

OVERVIEW OF PRELIMINARY DUE DILIGENCE TASKS **For Open Air Shopping Centers**

The following presents an overview of the eight go-no-go tasks, one must undertake to develop shopping centers of all types, all sizes and with any mix of tenants.

By: Arthur L. Pearlman, Chairman of Arthur Pearlman Corporation

The development of shopping centers of any type, any configuration and with multiple uses, follows the same basic process and procedures. Though the Tenants may be different and the mix of uses, shape, height and sizes of the shopping center may vary, their due diligence follows a basic set of steps to get to the end product. The shopping centers can consist of any mix of uses, e.g., retail, residential, entertainment, grocery, food, office and other industrial type uses. The nuances associated with the details of their height, zoning, and other technical considerations will impact their success as well as cost and profitability. This article explores the simple Rules-of-Thumb and technical details that cause a continual re-analysis and raises important questions regarding the go-forward decisions. Though, the processes presented below are presented in a sequential manner, nothing continues in a straight line throughout the Pre-Development and Development processes. Each step becomes an iterative task which is challenged by the previous and future steps within this process. The following presents, 8 basic steps, how one must develop a meaningful and successful shopping center project.

The Pre-Development work consists of the following generic tasks:

- I. Site Designation
- II. Purchase Types
- III. Due Diligence
- IV. Presentation Package
- V. Initial Proforma
- VI. City / Homeowner Meetings
- VII. Major Tenant Meetings
- VIII. Financial Partner / Lender Meetings

Upon reviewing the above tasks, it is apparent that the process is far more complicated than following these 8 sequential tasks. In fact, nothing proceeds in a straight line. If one were to plot these tasks in a Critical Path Method, one would see a “spider web” of several hundred interactive tasks that iterate across time.

AS stated above, there are certain basic Rules-of-Thumb that drive the decision process. The Rules-of-Thumb presented herein are stated to “test” one’s focus for the next step or steps. Each rule should raise questions that continue to affect the decision process for a go-no-go evaluation to proceed forward. This could be a “time out” indicator to re-evaluate the project or a time to test the interim findings of the process or it may be an indicator that the next step is to take your loss of time and resources and move on.

SOME RULES OF THUMB: When one begins to evaluate a site, there are several rules of thumb that could drive the early site plan or evaluation process. For example, if one is contemplating a site for a supermarket anchor tenant, then one must “test” the community to (1) The first Rule-of-Thumb is to understand your trade area within 5-mile radius. How many other food markets (of all sizes and types) exist within that 5-mile primary and secondary trade area. Why? Because the supermarket tenant (and you) need to know who the competition is, by size of store, depth of product mix, and how close they are to “your” primary trade area. This brings up the next Rule-of-Thumb. Will your prospective supermarket client be in a competitive position to serve “his” primary trade area of about a 1.5-mile radius? Thus, if more than one food market exists within that 1.5-mile area, the Developer must determine if the prospective supermarket anchor can be profitable within the proposed shopping center. The same test needs to be undertaken within the secondary trade area. (2) Next Rule-of-Thumb; a supermarket ideally requires 5,000 homes within their primary trade area because, on average, this equates to about 15,000 residents, i.e., shoppers for the proposed store. (3) The next Rule-of-Thumb: a supermarket ideally seeks to have sales of about \$400,000 per week just to meet their internal business plans and proforma (4) The next Rule-of-Thumb; The Developer must meet with the City to determine if their business and residential plans for zoning and Conditional Uses (for the site) and surrounding area meets your needs (5) Another Rule-of-Thumb; a prototypical site, that will allow for the supermarket and the center’s co-tenants, is based upon the a development criteria that allows 10,000 s.f. of Gross Leasable Area (“GLA”) to be developed for every acre of land. Thus, a ten-acre site can be ideally planned for 100,000 s.f. of GLA. This simple Rule-of-Thumb will permit you and your architect to create a preliminary site plan that conceptionally meets all tenant, City Planning and parking codes.

Now we’re ready to explore each of the above 8 Pre-Development tasks

SITE SELECTION: One of the first tasks one must think about is “why this site”? Was this a site that was designated by your major tenant or by you? Do you really have a major tenant that “needs” to be at this site? Have you met with your Major Tenant(s) to explore this site? Have you met with the City to determine the support you will receive if you bring about this development? Be prepared to disclose the overview of your development with the City Manager and Planning Director. Remember, once you meet with the City, your information is then considered “to be in the public domain”. One must think thru these nuances. In my experience, the first task is to meet with the City Manager (who, in fact, is the CEO of the City) and explore and compare your project’s concepts relative to the City’s plans for current and future growth. Find out if there is any competition pending for “your” site or another site within your trade area. Determine the growth plans for the City’s residential and business community. In my experience, the competition (for developer or tenant or site location) usually remains an open-book issue in that I don’t believe there are too many secrets in our business..

