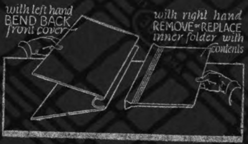
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THE MUTUAL PROBLEMS OF THE RETAILER AND DEVELOPER

IN SHOPPING CENTERS

A Thesis

Presented to

Dr. Edward M. Barnet

Michigan State University

In Partial Fulfillment

of the Requirements for the Degree

Master of Business Administration

by

Robert F. Witt

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THESIS

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CHAPTER I

INTRODUCTION

Shopping centers are a relatively new American industry whose growth has been stimulated by this generation's movement to the suburbs, seeking the leisure and freedom from congestion that suburbia is said to afford. The American businessman has been quick to respond to this migration of consumers.

Development of centers has progressed at an unprecedented pace. This increased interest in locating in a shopping center is not limited to any single type of business. For example, over half of the new supermarkets (55 per cent) in 1959 were erected as part of a shopping center,[1] and 308 of the 348 new W. T. Grant department stores were shopping center units.[2] Chain Store Age estimates that about $45 billion of retail trade will be transacted through shopping centers by the end of 1960.[3]

Although the shopping center is one answer to the shift of population and has been highly successful to date, this does not imply that it is the answer to every merchant's problems. As a word of caution, before the image of the grandeur of the shopping center is instilled into the merchant, it would be well for him to evaluate his present business situation, to question its maximum potential and to judge if he has fulfilled his objectives. The competition is tough, the rent is high, and the restrictions

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[1]"Facts about New Super Markets Opened in 1959," Preliminary Report Issued by the Super Market Institute, January 11, 1960. p. 7.

[2]"Shopping Center Locations Stressed," Redbook's Shopping Center Merchandising, April, 1960. p. 5.

[3]S. O. Kaylin, "Shopping Centers...Hotter Than Ever," Chain Store Age, May, 1960. p. 27.

ever present. It is a questionable tool of success for the marginal retailer.

Purpose

There are many problems inherent in any business promotion, especially one as immense as the development of a shopping center. This study has as its intent to point out and analyze some of the major problems common to many shopping centers. Fully aware of the fact that any single one of these problems could serve as a subject for a complete thesis, the writer's objective is that this study might serve as a foundation for a more complete and thorough study at a later date.

Scope and Method

Analysis of four major problems and the conclusion based upon this analysis will be presented in this study. The problems being considered are the following:

1. Overexpansion of shopping centers.
2. Financing of shopping centers and its repercussions on the independent operator.
3. The merchant's association and its part in the center.
4. The supermarket in the shopping center.

I have selected these problems from many that could have been selected primarily because of their present relevance to both developers and tenants.

The information presented in this study has been obtained from many sources with secondary information providing the bulk of the information. Using the secondary information as a foundation, observations, correspondence, and interviews have provided supplementary data to round out the study.

Limitations

The limited number of problems analyzed in this sutdy is the major limitation. Such problems as zoning, planning the layout of the center, engineering, traffic, and parking represent a few of the additional problems which have been ignored. However, as was indicated in the introduction, any one of these problems could serve as the subject of a complete thesis. Thus, to fulfill the objectives of this study, only the four problems indicated will be considered.

CHAPTER II

INCEPTION

The shopping center movement is one of the major changes in distribution which is effecting the retail industry. Sociological and economic changes since the end of World War II have fostered the growth of a suburbia around our large and middle-sized cities. This growth has furnished the retail industry with a new and dynamic outlet for large scale merchandising to areas having distinctive living patterns as contrasted with the mass market existing within these cities.

The organization of a shopping center presents many new problems that downtown retail units have never had to face; parking ratios, snow removal, etc. Increased awareness of the problems of layout, architectural design, financing, and management all enter into the planning of a center. In the downtown area of a city, the retailer is almost guaranteed traffic since it is pre-established that dwellers in the city shop in the downtown area. But in the shopping center, the developer must ascertain his market, since he must sell other retailers on the concept that the center is ideally located to serve a distinct type of trade from an outlined trading area. The shopping center serves the fringe, the new suburbia, not the trade-established downtown.

History and Growth

While shopping centers have almost overnight become one of the most important and significant marketing devices in the country's history, they are not entirely new. Their history dates back to the year 1907. The Urban Land Institute of Washington, D. C., credits Edward H. Bouton of Baltimore with the first "shopping center" idea. Bouton set up the

Roland Park Co. in his home city in 1907. This was an architecturally unique store building set back from the street, with off-street parking for the carriage trade.

