TREND report

Successful Management Strategies for Retail Assets

Angela DiFuccia • published in the March 2019 issue

Locally owned and operated DSW Commercial Real Estate initiated their retail platform in 2016 with the off-market acquisition of the re-developed Wilmot Plaza. Since this time, owners Michael Sarabia and James Hardman have continued to develop and acquire retail in Arizona, most recently with the purchase of the historic Campbell Plaza Shopping Center.

To support the continuous expansion of assets, DSW's burgeoning property management department allows the company to scale operations as needed. A fair number of third-party owners have taken advantage of this property management infrastructure by signing management contracts with DSW to inject new energy into their assets. These owners appreciate that DSW has an expertise in change-management, the systematic approach to restructuring a budget and operations to implement strategic initiatives that breathe life back into an asset.

"…clearly communicate asset goals to property management."

An alarming number of assets are held on property management "auto-pilot" with managers applying a one size fits all approach. Preferred practice will tailor management decisions to meet objectives of an asset's strategic plan. If you are an owner or an asset manager, you want to make sure to clearly communicate asset goals to property management. Operational decisions as granular as a vendor selection will work either for or against a center's objectives. Every individual who touches your real estate has an opportunity to enhance these goals and will impact the experience of the tenants and patrons.

"…know market rates for services."

The indispensable role a manager plays is maintaining center costs. Review your management agreement contract; it should stipulate how often and under what circumstance they are required to bid out work. Management should know market rates for services and articulate why any given expense is above or below market. It is worth noting, the practice of taking the lowest bid may not always be the correct strategy and could end up costing an owner or tenants more money in the long term. In addition to understanding costs, forward-thinking managers also consider how lease provisions impact the reimbursement of these operating expenses.

While triple net (NNN) is the standard in retail shopping center leases, fixed reimbursement amounts, caps on controllable expenses, and exclusions of certain expense items can result in what is referred to as leakage or lost revenue. A true NNN lease is structured so that 0% of property expense responsibility falls on the owner while 100% of expenses are the responsibility of the tenant; a true NNN lease is uncommon. Property management accounting should provide a leakage analysis at the time of budget and at reconciliation so that owners and asset managers clearly understand what expenses are not truly being recovered.

It may appear beneficial to keep all costs as low as possible for as long as possible. Nonetheless, if costs are suppressed over time, negative consequences may arise. Vendors may cut corners to maintain contract rates that are well below market which may result in deferred maintenance. Upon correction, a significant increase in this cost over one calendar year could cause leakage as a result of tenant caps on operating cost reimbursement. Expenses that increase slowly over time result in expense recovery that is naturally absorbed within lease designated caps.

Obtaining a reserve study and forecasting capital item replacement are essential to managing the costs of your asset. Advanced accounting tools may be utilized for recovery of these large expenses, such as roof seal/replacement, parking lot reseal/replacement, painting, landscaping replacement etc. The terms of each lease will determine what tools may be utilized. The collection of reserves for replacement may be allowed or, conversely, the recovery of large expenses may be amortized and collected over time. Attempting to recover major expense items in the same annual period, even if permitted by the lease, could prove to be detrimental to tenants financially, create an unsavory landlord/tenant relationship, or in the worst case may result in a tenant defaulting on their lease as a result of inability to pay.

"…require NNN tenants to maintain their space…"

When a space reverts back to the landlord after occupancy, unexpected costs could arise that may have been prevented. The NNN lease will require a tenant to maintain their space and provide adequate repairs. If a tenant has not properly maintained mechanical, electrical, or plumbing, the landlord will be forced to address in order to re-lease the space to a new tenant. When a NNN cost responsibility belongs to the tenant, property management often remains hands-off. Best practice is for management to be regularly communicating with tenants and overseeing repairs and maintenance that tenant procures. This is especially important of work that takes place behind walls and under floors, which the manager should oversee and document with photographs. Require tenants to provide proof of maintenance for HVAC and grease trap pumping to keep on file. These extra steps can rescue a property owner from the significant burden of an unbudgeted and non-recoverable expense.

"A healthy center operates as a community…"

Lastly, the other indispensable role of property management is in maintaining tenant relations. A healthy center operates as a community where individuals know each other and trust exists between tenants, tenant staff, vendors, management, and ownership. Prompt response time to questions and requests leave tenants feeling that their concerns are heard and are being addressed. In the event a request cannot be met, managers can facilitate by pointing tenants to the section of the lease to educate and discuss. Additionally, managers should communicate landlord accommodations so that the tenant recognizes the benefit, as opposed to misunderstanding lessor/lessee roles and responsibilities. Remain sensitive to the CAM rates your tenants are paying. Research CAM rates at other comparable centers, which are available on almost all leasing brochures made public online. Know where your expenses are relative to these other centers and understand why.

Angela DiFuccia is Director of Property Management at DSW Commercial Real Estate. She is responsible for analyzing existing management, restructuring budgets, auditing vendor contracts, and updating property operations to DSW standards. She has 13 years of commercial real estate experience and is a Certified General Appraiser, Registered Property Tax Agent, and a CPM candidate with the Institute of Real Estate Management (IREM). She can be reached at adifuccia@dswcommercial.com.