

No small concern

By Joel Groover

When a top mall REIT files for bankruptcy protection, closes on a huge CMBS loan or launches a hostile bid for one of its rivals, the news travels fast. After all, these strategic moves affect thousands of people in the shopping center industry and yield important clues about where the economy is headed. By contrast, the successes and failures of local and regional owners, managers and brokers rarely make the front page of *The Wall Street Journal* or zip across the crawler on CNBC.

And yet, smaller firms' strategic adjustments to the so-called Great Recession offer lessons of their own. Indeed, smaller firms make up the bulk of the industry. When a boutique brokerage finds a way to tap into global growth, or a local landlord learns how to beat the odds on sales and occupancies, that is news more people can potentially use.

To be sure, shopping center companies of all types and sizes are coping with similar challenges, such as the slowdown in real estate transactions, the barrage of rent-reduction requests from ailing tenants or the looming refinance dates on centers that have plummeted in value. Far from being uniquely vulnerable in this environment, however, local and regional firms actually enjoy certain advantages that can make it easier for them cope, observers say.

"Our total number of transactions did decrease from the peak of 2007, but a lot of companies on the investment side went down to zero," said Edward B. Hanley, president of Irvine, Calif.-based Hanley Investment Group, a boutique retail investment advisory firm with eight active agents. "We got cut down to about 50 percent, which in comparison is doing great."

When the market was hot, Hanley's firm jumped into the fray with the very biggest brokerages. In 2007 it sold the largest shopping center in San Bernardino County for \$46 million. But the firm has fared relatively well during

the recession by focusing on its core business: selling smaller strips, single-tenant properties, and neighborhood and community centers valued at less than \$5 million. "Those properties valued at under \$5 million still sell consistently," said Hanley. "Once you get above that, on any type of property, it is extremely difficult to get financing."

With transactions for behemoth centers at a near halt in Southern California, brokers at the largest firms would love to snatch up some of these smaller deals. They often lack the expertise and relationships needed to do so, Hanley says. "It is much harder for a brokerage firm that specialized in \$100 million malls to come down and tell an investor or property owner that they can sell that single-tenant Jack in the Box," he said. "It is a totally different buyer segment."

Among both retailers and developers, moreover, the motto is no longer, "Sign the leases and ask questions later." Landlords and tenants that once hired a single big brokerage to sign deals at a dizzying pace are now proceeding with extreme caution. This puts the advantage squarely in the court of smaller firms that specialize in leveraging local expertise and connections, says Christopher A. Wilson, president of Wilson Commercial Real Estate, which employs six leasing agents and two investment sales brokers in Los Angeles. "During the expansion period it was important to have broad reach," he said. "Today it is much more locally driven. We are probably in a better position today than we were before, because people know exactly what we do. If they've got a vacancy in a neighborhood or community shopping center in the markets we work in, we get a call."

And while times are tough for mom-and-pop stores across the country, today's lower rents and higher vacancies spell opportunity for local operators with adequate capital and solid concepts. Back when many landlords were pushing rents ever skyward and doing deals only with household-

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name-credit tenants, small tenants were priced out of the market, says Kenneth S. Katz, co-founder and principal of Baker Katz, a Houston-based brokerage, consulting and development firm. That is no longer the case.

“There is a particular broker here in Houston who probably leases more shopping centers than any other broker in the city,” he said. “He was telling us that in 2009 the vast majority of deals he did were with mom-and-pop and regional retailers, on leases of 800 to 1,400 square feet. The percentage was much higher than in any previous year. That is where a lot of the activity is happening.”

Like their larger counterparts, many smaller companies have been forced to make strategic adjustments.

Here, too, smaller size can have certain advantages, such as greater flexibility. When stalwart expanders like Starbucks started to pull back in the first quarter of 2008, Wilson sensed a change in the leasing environment. “We started to see a lot of deals that would have been made in the previous several years start to fall apart, for no apparent reason,” he said. Though his firm primarily represents landlords, Wilson seized the opportunity to start representing Dollar Tree, now one of the few national chains embarked on aggressive expansion. “We’ve done multiple deals with Dollar Tree and are now representing a few other very specific tenants,” he said. “This is something we’ve never done before, because our landlord business was so healthy and so deep.”

Jumping into tenant rep helped Wilson make another key strategic move: cutting ties with landlords who were overleveraged, in denial about today’s lower rents, or both. The goal was to work only with those willing and able to do deals. “My estimation is that only about 30 or 40 percent of the retail properties in Southern California have adjusted to the new market rents,” he said.