Conversion from grass areas for horses and carriage, to black top for automobiles was easy. Jesse Clyde Nichols created the Country Club Plaza, for automobile trade in Kansas City in the early 1920's, and the modern shopping center was on its way.

The "modern" style of architecture, now common because of its clean lines and comparatively low cost, was born in Hugh Potter's River Oaks Shopping Center in Houston in 1924.[4] Then came the Sears and the Wards stores, closely followed by supermarkets, who left the crowded, high rent, downtown areas in search for consumer dollars in locations more convenient for the surburban shopper.[5]

The large chains discovered the benefits of supermarkets in the 1930's and cut their merchandising costs by erecting huge stores, maximizing an appealing display of goods and minimizing services. In the same period, the downtown department stores began giving thought to establishing branches in the suburbs to follow the migration of population away from the city core area.

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[4]United States Congress, Senate, Select Committee on Small Business, The Impact of Suburban Shopping Centers on Independent Retailers, Report No. 1016, 86th Congress, 1st Session, (Washington: Government Printing Office, 1960), p. 5.

[5]John C., Perkma, "Shopping Centers," Barron's, Vol. XXXV, No. 33, (August 15, 1955), p. 3.

The shopping center may be considered as being one of today's most remarkable retail business evolvements. It is also one of the first established commercial building types which takes into account the American's use of their automobiles as a part of their everyday living habits.

> "The shopping center's form has evolved from prototypes devised earlier to deal with a spreading conflict between retail shopping and automobile parking. It has grown out of the first moves by astute land developers to build in outlying areas stores on a lot with places for customers to park their cars on that lot and off the street."[6]

With the growth of population and the vast urban expansion brought about in the vigorous economy since World War II, the shopping center has progressed faster than it otherwise might. The waves of residential building construction has prompted the erection of commercial facilities accessible to the location of purchasing power, mostly in the new suburban areas.

Population Shifts and Growth of Suburbia

The shopping center phenomenon is appreciated when we understand what is happening in the supporting growth of population. The 1950 decennial census showed statistically, that the country's population had changed to an urban predominance. With 64 per cent of the population

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[6] "The Evolution of the Shopping Center," The Community Builders Handbook, Members Edition, (Washington: Urban Land Institute, 1954), p. 3.

then living in urban areas, the population in and around cities had grown two and one-half times faster than the country as a whole.

During each of the past ten years, the American population has been increasing at a rapid race of about 1.7 per cent.[7] A continuation of this current rate of growth will mean a population in the United States in 1970 of 210 million, by the year of 2000 a population of 350 million, and by the year 21000, a population of 800 million.[8]

Though our big cities have grown during the decade of the fifties, they were far outstripped by the surrounding suburbs. Smaller cities grew at a rate faster than the cities over 100,000 population and many of these, particulary in the South, outstripped their outlying areas. But in general, the fastest growing metropolitan areas--including both cities and suburbs--were in the south and the Far West.

Civilian construction, long held back by the demands of World War II, boomed in the late 40's and early 50's. Building for retail distribution was high on the list of new construction, and suburban locations near the new teeming population centers were most popular. The reason for this is that population growth in this country has taken place largely on the fringe of cities, and alert businessmen have taken their retailing operations to the places where consumers have chosen to live. The following chart shows the tremendous population growth that has occurred in the

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[7]George J. Stalnitz, "Our Growing Population, Threat or Boom?" Business Horizons, (Spring, 1959), p. 37.

[8]"What the U. S. Will Be Like 10 Years from Now," U. S. News and World Report, (November 9, 1959), p. 76.

suburban areas:[9]

TRENDS IN URBAN GROWTH

	1950	1955	Change in 5 Years
In suburbs of 168 metropolitan areas	34,660,700	44,281,000	Up 9,620,300 or 27.8%
In major cities	49,135,000	51,023,000	Up 1,880,000 or 3.8%
In other urban areas	23,067,000	51,023,000	Up 1,150,000 or 5%
In rural areas	42,771,000	41,440,000	Down 831,000 or 1.9%
Total United States	149,630,700	161,461,000	Up 11,827,300 or 7.9 per cent

It is projected that by 1976, urban areas will contain three-fourths of all the population. If the suburban development continues at its present rate, 80 per cent of the expected 46.5 million increase in urban areas will take place in the suburbs.[10] In addition it is projected that there will be 70,000,000 registered passenger cars by 1965.

