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Shopping Center Execs Say Holding Onto Current Tenants is Top Leasing Strategy

Marcus & Millichap; Donahue Schriber, Cousins Properties and Stirling Properties Give Leasing Advice to Retail Landlords and Leasing Agents

This week, the International Council of Shopping Centers held a webinar on "Successful Leasing Strategies in a Volatile Market" featuring an esteemed panel of open-air shopping center industry executives who offered their views on effective leasing strategies in the current environment.

Managing director of research services for Marcus & Millichap, Hessam Nadji, began the strategy session with an overview of the key economic drivers affecting today's retail real estate market, and addressed expectations for the impending recovery.

"There is plenty of positive evidence that suggests the worst is over in what is now being called the 'Great Recession,'" said Nadji, but warned the economy still faces risks and headwinds. "We've seen the steepest job loss since the great depression, but now that loss has moderated, showing the end is near. We anticipate the job loss cycle will hit bottom by the end of 2009 and the economy should be poised for recovery in 2010," he added.

Analyzing the housing market as the "foundation of the consumer in many ways," Nadji noted that the velocity of home sales has improved over the last several months. However, the bad news is that 30% to 40% of the most recent sales are comprised of foreclosures or short sales. Nadji expects the home pricing cycle will bottom out in first quarter 2010.

In past recessions, Nadji pointed out, consumers responded to the Fed lowering interest rates by buying houses, which made the recession(s) short lived. That has not been the case this time around. "The effect on the consumer in this recession has been dramatic and has had a deep effect on retail sales and the retail real estate industry," added Nadji.

While retail sales showed the mildest year-over-year decline and were better-than-expected last month, Nadji warned the industry to prepare for the worst-case scenario, which he described as a "muted and difficult" recovery, one in which consumers will continue to face debt issues and a lack of jobs in the 12 months following the bottoming of the employment losses.

Addressing concerns over store closures and retail vacancy, Nadji said the industry has been afflicted with a "dramatic loss of tenants," citing ICSC's historical and forecasted major store closing announcements, which totaled 6,913 in 2008 and predicted to total 5,500 stores in 2009.

"The effect of store closures on retail vacancies has been incredibly sharp because retail was the only sector in which construction actually went up during 2001-2003 because there was so much consumer stimulation going," he continued. It's good that retail construction has come to a "screeching halt," he added, but the drop-off in new supply was too little and too late because, "the (current) pipeline is big enough to cause vacancies to rise well into 2010 before we expect a peak in vacancy rates," he said.

On the investment side, Nadji noted that the pricing gap and credit crunch have driven property sales activity down 75% to 90%, depending on the price range of the assets. However, "in recent months we've seen a narrowing of the pricing gap as more product comes to market at more reasonable prices and buyers begin to recognize the fact that the discounting is not the same across the board because property

CONTINUED: Shopping Center Execs Say Holding Onto Current Tenants is Top Leasing Strategy

quality and market quality still matter in this environment," he said. "What we're seeing now is a market basic re-definition of how to underwrite and value properties."

He added that cap rates on multi-tenant properties have risen at a rate of 100-200bps, depending on the product type. Nadji said there are signs showing a "thawing of credit markets, but overall, a rather difficult financing market is expected over the next few months."

LEASING STRATEGIES

Marty Mayer, president of Covington, LA-based Stirling Properties and Lawrence Casey, COO of Los Angeles-based Donahue Schriber, were the first to offer up how their firms altered their leasing strategies in response to the "rash of retailer bankruptcies and resulting vacancies."

Above all else, Mayer and Casey agreed that keeping existing tenants intact is key.. "Once you have a vacancy, it's much more difficult to lease," said Mayer. "Consider the tenant improvement dollars and leasing commissions and the downtime being much longer to replace that tenant," he added, noting that rent levels for new leases are trending down faster than rental rates for renewals.

Stirling said he is looking ahead at least one to two years to see which tenants are scheduled to roll over and then evaluate those retailers in terms of sales performance, occupancy costs -vs- sales, and how the store is doing relative to other stores in the same chain. He then categorizes each tenant, placing them on one of three lists: "Healthy," "Watch" or "Critical." He said doing so helps him determine if vacancies can be avoided and where to focus his resources.

Mayer and the other panelists agreed that maintaining current tenants and seeking to secure early renewals is the lead strategy with their portfolios today. Lawrence Casey, COO of Los Angeles-based Donahue Schriber said that, in his experience, most tenants approached about early renewal are willing to talk, while only "20% tell us to come back later."

