Insights

The importance of micro location

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Looking beyond the basics

All too often, private investors are buying properties based only on price, credit covenant of the tenant, cap rate, rental levels and the lease duration, but often neglect to sufficiently evaluate location risk and the strategic importance of micro-location for that tenant in the longer term and customer access considerations.

With smart retail chains closing anywhere from 5 to 10 percent of their least-productive stores every year as part of their adaptive real estate strategy, undesirable locational characteristics such as difficult ingress and egress, poor visibility, being on the wrong side of the road at critical business times, poor parking access, the condition of surrounding buildings and homes, and or a declining population and traffic in the trade area, will all be major contributors to a tenant’s head office making a decision not to renew their lease.

There are many other scenarios in which tenant loss can be consequential. For example, certain high-traffic, high-volume operators are known for paying high rents for freestanding or, in the case of multi-tenant sites, endcap locations with drive-thru lanes, but with the problem being that many of these same chains continually tinker with their real estate strategies. When they walk away, investors can often find it impossible to replace those above-market rents. Assuming that a tenant with a looming lease-renewal date will stay forever is a rookie mistake.

Focus on access

If a single-tenant, triple-net-leased asset is situated on a corner at a traffic light, and customers can make a right in and a left out on both streets, it rates 10 out of 10. However that rating would go down to 7 if the property is on a corner at a traffic light, but people can only make a right in and out on both sides.

A rating of 5 or 6 would be assigned to a mid-block site with a dangerous turning lane in the middle of the roadway. Shoppers—especially parents with children in the car, tend to be reluctant to sit in that middle lane trying to make a left into the property. The same on taking a harrowing left out of the property. When access carries this kind of “fear factor,” the property will suffer from lower traffic and sales.

The worst-case scenario? Single-tenant assets on divided highways that require a shopper to drive past the building and make a U-turn to gain access. Here the rating could range from 0 to 4 based on how far people have to drive before they can turn their car around.

Regional access is another important consideration. Properties that are near the intersection of at least two major interstates, ideally with additional highway access as well make good acquisition candidates if all other parameters make sense.

Real estate ‘Rosetta Stone’

Locational characteristics don’t just help to evaluate a particular property—they can also serve as a kind of Rosetta Stone for understanding everything around it, including potential sources of competition and cannibalization via the same tenant having another nearby location.

The importance of physical inspections

While use of desktop technologies like Google Earth are useful with initial high level screening, nothing should ever replace the investor physically visiting a subject property and walking not just the site, but the entire surrounding neighbourhood to properly contextualise the site and to understand the unique demographic trends of that location.

In addition to store performance data requested as part of an investor’s formal due diligence, investors need to go beyond and also understand nearby competition, trade area growth, daytime population, traffic counts, cannibalization risk and proposed future competition.

Pay attention to detail in the lease

In addition to locational criteria, an astute investor needs to also carefully consider the reputation of the tenant with regard to the tenant's promise in the lease agreement to "maintain the property in good repair and condition."

For example, all too often, tenants fail to attend to issues with potholes, oil stains and striping in their parking lots. Apart from the potential risk to those visiting the site, lenders require that such maintenance work be performed in a timely manner on properties which they hold as collateral. If not, there may be adverse financial consequences to the property owner in the loan agreement.

Credit: This insight has been adapted from the July 05, 2022 article by the retail leasing specialist Richard J. Brunelli (of R.J. Brunelli & Co) which appeared in wealthmanagement.com

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