ICSC European Retail Property School

LEASING AND DEVELOPMENT STRATEGIES

7 July, 2014
Berlin, Germany
Brian Jenkins

• 25+ years of doing this stuff
• CEO of Kings Street Retail, a Blackstone retail portfolio in Poland
• Still learning something new every day

.....Who are you?
What should we accomplish today

Key Topics:

• Understand the Interrelationship between Development and Leasing

• Your Role in both as a Manager

• Deal Making

• Terms and Conditions

• Negotiating Basics
• An explanation of these two key interrelated Shopping Center disciplines

• How each defines the shopping center

• Does Leasing drive the Development Train or vice versa?
The Development Process

- Market Research
- Site Review
- Concept Design and Anchor Interest
- Due Diligence
- Acquisition Deal
- Planning, Design, and Permitting
- Leasing and Marketing
- Cost Control, Reporting, and Bookkeeping
- Debt Financing
- Construction
- Opening
- Operation
LEASING AND DEVELOPMENT... A key interrelationship

1. Site Review and Acquisition
2. Project Parameters derived from Market Research
3. Design and Leasing Concept
4. Proforma Budget
5. Financing
6. Project Approval
7. Project Execution
TEAM APPROACH...For best results

• Project Director
• Leasing Manager
• Tenant Coordinators
• Construction Director
• Legal Counsel
• Architect
• Consultants
• Mall Manager
• Marketing Director
• From Development to Asset Management
• From Opportunistic to Tenant Driven
• Retailer Consolidation
• No more borders
• Evolution of new income sources – non retail
• Team Leasing – “All hands on Deck”
• Vacancy management
• In House versus Broker
• Environmental consciousness
“We’re Number 1!”

Global CO₂ Emissions by Sector

#1. Buildings
#2. Transportation
#3. Industry
SUSTAINABLE DEVELOPMENT

IMPACTS OF U.S. BUILDINGS ON RESOURCES

40% primary energy use*

72% electricity consumption*

39% CO₂ emissions*

13.6% potable water consumption**
# Energy Savings in Lighting

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uninterrupted use</td>
<td>0%</td>
</tr>
<tr>
<td>With timing control</td>
<td>30%</td>
</tr>
<tr>
<td>With motion detector</td>
<td>50%</td>
</tr>
<tr>
<td>With natural light control</td>
<td>60%</td>
</tr>
<tr>
<td>Combinations of all control systems</td>
<td>75%</td>
</tr>
</tbody>
</table>
"Sensible Design and Management"

- Use of Natural Light
- Water reclamation
- Green and more green
- Low volume water usage
- Alternative energy sources
- Mass transportation
- Recycling
- BMS

- The list is extensive and not so complicated

- Breeam or Leed certifications
Value Enhancement Strategies for the Competitive Marketplace

- **Space Reconfigurations**
  - Subdivisions
  - Unit consolidations
  - Issues with both
- **Functional Adjustments**
  - Food court additions/relocations
- **Conversions**
  - Specialty store GLA to Big Box and vice versa
- **Expansions**
- **Renovations**
THE OUTLETS AT BERGEN TOWN CENTER
REDEVELOPMENT SITE PLAN

SITE PLAN - EAST & WEST PARCELS
BERGEN TOWN CENTER COMPLETED
Bayshore Mall, Eureka California
Bayshore Mall Conversion Results

- Minimal change in GLA
- 16% increase in NOI
- 6% increase in Sales
- 23% increase in occupancy
- Full cosmetic upgrade
Renovation Example

Spring Hill Mall, Dundee, Illinois

- Renovation in 2007
- $7.0 M approximate cost
- New Tenants – 15
- Today’s occupancy under 70%
- Why? Tenants or Tiles?
Spring Hill Mall
Before
Financial Feasibility is First Priority

- Develop a realistic Proforma or Budget
- Identify ALL costs and income
- Evaluation – Cash on Cash Return, Return on Equity or Investment, Value increase
- Quick Exercise
• Break into your groups and review Handout on Forum Arcade