Mayer said retailers are interested in renewing their leases early if they can get something of value from doing so. Usually he said they push for lower rent and occupancy costs. But on the flip side, they're willing to give on co-tenancy and use clauses, said Mayer, adding that the question then goes back to the landlord judging his needs.

For example, if there is a large lease expiring in one year on a center that needs to be refinanced or have its loan extended in one to two years, "then you need to look ahead and think how you're center's going to look at that time and it would probably behoove you to renew" the tenant, said Mayer.

Steve Yenser, executive vice president of leasing and development for Atlanta-based Cousins Properties, said meeting with tenants on rent and occupancy costs issues can present an important opportunity.

"A lot of times, a discussion starts about a specific center, but it usually can expand into a broader discussion about their other stores in your portfolio. So the opportunity is there to get into a renewal conversation on another center while you're talking about concessions for other stores in their portfolio."

On rent relief, Casey said that Donahue Schriber is also closely tracking the health of its tenants, which means the company knows in advance which tenants are struggling and if there is "substance" to their rent relief requests.

"We're basing our rent relief on their cost of occupancy, but its not scientific. It's a question of what they can afford to pay to get them through this difficult time," said Casey. The tenant has to give some, too however, on issues like co-tenancy and use restrictions, he said. Generally, "any refunds of CAM or insurance or taxes would not be refunded to a tenant on rent relief," added Casey.

Mayer said that Stirling has spent more time on market research, sharing information on the market dynamics of a specific center with retailers so that they can make the most educated decision on whether

to remain at a center.

All the panelists said a major strategy for them this year was to improve leasing by strengthening their teams. "We have the whole team much more involved, from the property manager, to the leasing person, to the asset manager and our marketing and research department," said Mayer.

Casey said Donahue Schriber "doubled its leasing resources overnight" by moving dealmakers from their acquisitions and development departments into leasing. Additionally, the company moved its construction staff into tenant coordination with the goal of getting tenants open as fast as possible. In doing so, Donahue Schriber said it has kept its personnel largely intact, and expects to capitalize on those resources when the market does recover.

Some firms have bolstered their leasing staffs as well. Donahue Schriber hired leasing personnel in their markets that faced the most challenge from high vacancies. Cousins has hired more local brokerage people to work with its leasing personnel to source local and regional tenants for specific centers.

Casey pointed out that cold calling is "critical" in today's market and Yenser said its best to pound on the doors of local or regional operators that are already in business that may be interested in getting into a better center or new trade area.

Yenser said that prior to this recession, Cousins, since it specializes in lifestyle and power centers, made 80% of its leasing deals through the national tenant market. With that expansion market nearly shut down, the company has had to go outside of its "comfort zone" to expand its tenant pool by reaching local and regional retailers, something it wasn't really doing before when it felt tenants were "replaceable," often at better rental rates.

Yenser explained why sourcing local and regional tenants could be more challenging. "As you're looking into the local and regional tenant communities, the ability to finance those operations become critical," he said, explaining that Cousins is spending a lot of time carefully evaluating whether a tenant will have the ability to perform.

Mayer said another challenge in doing deals with local and regional retailers is getting the financials to work. "These retailers are going from B locations to A locations at B rental rates, so there's opportunities for strategic move-ups. However, if they require tenant improvement dollars, it sometimes becomes problematic. With compression on rental rates, to get more TI dollars from a lender when the proforma is less than what they underwrote it for, is difficult and in many cases, a deal killer."

As a backup to sourcing local and regional retailers, is the strategy of leasing to non-traditional tenants. Yenser said Cousins has been sourcing "fringe uses" it would not typically have had space for in its centers. However, the firm is still careful to select uses that are conducive to its desired customer profile for a center. For example, children's play centers and pediatrics offices work well, for their lifestyle centers. The other panelists echoed that sourcing medical uses was a popular strategy.

And in another "keep the lights on approach," panelists conferred they're doing temporary deals in cases where they can't find the right long-term tenant for a vacant space. Halloween-costume stores were identified as a top example of such a temporary use, followed by furniture and liquidation operations.

Other strategies include relocating and shrinking existing tenants that have the need in order to create more viable spaces that new tenants might be interested in. Cutting up and changing the configuration of space to make it into something more marketable is another strategy, said the panelists.

Lastly, Casey noted that one very effective, but painful strategy, has been "marking rents to market. Landlords must consider it to lease vacant space in this environment."

(Editor's Note: To keep up on happenings and trends in retail real estate, subscribe to CoStar's Retail News Roundup, a weekly column covering retailer expansions and new concepts, store closings,

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