With these factors being considered and other related considerations, it is estimated that the 4,500 centers in operation by the end of 1960, will swell to more than 10,000 shopping centers by the end of 1965, a mere five years from now if no major economic crisis develops.[11]

It is clear that the shopping center industry which is enacting the

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[9]United States Bureau of the Census, Trends in Urban Growth, (Washington: Government Printing Office, 1956).

[10]Utilities and Facilities for New Residential Development, Technical Bulletin No. 27, (Washington: Urban Land Institute, 1955).

[11]Kaylin, op. cit.

most tremendous success story of the twentieth century, has come of age and is taking it's place among the growing industries of the world.

<u>The Gigantic New Market</u>

The automobile accounts for suburbia, and suburbia accounts for the shopping center. Suburbia also generates the vast new market demands for practically everything from baby carriages to washing machines. In the suburban market, young married couples with growing children are the customers whose shopping and convenience needs have to be met. This is not the only market for the merchant to seek out, suburbia is now accommodating ones entire life cycle.

> "Developers would like one to live in one court as a child; a two-bedroom apartment as a newlywed; then a ranch house. Finally, when you're old and gray and your children are scattered to the four winds, you would move back to a court to serve out your term as a baby sitter."[12]

Suburbia affords not only more new customers but better customers. Suburbia families are potentially bigger spenders than city families. Average income is estimated at $6,500 a year, fully 70 per cent higher than the average U. S. family.[13] The casual, do-it-yourself life in suburbia has opened the vast market for products such as power tools, sportswear, nursery items, etc. The suburban shopkeeper has to stock items that often would stay on the shelves in city stores.

12"From These City Areas Come Tomorrow's Vast Interbian Markets," <u>Printers Ink</u>, (April 26, 1957), p. 39.

13"Selling to an Age of Plenty," A special report. <u>Business Week</u>, (May 5, 1956).

The shopping center developer-owner must be aware of merchandising because new products and departments in selling may or may not have repercussions on sales volume. Where this is the basis on which he is paid rent, he must be awake to changes in ways of doing business and to the types of market which are his customers. However, new departures in merchandising are not likely to be so radical as to eliminate the newly found convenience and mode of shopping in the automobile.

The shopping center concept has arrived at a stage for effectiveness in retailing. But building a center and keeping it running profitably are two different things. Location and site arrangement, even based on correct planning principles does not always make up for the intangibles of operation and merchandising.

Basic Definitions

Before proceeding further, it would be well to define a shopping center. Even though shopping centers are widely dispersed throughout the country, the term is often misused. Basically a shopping center is a group of stores, not very different from those of the ancient market places or of the typical American business district. However, the developers of these "authentic" modern retail distribution units have their own definition of the term. Richard L. Nelson, one of the country's most noted real estate economists describes the modern shopping center as follows:[14]

1. "A tract of land and buildings under single ownership or control, though a center may include an isolated store

[14] Richard L. Nelson, The Selection of Retail Locations, (New York: F. W. Dodge Corporation, 1958). p. 174.

which owns its land and buildings (most frequently a department store, a gasoline service station, or a restaurant).

2. A single building or a carefully coordinated group of buildings having a variety of types of stores tending to maximize the cumulative attraction of the unit as a whole.

3. A facility which includes a large amount of free parking.

4. A location which is 'outlying,' at least in the sense that it is not the central business district of a community. There are some exceptions, for example, the 'downtown' of Park Forest, a large Chicago suburb built by a single developer, with a business district in the center; in all other respects it follows the definition of a shopping center and is commonly so termed by the people in the community and in surrounding localities."

As the shopping center has evolved, three distinct types have emerged, each definite in their own function: the neighborhood or convenience shopping center, the community shopping center, and the regional shopping center. Usually the neighborhood center is where people go to buy their food, pick up dry cleaning, have their shoes rescled, or gas the car. The community center is one which is built around a variety store or junior department store as a major tenant. Since some shop ing goods are available, the shopper wants to compare price and style, this complicates sales volume predictions and often opens the community center to the competition of the regional center. It is the regional center, built around a major department store as a core, which provides for a vast variety of general merchandise, apparel, furniture and home furnishing. Since the regional center offers shopping goods in great depth and variety, its drawing power is based on its capacity for comparative shopping modified by the factor of time spent in travel with the least amount of irritation to reach the center. This size center comes the closest to reproducing the shopping facilities once available only in downtown areas.

What Tenant Types Go into a Center?