• Answer the questions. Is this a good deal?
Leasing = Revenue = Value

- Development vs Operational Leasing
- Merchandizing and Leasing
- Filling the mix not just the space
- Proactive vs. Re-active
• Design
  • Format,
  • Write the “Story”
• Tenant Mix
  • Anchors, Feature Stores, Specialty Stores
• Budget/Merchandizing Plan
• Leasing Strategy
• Management
  primarily involved in Expansions and Remodels
The Common Objective – “Value Enhancement”

- Team Leasing – “All Hands on Deck”
  - Expirations and Renewals
  - Vacancy Management
  - Limit Downtime

- Strengthen the Mix
  - Find “Distinction” and a “Point of Difference
  - Know the Competition better than they know themselves

- Tenant Allowance Planning
  - Know your limitations
  - Find alternatives to make the deal
DEAL MAKING
THE MANAGER’S ROLE…Local Expert

• KNOW YOUR TENANTS:
  • Lease Expirations
  • Sales Performance
  • Collections
  • Other Issues
• The CUSTOMER, and your COMPETITION
• Update market research
• Know the gaps in the mix and be realistic about the retailers that can fill them
DEAL BACKGROUND...Tenant Investigation

- Comparables for rent and sales
  - Within the portfolio
  - Within the country
- Performance of other stores in the market
- Is their Customer in Your Center
- Financial stability
- Owned or Franchisee
- Long term player or short term fad
OTHER FACTORS

- Sales Trend
- Staff Turnover
- Price Points
- Sales Category Depth
- Advertising Campaigns
- Participation in Marketing and Promotions
• Local Concentrated Effort – Recommendations

  • One full afternoon per week
  • Targeted – Specific city and retail zones, What is missing in the mix?
  • Eliminate the obstacles
    • Rent too high – open book comparison
    • Build out costs – provide a vanilla shell, free rent period
    • Utilities should be cheaper

• Look within – Pop-ups/Short term retailers
OTHER SEARCH METHODS

• “Cold call” – You…the Manager
• Local Merchant Advocates
• Manufacturers
• Active local PR – Success stories, new retailers, customer tributes
• Discussion: Other Resources?
DEAL MAKING STRATEGIES

• “Bridging to a Positive”
  Example: Pick a Center

• Find 5 best positive attributes
• Adhere to or Create a Leasing Strategy
• Budget Conservatively based on Comparables
  Tenants or tiles?
• Fill holes in the mix not just holes in the center
• Tenant Mix Vs. Revenue Issues…What comes first?
The art of aligning the mix for improved customer shopping and the increased value of the center

• Comparison… Dept. Store to the Shopping Center
• Zoning or grouping by…..
  • Use
  • Price Point
  • Store Design
• Recommendation: Don’t overdo it!
• Budgets are usually fixed and approved based on theory and projections….It is obtaining the final NOI number that is Key.

“Conservative budgeting makes future happy faces”

• Software can not replace the accuracy of space by space budget team based projections

• The rules of budget are constant (never down)

• Actual/Projected rents can and will change based on tenant space demands, design modifications, and unknowns

The Bottom Line is to make the Bottom Line
GROUP EXERCISE

• Discuss the info provided on the next page with your other members of your table

• Create a Leasing Strategy to achieve 100% lease up at opening
LEASING STRATEGY EXAMPLE:
GALERIA DEKA

Competitor

• Edge City Location, 5 KM away
• 30,000 m² GLA
• Anchors - Media Markt, Supermarket, Sports, Food Court, Zara
• Underground pay parking
• Connected to Metro line
• Catchment Area – 230,000 within drive/walk time of 15 minutes

Your Center

• Suburban Location at cross roads of major ring road
• 55,000 m² GLA
• 3,000 ground level free parking spaces
• Connected to Bus line
• Catchment Area – 300,000 within drive time of 15 minutes, 1.2 M in 30 minutes
• There are 4 anchor spaces. The Hypermarket deal with Auchan is done 18,000 m². 3 other anchors remain unleased. Average remaining anchor space size is 4,000 m²
• Opening in Oct 2015
Deal Making

