How the "Go Local" Crusade is Impacting Retail Real Estate Finance

By **Charles Krawitz**

Mom and pop shops have gone from persona non-grata to the new darlings of the retail real estate world. Iconic "local favorites" are emerging as some of the most reliable tenants for shopping center owners and lenders alike. It's no surprise that the most coveted local tenants are the ones offering experiences or customized products that customers can't find on Amazon.

As recently as a few years ago, a major grocery store or big-box retailer drove the success—and loan approval—of a shopping center. Yet landlords are increasingly challenged to fill big-box space. In the Chicago area, for example, available retail anchor space has doubled since 2012, hitting an all-time high of 15.7 million sq. ft. in the first quarter of 2019, according to CBRE research. Meanwhile, even big brands are experimenting with smaller formats, like the Nordstrom Local concept and Amazon Go stores.

While there is still a place for national chains in today's shopping centers, smaller retailers have a bigger role to play. That's partly because the rise of Amazon came with a juxtaposing consumer movement to "buy local" and support small businesses. From craft breweries to clothing shops with carefully curated merchandise, consumers are seeking unique experiences they can't get online.

The "go local" movement reached a fever pitch in 2018, with consumers spending a record $17.8 billion on Small Business Saturday (not coincidentally, the day after Black Friday), according to American Express and the National Federation of Independent Business. More than a passing fad, consumers' infatuation with all things local is here to stay—improving local business owners' appeal in the eyes of lenders looking to pursue shopping center opportunities.

The e-commerce-proof tenant mix

Underwriters evaluating shopping centers are looking for a strong mix of internet-resistant and service-based tenants. When basic goods like laundry detergent, tube socks and cell phones can be delivered to your doorstep with a few clicks of a mouse, luring customers into physical stores requires a different experience than what big-box retailers have traditionally delivered. Local shops contribute to a diverse tenant mix when located alongside well-known national tenants, including discount merchandisers like Marshalls, TJ Maxx and Ross.

Just northeast of Indianapolis in the hip and historic community of Noblesville, Ind., Noble West Shoppes offers a prime example. The nearly 60,000-sq.-ft. retail center includes a stable mix of national brands and local shops. Alongside a Jimmy John's, Great Clips and Verizon Wireless, customers can find a one-of-a-kind Italian market, an animal hospital and a local dancewear shop. The diverse tenant mix helped the center's owner secure a $14.1 million cash-out refinance of the property in 2018.

Photo: Getty Images

Key ingredients for retail financing success

While the tenant mix plays heavily into financing decisions, it's not the only factor. Credit officers are favoring infill urban locations in areas with strong demographics and population growth. They're also giving points for centers with staggered lease maturities, which mitigates the risk that a slew of tenants will move out all at once when their leases expire. And in today's challenging retail landscape, lenders are scrutinizing the experience of property owners, seeking investors with a proven track record of success.

As the retail landscape continues to evolve, shopping center owners shouldn't overlook the value that local stores bring to the tenant mix. After all, shops with strong community roots are well poised for long-term growth. ■

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