Whether or not certain tenant types are available for a particular center will depend not only on the size of the project and the quality of the location, but also on merchandising practices and consumer buying habits in the area under consideration. As was previously mentioned, the supermarket is considered the main tenant of a neighborhood shopping center and the department store the prominent regional center tenant. The other stores in the particular center will vary according to "rule of thumb" methods which developers and tenants follow. There is no "ready made" rule which can assure the correct selection of tenants. For example, if the area in which the proposed shopping center is to be located contains an extensive number of factory workers as residents, a working mens' store would supposedly be a desirable tenant. A large number of executives living in the area would be a criterion for locating an airline office in the center.

To insure success in the correct selection of tenants, an economic study of the area should be taken which would point out among other factors, income, home ownership, nationality, and ethnic characteristics. A study of this nature, coupled with the experience of the develcper and tenants, can aid in determining the tenant types of a center and the size store most economically feasible for the tenant.

Listed on Table 1 are the indicators for types and sizes in shopping centers based on the writers calculation, as taken from the various statistics available.

TABLE 1

TABLE OF INDICATORS FOR TYPES AND SIZES IN SHOPPING CENTERS

Type of Center	Neighborhood	Community	Regional
Average Gross Floor Area	40,000 sq. ft.	150,000 sq. ft.	400,000 sq. ft.
Ranges in Gross Floor Area	20,000-75,000 sq. ft.	100,000-400,000 sq. ft.	300,000-over 1,000,000 sq. ft.
Average Minimum Site Area	4 acres	10 acres	40 acres
Minimum Support	1,000 families 7,000-20,000 people	5,000 families 40,000-100,000 people	70,000 to 300,000 families 200,000 or more people
Leading Tenant	Supermarket or Drug Store	Junior Dept. Store or Variety Store	One or Two Department stores

CHAPTER III

SHOPPING CENTERS...

ARE THE TENANTS ASSURED SUCCESS?

The shopping center has been a significant factor in changing many shopping habits. It affords the public an easier and better way of making its purchases by bringing close together, close to home, and close to adequate parking, those lines of merchandise which have the greatest demand. In addition, it offers an ease for shopping, compared with downtown stores, that will be increasingly important in our national retailing picture. However, as in many situations there are often misconceptions that arise among the public, developers, and even alert merchants. There is a popular misconception of the infallibility and huge profits in the development and operation of shopping centers. Some centers are profitable, but indications are that the degree of profitability is surprisingly low. No statistics have been published denoting the various failures or profitability of centers, however, the rate of return to the developer is quite low.

> "Very few of the larger centers will yield better than 8 per cent net, free and clear. The cost of mortgage money, to include both principal and interest, is now approaching the 8 per cent figure, so that very little leverage is left for the equity money in this investment field."[15]

The fact that many people think shopping centers are so profitable hurts the business in many ways. One of these ways is the view taken by many municipal taxing authorities throughout the country. Tax authorities seem to look on shopping center ownership as being equivalent to ownership of a producing oil well. It is this reason that causes the unrealistic

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[15] Leonard L. Faber, "Keynote Address," 1959 Annual Convention Proceedings, April 5-9, 1959, (International Council of Shopping Centers, 1959), p. 9.

and unfair tax assessments. Unfair tax assessments, in turn, increase the rental burden on the merchants within the center since many leases stipulate progressive rent scales which accomodate real estate tax increases. If the lease does not call for increases caused by such assessments, the developer is burdened with the additional operating expense, thereby leaving him less funds available for promotion and improvement activities. It is a situation where a merchant who leases from a misguided developer can suffer, that is, if the tax problem is not worked out at the time of the lease signing.

Coexistence with the Amateur Developer

Closely allied with those holding a misconception of shopping centers are the many inexperienced people in the business, which is also adding to the overproduction of centers. The situation often occurs with a home builder, setting aside a tract of land in the center of his development, for the purpose of creating a shopping center. The builder usually knows little about leasing, nothing about merchandising, and figures his job is done when he completes the building and turns over the keys to his tenants.

The merchant who leases from this type of center must be very cautious. Though he can coexist with the amateur developer, the writer recommends that a prospective tenant, chain or independent, review the following outline dealing with the amateur developer.

1. Determination of the trade area tributary to the shopping center. Analysis of the area's population changes, both numerically and in percentages for past, present, future growth, translated into maps and figures. Analysis of access, highway patterns or future ones, traffic counts and street capacities.

2. Purchasing power for primary, secondary, and remote trade areas. Disposable income in amounts or percentages after standard deductions for Federal income and local taxes, housing costs in terms of mortgage or rental payments, insurance and savings, and transportation costs have been eliminated.