•HOT/LOI (binding or non-binding)
  •Positives and negatives
  •Email effect
•Internal Lease Approval (Done usually on a form)
•Signoffs
  •Financial status
  •Bank signoff (if applicable)
  •Management signoff
•Standard Lease Document (yours not theirs)
  •Tenant signs first!
<table>
<thead>
<tr>
<th>Tenant</th>
<th>Sports #1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit</td>
<td>#1</td>
</tr>
<tr>
<td>Term</td>
<td>10 years + 2 opt of 5 years</td>
</tr>
<tr>
<td>Size</td>
<td>2,500 m2</td>
</tr>
<tr>
<td>Rent</td>
<td>Eur 10/m2</td>
</tr>
<tr>
<td>Percentage Rent</td>
<td>4%</td>
</tr>
<tr>
<td>CAC</td>
<td>full prorata</td>
</tr>
<tr>
<td>Marketing</td>
<td>full prorata</td>
</tr>
<tr>
<td>Grand Opening Assessment</td>
<td>Eur 25,000</td>
</tr>
<tr>
<td>TA</td>
<td>None</td>
</tr>
<tr>
<td>Free Rent</td>
<td>None</td>
</tr>
<tr>
<td>Space Handover Condition</td>
<td>Modified Shell</td>
</tr>
<tr>
<td>Landlord Construction (add)</td>
<td>Eur 45/m2</td>
</tr>
<tr>
<td>Other Clauses</td>
<td>Exclusive above 900 m2</td>
</tr>
<tr>
<td>Cotenancy</td>
<td>Minimum Anchor GLA of 4,000 m2 in Fashion and Electronics</td>
</tr>
</tbody>
</table>
THE LEASE PLAN – ROADMAP FOR LEASING

- Spaces, Uses, Numbers, Areas
- Columns, Penetrations and Obstructions
- Ceiling Height Differences
- Dimensions
- Vertical Transportation
- Servicing
- Color Code or Cross Hatch
  - Executed and Committed spaces
Rent

• Minimum/Base Rent
  • Flat, Stepped, Indexed,
  • Per m2/month and/or Total rent Per year

• Percentage/Overage/Turnover Rent
  • Explanation and Computation

• Gross Rent

• Additional Rent
  • Service/Operating/Common Area Charges
  • HVAC
  • Marketing
  • Special Assessment
What is it?

It is the difference between
A Negotiated Percentage of Sales (i.e. 6%)

And

Minimum Annual Rent

Whichever is Greater
General Rule: Higher the margin…higher the percentage

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supermarket</td>
<td>2%</td>
</tr>
<tr>
<td>Electronics</td>
<td>3 to 4%</td>
</tr>
<tr>
<td>Apparel</td>
<td>6 to 8%</td>
</tr>
<tr>
<td>Jewelry</td>
<td>10%</td>
</tr>
<tr>
<td>Fast Food</td>
<td>8 to 10%</td>
</tr>
<tr>
<td>Shoes</td>
<td>6%</td>
</tr>
<tr>
<td>DIY</td>
<td>1 to 2%</td>
</tr>
<tr>
<td>Service Retail</td>
<td>0%</td>
</tr>
<tr>
<td>Furniture</td>
<td>2%</td>
</tr>
</tbody>
</table>
What is it?

• The point where percentage rent exceeds minimum rent
• Easy Calculation... divide annual rent by the percentage (of percentage rent)

Euro 100,000/6% = BP - Euro 1,666,666
Landlord gets 6% of all sales over BP
Types

• Natural – Percentage remains constant

• Artificial – Percentage is varied to increase / decrease the breakpoint or increase / decrease the percentage of sales recovery

Example 10% to the break… 6% thereafter (good deal) or 4% to the break….6% thereafter (Not so much).
• Define Gross Sales (Lease)
• Define Reporting Requirement (Lease)
• Enforce Sales Reporting (Management)
• Enforce Accuracy (Random Audits)
• Bank on It? ......Never!
Lease Term

“Shorter Leases Make Better Tenants”
…..Irving Wolf (the godfather of retail leasing)

• Benefits of the short term deal
• The horror of the Woolworth lease term
• Options- Unilateral, Bilateral
• Termination or Break Clauses
• Amortizing tenant allowance and other concessions
Use Clause

