Commercial classroom: Back to basics - retail properties - by Edward Smith Jr.

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This column is offered to help educate agents new to commercial and investment brokerage and serve as a review of basics for existing practitioners.

Stores may be free standing, found in strip centers, shopping centers or malls. Retailers differ in their preference but have a common concern about finding the right location for their business.

A strip center is a single building that has been divided typically into five to 10 stores. The structure allows for reconfiguration of the individual store sizes. Stores are either inline next to each other with common demising (dividing) walls, consequently their signage is limited to their front window and door. Or they are end caps, stores located at each end of the center that have the advantage of sign exposure on two or three sides of the store and the possibility of drive-through service.

Adding an anchor tenant with the small stores creates a shopping center. Anchor stores are large in size (often a supermarket or department store) and do their own advertising drawing customers to their store and the other shops in the center. Historically anchor tenants pay less in rent and the smaller stores “gladly” pay higher rent to benefit from the anchor stores advertising.

Retail stores are measured by square footage. Measurements are taken from the outside walls wherever possible including the thickness of the exterior walls. When stores are adjacent to another store they include half of the thickness of the demising wall(s) in calculating their total square footage.

Moving up in size, a number of anchor stores, also known as big box retailers, may be clustered on a site without small stores; this is known as a power center. When we have several anchor stores and a large number of specialty shops we call this a regional shopping center or mall.

Retail pricing begins with a base rent per square foot and often passes through additional rent costs to the tenant. Commonly included are their proportionate share of real estate taxes, utility costs and common-area-maintenance. In other cases, when there is a single tenant in the building, there may be a triple net lease (NNN) structure, whereby the tenant pays all the operating expenses of the property.

Commercial practitioners can lease any of these stores or sell the properties as investments. Buyers and tenants will be interested in the tenant mix. What are the businesses of the other stores in the center and surrounding area? Hint: when you list a store for lease, analyze the tenant mix to determine what type of business is missing from the area.

Demographics provide statistical data usually in rings, 1-3-5 mile or 5-10-20 mile radiuses from the site. Population, median household income, number of single family homes (rooftops), number of apartment units and age breakdowns within the ring are used by retailers to determine if their business would be successful at that location. Traffic counts, the number of cars that pass the site each day and in cities pedestrian counts can also influence site selection decisions.

Unique only to retail are percentage leases. These can be structured in various ways. In addition to the base and additional rent, a percentage of all retail sales is required, common in the larger malls. Sometimes, the tenants base rent may be reduced and a percentage of sales is added. For example, an anchor tenant's fixed rent may be $3 below market value but they also pay 2% of their retail sales. Or in lieu of rent, the tenant just pays a percentage of all sales.

Many retailers look at their business by the calendar year, considering they buy all their inventory at the beginning of the year and make their profit at the end of the year; actually, starting to make a profit in May, June or July of each year. In addition to their base rent they will have to pay a percentage of sales when they reach a defined cap (start making a profit), for the remainder of that calendar year. Then the cycle starts all over again the following year. This is called a natural breakeven point.

In this case the percentage of sales is negotiated then applied to a formula: annual sales divided by this percentage equals the dollar amount of the cap (the amount of sales that must be reached for the additional rent to be due).

When listing properties, find out everything your customers will want to know.

The pandemic was a huge challenge for retailers and changed how many are doing business today. Smaller stores, less inventory, curbside pickup, online sales and delivery, more social media advertising are all parts of the "new" retail models. Malls are becoming more mixed-use offering combinations of shopping, living, entertainment and dining.

The consumers are changing too, the high inflation and interest rates have people buying less products. The concepts of recycling and reuse are having some retailers adding pre-owned items to their product lines.

In most areas, the present economic uncertainty has retail rents declining and lease lengths being shorter. Unfortunately, this will probably continue well into 2023.

On a positive note, the traditional "churning" by national chains is back. That is a review by national retailers of their various stores sales activity. Those locations that are not being productive may be closed. But, at the same time many of the "national" retailers are also looking for and opening new locations to replace the ones closed.

Some local business may be struggling and in some areas the vacancy rates in retail are up, but empty stores create lease opportunities for agents and brokers. Don't let the market "talk" affect you, get out there and make deals happen!

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