3. Measurement of competition--discount for composite pull of other competing retail outlets.

4. Sales potential, estimated per annum volume of business, operational expenses, etc.[16]

Actually the best criteria for making a sound judgment is good judgment itself. Charts, studies, and various analyses are merely tools to assist in a decision. Original research will considerably aid a merchant's projections of the feasibility of entering into a particular shopping center.

Is the Shopping Center Indirectly Guilty of Overbuilding?

Due to the rapid expansion of the shopping center industry since the end of World War II, an important question arises; Are there too many shopping centers? In general the answer is no! Statistics in Chapter One have shown that population increases and projected income growth should absorb and utilize the existing and future centers. When asked if there are too many shopping centers, S. O. Kaylin, Executive Editor of Chain Store Age replied, that the population is likely to catch up with any overexpansion. It must be remembered, that the 10 million new families moving into suburban areas from 1960 to 1975, will be spending $60 billion in retail stores. To handle this volume at an average of $100 worth of

[16] J. Ross McKeever, Shopping Centers Re-Studied, (Technical Bulletin No. 30, Washington: Urban Land Institute, February, 1957), p. 21.

sales per square feet of gross store area would require 600 million square feet of building area.[17] This will require extensive store construction of which shopping centers will be a significant part.

It has been found, however, that there are signs of overexpansion of shopping centers in certain market areas of the United States. Many of these were built because a reputable market analysis was lacking on the part of the developer and leasing merchants. The fact remains that there is just so much spendable income in any municipality or locality. Whether there are too many shopping centers depends on how thinly they divide the total available spendable income of the community.

A real problem of overbuilding concerns the financial status of the developer and present tenants while awaiting for the particular center to become profitable. Eventually, the developer will be foreclosed if the center is his only source of income, while the merchants of competing centers will be tempted to "cut each others throats."

The only foreseeable solution to the problem of overbuilding is tighter lending requirements on the part of the investors who supply the capital for the actual construction. In addition, merchants themselves should execute better judgment before entering into a center which is located in an overdeveloped shopping area.

Possibly, a shopping center trade association could act as a "go-between" among developers, financiers, and merchants to eliminate some of the existing harmful duplication of centers in the future. Financiers,

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[17] Homer Hoyt, "Changing Patterns of Urban Growth," Business Horizons, (Summer, 1959), p. 31.

developers, and merchants would use the association as a clearing house to report their planned activites on particular sites. If other interests had plans formulated for a nearby site, the two groups might compromise or join forces to build a bigger center in order to eliminate the possibility of two competing unprofitable centers.

There is one area, in particular, which stands out as an opportunity for potential shopping center building, this being the urban renewal program which is being undertaken in various communities throughout the country. There are approximately 40 projects which have land that may be suitable for shopping centers of the neighborhood or convenience type. These would represent new centers built in an old area which have gone through the process of urban renewal.

Developments such as the urban renewal projects, coupled with the growing population has reduced the problem of overbuilding of centers. Richard L. Nelson had this to say about the future of the industry: "I think the opportunities will be as great in the next eleven years, but it will be much more competitive."[18]

In reference to the original question, are shopping center tenants assured success. The answer is no!

Success for a merchant depends not only upon his merchandising ability which must be exerted just as if he were in a downtown location, but in addition, his success is often dependent upon the capabilities of the developer of the center in which he is a part. A misinformed, inexperienced,

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[18] Richard L. Nelson, "Selecting the Right Site for a Shopping Center in Today's Economy," <u>1959 Annual Convention Proceedings</u>, <u>op. cit.</u>, p. 17.

or amateur developer may tend to lessen the success of the center. Over-building obviously is another factor which may reduce a merchants chance of success.

It must be remembered, that shopping centers are not only real estate ventures, but also a merchandising function. When this concept is not adhered to by the developer, the tenant suffers.

There is more likelihood of a progressive tenant achieving success in a center if the developer is "market orientated" and is interested in promoting the center as a unit, rather than as a "get rich quick" real estate venture, which the shopping center industry claims has been the downfall of many centers.

CHAPTER IV

SHOPPING CENTER FINANCING...

WILL IT ELIMINATE THE INDEPENDENT?

"America can no more survive and grow without big business than it can grow and survive without small business."

Benjamin Franklin

One of the most serious problems facing the shopping center industry at the present time is the trend in financing which appears to act as a discrimination against the independent merchant. It seems that many financial institutions will not lend a developer funds unless the loan is secured by leases signed by a high proportion of chain operators. The result of this could easily initiate the downfall of the independent merchant. Concern was voiced over the situation by a United States Senate Subcommittee of the 86th Congress, which reviewed this problem. The writer, in this chapter, will investigate the background and implications arising from the current trends in shopping center leasing.

