproduction cost of improvements

•Market Approach:

The value estimate based upon direct comparison of subject to other properties that have been sold

•Income Approach:

The value estimate based upon the subject property's income.
The primary method used to value shopping centers



Determining Rental Rates & Creating Value

Value – (Market Value) not Investment Value

Income Approach:

- The value estimate based upon the subject property's income. The **primary method used to value shopping centers**
- Uses the Center's Net Operating Income (NOI) as the basis of value estimation



Determining Rental Rates & Creating Value

- **The IRV Formula Elements**
- **Value (V) – Estimated Market Value for all Parties**
- **Income (I) NOI – The Economic Engine**
- **Rate (R) – The Simple Rate of Return Produced**
- **NOI (Net Operating Income) is used to Estimate Market Value. It is the single indicator of the performance of a property. **Let me explain****



Determining Rental Rates & Creating Value

Base Rents

$$\begin{aligned} &+ \text{ Other Income} \\ &= \text{ Gross Operating Income (inc. reimbursements)} \\ &- \text{ Operating Expenses (all non-capitalized)} \\ &= \text{ ***Net Operating Income*** (Before Debt Service)} \\ &- \text{ Debt Service and Capital Expenses} \\ &= \text{ ***Cash Flow***} \end{aligned}$$

- ***Cash Flow*** represents the **performance of the investment** for the owner and not the **performance of the property**



Determining Rental Rates & Creating Value

Formula for Income Capitalization to Estimate Value

- $I / R = V$ (Income is NOI)
- $I / V = R$
- $R \times V = I$



Determining Rental Rates & Creating Value

V = Value

R = Rate (Rate Of Return)

I = Income (Net Operating Income)

$$I \div R = V \quad 100 \div 10\% = 1000 \text{ Value}$$

$$I \div V = R \quad 100 \div 1000 = 10\% \text{ Rate}$$

$$V \times R = I \quad 1000 \times .10 = 100 \text{ NOI}$$

$$\frac{I}{R} \times \frac{1}{V}$$



Determining Rental Rates & Creating Value

Example I of Changes in NOI Affecting Value

Would spending \$50,000 for an energy savings program be justified to obtain A \$10,000 increase in NOI?

NOI increase	\$ 10,000
Rate on incremental increase	\$ 11.5% **
Value increase	\$ 86,956.52
Cost For incremental NOI	\$ 50,000
Net increase in value over expense	\$ 30,956.52



Determining Rental Rates & Creating Value

Example II of Changes in NOI Affecting Value

Productivity of Space:

- You have a **900 M2** space that is currently earning € 16. M2 mo. or €172,800 per annum
- You split the space into **two (2) 450 M2** spaces that will earn € 20. M2 mo. or € 216,000 per annum
- This incremental income of **€ 43,200.** per annum will increase the value of the center by **€ 375,652** (cap of 11.5%)
- **Note:** that the Cap Ex used for this division of space is capitalized and not included in off-sets for Market Value



Determining Rental Rates & Creating Value

- **Maximizing The Value of the Center is the Landlord Team's Primary and Driving Responsibility**
- **Increasing the NOI is where the Leasing & Management team should focus & by minimizing **The Four Threats to Value**. These are:**
 - **Threats to Income Stream**
 - **Threats to Market Position**
 - **Threats to Physical Health**
 - **Staying in Sync with Owner's Goals & Objectives**



ICSC Trends In Retail Leasing

•Ownership Trends

- Landlords – REITS, Funds, Quick-Flip Developers
- Retailers – Larger number of “Groups”
- Architects

•Refurbishing Older Centers – Important in Market

•Expansion of Existing Centers – Economies of Scale

•Consumer Trends – Demands in Service, Convenience, and Current Goods & Services



Trends in Retail Leasing - Data & Information

- **E-Commerce** – The Internet
- **M-Commerce** – Mobile Applications
- **T-Commerce** – Tablet Applications
- **Customer Centric Retailing** – Customer Loyalty Cards
- **Home Delivery** - by Retailers & driven by age and income



Class Evaluation:

Please remember to complete the class evaluation by using your smartphone or tablet.

Class Evaluations Link:

survey.icsc.org/2014ERPS

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SESSION:
INSTRUCTOR(S):
Please rate the following by circling the appropriate number.

SESSION:	Excellent	Good	Fair	Poor	
1. Satisfaction with the program overall.	5	4	3	2	1
2. Session increased my knowledge.	5	4	3	2	1
3. Content was timely and relevant.	5	4	3	2	1
4. Session and materials were organized.	5	4	3	2	1

INSTRUCTOR(S):	Excellent	Good	Fair	Poor	
1. Satisfaction with the instructor overall.	5	4	3	2	1
2. Instructor demonstrated a strong command of the information.	5	4	3	2	1
3. Instructor was enthusiastic, professional and kept me engaged in the learning.	5	4	3	2	1
4. Instructor provided practical and relevant examples?	5	4	3	2	1

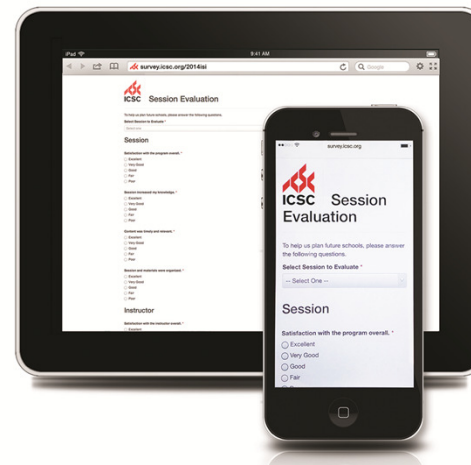
COMMENTS:

1. What issues, challenges or trends are you dealing with now that could be recommended for future education sessions?

2. What is the most valuable takeaway you gained from the session?

3. What enhancement would you recommend for the session?

4. Additional comments?





**•Thank you very much for your attendance today
and enjoy this experience by building your personal
networks starting TODAY!**

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