One of the key issues to be considered is “on what side of the street” does the subject site reside? Is it on the going home side of the street or the going to work side of the street? This is critical for your tenant mix and types of uses which you can place within the center. Next, who are your anchor tenants, e.g., an anchor is defined as a tenant that has the strongest “draw” into the center. This can be a supermarket, movie theater, restaurant, small coffee shop, large retail (department store) tenant, junior department store tenant, residential units, office units and / or even a cluster of tenants. Each of which brings a business strength to your project. All of these issues (and others) will begin the next process for determining such things as the site plan, parking, ingress and egress concepts of your project.

The above is iterative and can best be solved or determined by understanding nuances and needs for each and every major or important use and user / tenant that resides within a 5-mile radius of your projected site. Therein lays the basis to determine your project's initial proforma and the best and most competitive tenant mix by size, shape and specific uses within your project. These "Rules-of-Thumb" are a quick way to focus towards your conceptual project and provides a beginning situational analysis to determining the answers to "What's There" vs "What's Not There". Once this step is understood, the developer can move to the subsequent sets of tasks.

PURCHASE TYPES: There are many types of purchase and ownership relationships that one can undertake with regards to an individual investment, partnership, joint venture etc. The best determination of this ownership entity can begin with the conclusion of the initial Site Selection process. The issues raised will become a basis of who your partners may be for that particular project. As an entrepreneurial developer, there is no best approach. Quite often the best answer becomes clearer with the completion of the relevant Pre-Development tasks. Information and honesty are imperative to solving the problem of opportunity vs return on investment. In summary, I have found that most developers have a concept that best works for them and their partners once the Due Diligence is completed.

DUE DILIGENCE: More Rules-of-Thumb; When one first visits a site, it must be looked at initially through the eyes of one or more of the prospective tenants that the Developer plans upon locating within the site. Remember, "the tenant is king" i.e., without them, there is no development. A development includes the inputs and support from Community as well as from the City, co-tenants and finally, the Developer's partners. So, the developer's work begins with the site analysis, City and with tenant meetings, Then, it will be followed by the a review of title to see who owns the property as well as a history of ownership including the site's prior uses over the past 50 years. In summary, meet with the City Manager as soon as possible to understand the City's support as well as understanding where other existing and prospective retail and residential uses are underway or planned. One must understand the community's desires, competitive uses and developments throughout the area. Finally, interview architects with "retail experience" that can best meet your tenant's needs as well as those for the prospective mixed-use project.

PRESENTATION PACKAGE: This is a simple process that focuses one to look at the site through the eyes of the tenant(s). As a Rule-of-Thumb, one must think about what the Real Estate Manager needs to obtain a (future 3-5 year) commitment of operating and construction funds (interior and merchandise). Remember, you represent only one of many developers that are vying for these same operational funds. Think like a consultant and prepare a presentation package for the tenant that views the subject site, and presents an analysis of the competitive sites and their uses. Understand the City approvals, zoning, residential needs throughout the trade area; present that information to the Tenant. Start building your time line and project schedule.

INITIAL PROFORMA; This is a process that should begin on the first day of the development venture. As a Rule-of-Thumb, keep this simple and keep adding and changing the proforma as you complete specific tasks. This can be a simple Excel spread sheet or a complex proforma program. The importance is to set this up early with lots of assumptions that begin on day 1 and continue its updates throughout the predevelopment and development process. This is needed for you and your partners to understand what the Developer is planning. Remember, change your assumptions often and as soon as you receive more data from the various City, Tenant and other technical sources.

CITY & HOMEOWNER MEETINGS: The importance of this task can't be overemphasized. These meetings are necessary, should begin as soon as you meet with the City in order to gain City and community support for your project. Seek out the special interest groups both within your project's trade area as well as within the surrounding trade areas. As a Rule-of-thumb, these Special Interest Groups will come from within and outside of the City; meet with them early. Include the City Planning Department in these meetings and begin the communication process and ask for their support. Share this information with the City, your major tenants and partners.

MAJOR TENANT MEETINGS: Treat the major tenants as your partner. Remember, without them, you do not have a project. As noted above, the major tenants are part of your approval process regardless of their store size; they are the key to your success. So, include them early and on an ongoing development basis.

FINANCIAL PARTNER / LENDER: Like the Major tenants, without these parties, you will not have a project. Therefore, meet with them early and keep them in the information loop. Remember, the Best Secret is No Secret.

Please Click on the ARTICLES TAB within the Arthur Pearlman Web Site to read other Pearlman papers.

A detailed follow up to this paper is entitled "Development Tasks- The Steps and Cost to Develop Open Air Shopping Centers". This article will provide a detailed outline of the of hundreds of steps, costs and relative time frame needed to develop a shopping center.