What are the Requirements and Types of Financing Needed?

There are various factors which determine the extent to which satisfactory financing can be obtained for a shopping center. The more important ones are the following:[19]

1. Location
2. Tenants and rents
3. Economic analysis
4. The developers investment

The favorability of the first three factors are determined primarily by sound judgment on the part of the many lenders. There are no set rules, because each center is radically different in its size, scope, trading area, leases, etc. Each must be considered on its own merits and faults. When the location, tenants, rents, and economic analysis are favorable and when the mortgage market is in a healthy condition, it is possible that the

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[19] Larry Gruen, Victor, and Smith, Shopping Towns U. S. A., (New York: Reinhold Publishing Corporation, 1960), p. 57.

developer of a project may obtain 85-100 per cent of the cost of the project (generally excluding land costs) in the form of a first mortgage, at competitive interest and with suitable repayment conditions.[20]

The actual types of financing for shopping center construction are termed mortgage financing and equity financing. Mortgage financing generally consists of either first or second mortgages at interest rates which depend on the availability of funds and the interest rates current in the market. On the other hand, the equity investment may be represented by ownership of the land and cash investment on the part of the developer or, in the case of corporate ownership, may be represented by investment in preferred and/or common stock.[21]

In addition, beyond these basic types, there are various unique ways which have been developed to facilitate the financing of shopping centers. These would include, split mortgages by which prospective mortgagees may loan on portions of the project rather than on the project as a whole; participation in a single blanket mortgage by more than one insurance company or other mortgages; sale and lease back by which the property may be sold to the prospective investor and leased back to the developer; sale or ground lease of the land, upon which the department store and other principal tenant is located to such tenant; and construction of the building or buildings for the use of such principal tenant by the tenant himself rather than by the developer; ground leases, by which owners of property

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[20] *Ibid.*

[21] *Ibid.*, p. 58.

lease it to a developer on conditions which may permit the subordination of the ownership in the land of the mortgage.[22]

Sources of Financing

To further present to the reader the financial workings of a shopping center, the sources and procedure for obtaining a mortgage will be briefly described.

The major sources of funds are as follows:

1. Insurance companies. Many insurance companies actually solicit financing for shopping centers and as a result, are the principal source of funds for shopping centers.

2. Pension funds. Administrators of pension funds of various retail businesses, industrial companies and labor unions show must interest in the financing of shopping centers.

3. Educational institutions. College and university reserve and endowments are often available for real estate projects.

4. Financing syndicates. This source will often take partial or full ownership of centers and will provide the equity capital as well as the know-how required for development purposes.

5. Real estate companies. These corporations have shown much interest during the last five or six years in the acquisition and development of shopping center properties.

The actual procedure used to apply for a mortgage varies as each institution has its own mortgage application form in which the bare essentials of the project have to be stated. In most cases, however, the developer will be required to provide a market study. Then too, he will normally be required to provide architectural plans indicating the locations of the stores, the dimensions of the project, the extent of the parking,

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[22] Ibid.

of the stores, the dimensions of the project, the extent of the parking, and other factors. Also included will be a schedule of rents indicating proposed tenants, amount of space they will occupy, amount of guaranteed rent, and percentage rent terms. Another requirement is an abstract of the leasing program showing the general nature of the leasing commitments, accompanied by the lease document proposed for use in tenant negotiations. In addition, the developer will ordinarily be asked to provide a profit and loss estimate indicating the amount of rent expected, together with the budget of expenses for the project and the net income figures. These will be used by the financing institution to determine the economic value of the project in comparison with the institution's own sources of this information.

The projected center is always appraised by the potential lending institution, which may agree or disagree with the developers market study and rental estimates. It is the appraisal of the financing institution which determines the decision to provide the requested financing.

To familiarize the reader with the various forms used by developers and mortgage brokers, copies of typical forms are found in the appendix.

<u>Form 101 Application for Mortgage Loan Commitment.</u> This form sets the mortgage terms under which clients can work. It is their minimum mortgage acceptance. In addition it sets forth the brokers commission arrangements.

<u>Form HA 102 Mortgage Loan Application.</u>

<u>Form HA 103 and HA 104 Shopping Center Analysis and Typical Analysis.</u> Form 103 is the means of compiling an economic picture of the center.

<u>Form HA 105 Correspondents Appraisal.</u> A companion to Form 103 setting forth the physical and economic appraisal of the center.

The AAA Stipulation, How Does This Effect the Tenant and the Developer?