But lowering rents is just one of the ways local and regional landlords can adjust to the economic slump. Bayer Properties could be considered a bit larger than a regional firm, given that the Birmingham, Ala.-based developer owns several properties outside its Southeast home base. Still, the developer focuses heavily on the

Southeast region, where it enjoys strong ties with a number of local municipalities.

Known for its Summit signature brand of lifestyle centers, Bayer has coped with the development slowdown in part by taking advantage of those local connections, says Jeffrey A. Bayer, a principal of the firm. “We’re now providing development services for municipalities that want to, say, grow their sales-tax base, or that need someone to come in and advise them on what to do with a piece of land,” he said. Working with officials in such places as Walker County, Ala., has enabled Bayer to keep his specialists in construction, finance, leasing and market research engaged despite the slowdown. “This uses all of our disciplines,” he said.

Three years ago, when Bayer sensed an inevitable shift in the leasing environment, he leveraged local expertise in yet another way. First, he took the counterintuitive step of hiring more leasing agents as the economy softened. Then he sent them out to scour local markets for novel, independent retail concepts, the best of which were welcomed into Bayer’s portfolio at what were extraordinarily reasonable rents for the time. In Georgia Bayer’s team discovered a hip, quirky restaurant concept called Flip Burger Boutique. “We brought them to Birmingham to open a store, and they are now just killing it,” he said. “The upshot is that all of our centers are still leased well into the 90th percentile.”

In sales and occupancies, in fact, Bayer’s portfolio continues to beat the National Retail Federation and ICSC averages. Local operators and expertise are among the main reasons for this success, Bayer says.

The developer’s experience with business cycles — Bayer founded the company in 1983 — is another. Indeed, timing often plays a critical role in the success or failure of a smaller firm’s strategic responses. When doom and gloom began to dominate business headlines in the fall of 2008, Patrick Galentine, a founding principal of Tustin, Calif.-based Coreland Cos., wasted no time dusting off the résumé he had amassed in the 1990s as a court-appointed receiver for some 250 distressed properties.

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“We started to go out and reconnect with many of those old contacts [in the loan-workout business] that we had not seen or spoken to in 15 years,” said Chris Hite, a founding principal of the 20-year-old firm. “To date, we have taken on close to 2 million square feet of new opportunities that were directly related to receivership from a variety of lenders.” At ICSC events, colleagues from other firms often ask Hite and Galentine for tips on breaking into the receivership business. “Unfortunately, they are a bit late to the game,” he said.

Still, a clear lesson from the past cycle is that adaptive professionals will indeed find and exploit niche opportunities that pay dividends when the economy bounces back, Wilson says. “From 1990 to 1995, the weak perished,” he said. “But those who were able to hang around formed boutique companies that are still around today. You’ll see the same thing happen again as all kinds of new groups and partnerships form.”

For some local tenant-representation firms, tapping into rising international retail demand might well represent an opportunity in years to come, says Patrick Heaps, a London-based retail director at global real estate advisory firm DTZ. Few local brokerages could afford to open offices in London, Paris, Rome or Shanghai. But they can join broker-alliance networks like X Team International, which relies on partners in the U.S., Canada and Europe to serve tenants, landlords, developers, owners and third-party service providers in roughly 45 markets. As more retailers crisscross the globe in search of new customers, brokers stand to benefit by building strong global alliances that enable them to refer these tenants to one another.

An X Team member in Houston, for example, might refer an expanding U.S.-based chain to an alliance member in London. Likewise, that London brokerage might refer business to its partner in Houston. The key is to make sure all parties are confident in the skill and experience levels of their alliance partners. “The most important thing is accountability,” Heaps said.

Formed now, such alliances would surely pay off big when the global economy takes off again. In the meantime, smaller firms like Baker Katz are thinking hard

about how to capitalize on the future. “Some are cutting back, but we’re pouring more money today into the right people, technology and software than ever before,” said Jason S. Baker, a Baker Katz co-founder and principal. “We’re looking closely at different parts of the business that we have been focused on for the past three or four years and saying: ‘What does that look like in five years? If it will not be profitable or have strong strategic byproducts associated with it, let’s not do it.’ We want to be that firm that does just one or two things, but at the very highest level in our market.”

That is just the kind of thinking that could turn the boutique firm of today into the powerhouse of tomorrow.