• For the sale…… and for no other use or purpose
• Importance of Control….future value
• The more specific the better…. 
  • Categories – i.e men’s or women’s shoes
  • Brand names- Hugo Boss or even private label
  • Sizes – Junior, Plus etc.
• Exceptions to the rule…Tschibo….. cool or not cool?
• Beware the term “and other accessories”
• Second most negotiated condition
• Triple net – NNN – all expenses charged
• Pro-rata Share
  • Based on total area or occupancy – big difference
  • The evolution of the CAP
  • Deficits
  • Reconciliation
• The US model
  • Fixed CAM or Service Charges
  • Revenue Growth
  • Could it work in Europe?
Space or Unit

- **Numbering** (skip a number between spaces)
- **Size** (approximate always)
- **Measurement**
  - Mid point of demising walls
  - Outside of front, corridor and exterior walls
  - Final measurement upon handover
- **Condition**
  - Shell (Cold and Hot)
  - Custom
  - Turn Key
Rent Commencement

- Handover
  - Partial
  - Final
- Costs during improvements
- Services during improvements
- Grand Opening
  - Goal is for all to open at once or as early as possible
  - Language should reflect this
  - Soft or Early Openings
  - Rent....The Earlier of ....
• **Tenant Allowance (TI/TA)**
  • Budget
  • When is it appropriate?

• **Free Rent**
  • Free rent vs. Allowance
  • 6 months limit

• **Stepped Rent**
  • Stabilize by 3rd year

• **Recapture from Overage**

• **Landlord Construction Costs**
• **Exclusivity**
  The worst word in Leasing

• **Co-tenancy**
  Tying other tenant deals to lease validity/rent start/termination (reserved only for key deals)

• **Termination Clauses**
  Kick outs, performance, conditions (only as an exception)

• **Common Area Charge caps (anchors only)**

• **Percentage Rent only (seldom)**

• **Gross Deals (popularity increasing)**

• **Turn Key Deals** (High rent and when the budget allows)

• **Affordability Clause**
  Occupancy costs not to exceed a %
EXCLUSIVITY...SACRED NO NO

• What is so bad about it?
  Restricts current and future flexibility to lease
  Decreases perceived value by investors
  It is a lose/lose for the Developer

• Best Solution...Just say NO and hold firm

• Rationale
  Defeats the purpose of a shopping center
  >depth=>customers=>sales... proven fact
  Stand alone stores do < sales than shopping center stores

• What are the Exceptions
  Category Killers and Dominant Anchors
  Conditional Exclusives by size, comp, use.
• Radius Clauses- Negative and Positive
• Security Deposits/ Corporate Guarantees
• Occupancy Percentage Kick Outs and Delays
• Store Hours….Is 24 Hours Good?
• Marketing
  • Assessments: Grand Opening, Advertising Fund
  • General trend
  • US model
DEAL MAKING DO’S AND DON’TS

• Know and use your leverage
• Always return phone calls
• Be careful with email…never for negotiation
• Check, check and check again all docs
• Get it in writing..verbal commitments are worthless
• Use the Partners or Board for cover
• Don’t take it personal
COUNTERING THE OFFER

• Options:
  Just say NO, Ignore it, Find a Solution
• Remember that the Goal is to make a deal
• Confirm positions on **ALL** terms and conditions
• Identify where you can and can’t give
• Solve the key terms… Rent, Rent, and Rent
• Don’t get stuck on the small points
• *Time Kills Deals!*

  Bring the your best possible deal forward for approval.
  What is the worst that can happen
• GLA
• Common Area Charges
• Minimum, Gross, Percentage and Additional Rent
• Demising
• TA
• Shells: Cold, Hot, Vanilla
• Fire Rating

• Grade
• Exclusivity
• Storefront Design Criteria
• Recapture
• Parking ratio
• Stub in
• As is and As builts
• HVAC
“People do Business with People they like”

“Best Tenant, Highest Rent, Worst Location”

“Every Location has a Positive”

“Honesty really is the Best Policy”

“Only a Fool represents himself in court but a good manager should be able to play lawyer from time to time”
CONCLUSION

….Leasing Merchandises the Center
….Development Builds initial value

BUT

MANAGEMENT DRIVES ASSET VALUE
Class Evaluation:

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

Class Evaluations Link:

survey.icsc.org/2014ERPS