Most insurance companies and other financial institutions are inclined to be heavily influenced by the amount of space that is rented to retailers with strong national credit, on the assumption that such renting will provide the maximum protection for the amount that is being loaned. The insistence that a large proportion of space be rented to companies of high credit rating may have a tendency to strait-jacket the developer; it necessitates his renting to companies of high credit regardless of whether local tenants or other tenants with lower credit rating would provide a better shopping atmosphere and a better complement of shopping amenities for the customer.

The financing of shopping centers with its many stipulations is very complex. The owner-developer of a shopping center must provide equity capital not only for construction costs but also for the acquisition of land, architecture and engineering fees, financing charges, interest, legal fees, overhead, etc., and finally, those costs associated with the operation of the completed center. It has been found that a large percentage of shopping center developments involve the syndicated type of operation in which the landowner, the architect, the builder, the developer or renting agent, and the attorney, contribute their services and the land and hope to borrow enough money from a financing institution to preclude their own cash investment.

The expenses associated with construction costs account for the largest share of the equity funds required for developing a center. Local banks provide short-term construction funds and are usually the first source of funds, often by mortgage loan. When the construction is completed the short-term lender is paid off and the insurance company or pension fund holds the first mortgage.

> "The Institute of Life Insurance states that the aggregate financing needs of shopping centers range from approximately $200,000 to as much as $45 million. The average value is believed to be between $1 million and $2 million."[24]

Shopping center financing takes on big dimensions, as indicated by the previous figures. It is so big that it is almost a universal policy of the major, permanent lending agencies, that before they grant a long-term loan on a shopping center, the developer must have obtained fixed-minimum, guaranteed rentals from AAA tenants (tenants with a net worth of at least $1 million) to cover amortization of the loan (both principal and interest), real estate taxes, insurance, and frequently operating expenses.[25]

Accordingly, this requirement of the permanent lenders usually amounts, in a typical shopping center development, to about 70 per cent of the total space that must be covered by the fixed-minimum guarantee rentals of tenants of good national rating. The vice-president of one of the largest insurance companies in the country made a study of 10 of company's 84 shopping center loans, taken at random. The cases studied ran from

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[23]United States Congress, Senate, Committee on Small Business, Shopping Centers--1959, Hearings before Subcommittee, 86th Congress, 1st Session, (Washington: Government Printing Office, 1959), p. 136.

[24]Institute of Life Insurance, News Release on Shopping Centers, (New York: Institute of Life Insurance, November 28, 1958)

[25]U. S. Congress, Committee on Small Business, Shopping Centers--1959, op. cit., p. 101.

loans of $500,000 to $15 million. He found that the "name" tenants provided 60 to 74 per cent of the income; the average of the 10 cases was 70 per cent.[26]

The policy of lending agencies regarding AAA chain store tenants is somewhat flexible, changing from time to time with changes in the money market, with the size and location of proposed centers, and with the skill and reputation of the individual developers. Various articles indicate that when money is tight, requirements are tightened up; when much money is available, usually the requirements are liberalized. In addition, it has been found that there is a higher percentage of AAA tenants required in the larger center than in the smaller centers and that an unusually good location and a highly reputable developer may persuade the mortgagee to take relatively more tenants with less than AAA credit. However, no matter how the situation is manipulated, around 70 per cent of the tenants must be of the AAA caliber, a rating which the typical progressive independent merchant is lacking. It presents a real problem and the need for good alternative measures that the independent can take in order to insure his continuation in the retail field.

Lease Restrictions

Discriminatory practices against independent merchants are taking place in many lines of retailing. Examples are on record of food, drug, and variety store merchants being refused shopping center locations because they lacked triple A rating even though in their particular locality, the

[26] *Ibid.*, p. 133.

merchants had proven themselves in merchandising and ownership functions.

At the Senate Subcommittee Hearing conducted by the Select Committee on Small Business in April of 1959, various merchants voiced their views at the hearings. One merchant, an operator of three successful supermarkets in Oklahoma City testified how he was denied space in shopping centers because of the AAA net worth requirement. The market owner was a personal friend of the developer and in addition, his wholesaler supplier having annual sales of $134 million and total assets of over $10 million agreed to cosign the lease. The developer had to conform to the demands of the lending agency and as a result, the 30,000 square foot supermarket was leased to a national chain, thereby restricting the further expansion of the independent supermarket owner in that city.

The story is similar in the drug industry. Highly successful independent drugstore owners, one in particular, the owner of 10 drugstores in the Washington, D. C. area, told of his unsuccessful attempts in trying to secure shopping center locations. In referring to the occupancy of a chain store in the new modern locations, one claimed,

> "It is not because we independent, local druggists are stupid. We want those locations, we will pay the owners more rent for those locations and we will sell as much or more merchandise in those locations. We can't even get consideration from the builders or developers of shopping center locations. Why not? Because we do not have national credit rating. That is our crime."[27]

These druggists in particular questioned the future of the independent under these circumstances. Finally, in the variety store field there is an

[27] Ibid., p. 46.

example in Florida of an operator of six locally owned variety stores who had operated successfully in Jacksonville for 25 years in direct competition with national variety chains. He was unable to obtain leases in the larger shopping centers because his company is not national in scope, thus unappealing to the financing organizations. The operator testified that the strategic locations of the new shopping centers are causing existing stores in old established locations to close their doors because of lack of customers. "In our area, the available locations for shopping centers will soon be taken up and the small businessman will be frozen out for good."[28]

Since shopping centers will play an increasingly important role in future retailing, the role of the independent may change if the present stipulations on leasing continue. Throughout the years, particularly in the food industry, the independent merchant's volume versus chain volume has not varied by more than one per cent. This fact is shown in many of the grocery trade publications such as the Progressive Grocer, Super Market Merchandising, etc. However, in relation to chain volume cannot remain steady if the independent is unable to attain a position in the shopping center. Independent operators have the vehicles to merchandise food, often at prices unsurpassed by any type operation through their buying affiliations with voluntary or cooperative wholesalers. Price, quality, and service are often the keynote of his story, however, if the independent market is not situated favorably in relation to his competition, his future

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[28]Ibid., pp. 61-62.

success is questionable.

Why Are Higher Rents Charged to Independents?

In addition to the AAA tenant requirements which independent merchants are exposed to, many are subject to higher rental charges if they do succeed in getting into a center. The department stores and chain stores, knowing the developer must have them because of the AAA tenant requirement, are in a strong bargaining position when it comes to negotiating the percentage terms of the lease. The developer, in order to obtain a department or chain store for financing purposes, will lower the percentage for the chain or department store and hope to make it up later by charging the smaller independent more.[29]

The reason for the higher rents charged independents seems to be traced back to the lending institutions, who are very insistent on the national chains being in the center not only as a guarantee in attempting to cover the cost of the interest and principal, taxes, insurance, management and maintenance, but as an attraction for consumers to shop at the center.

In this situation, the developer is caught in the middle of the squeeze. He realizes the need for local merchants to add "personality" to the development, however, he is faced with the situation of attracting good merchants who will agree to pay the premium rate of rent which they are often charged. The problem should work itself out when financial institutions become aware of the fact that uneconomical rentals to

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[29] Ibid., p. 2.

department and chain stores can jeopardize the financial success of an entire shopping center. This should occur on its own accord because invariably a developer will be in a financial difficulty if he is dependent upon the profits of the ridiculously low rental contracts that many developers made in order to get into the shopping center business. It will be a natural occurrence for developers to charge realistic rents to both chain and independent tenants so as to arrive at a favorable balance of each type of merchant in his center. A developer who presents a rent schedule to a financing institution which does not allow for profit will most likely be refused assistance.

Will the AAA Tenant Requirements Contribute to the Growing Concentration of Retail Sales?

By the end of 1958, there were 20,600 chain stores operating in shopping centers with an additional 6,025 new chain outlets planned for 1959 alone.[30] This represents an increase of about 30 per cent in one year. If the predicted growth in population takes place, it appears that the greatest number of new retail store openings in the years ahead will take place in shopping centers. The significance of this growth for the independent businessman is that what might otherwise be an era of increased opportunity for thousands of independent businessmen in a growing population and an expanding economy, will instead, be an era marked by further concentration of retail sales. The trend is already apparent. In 1958,

[30] *Ibid.*, p. 229, citing the 20th Annual *Chain Store Age* Construction and Modernization Survey.

receipts of the top 20 retail chain companies represented 12 per cent of the consumer spending in all types of retail stores.[31]

While perhaps these facts are discouraging to some, especially those who feel they are being discriminated against, the history of the independent merchant indicates that even as a tenant in the downtown shopping area, the key to obtaining a location was not based entirely on his skill or experience as a businessman, or even his ability to pay rent, but rather on the arbitrary requirement of net worth, set unusually high to meet the unusually conservative demands of one industry, financing institutions.

Whether they will change their ways is doubtful. As custodians for other people's money, financial institutions are interested primarily in the security of the factors of credit, stability, continuality, and management performance of the various tenants in a center, projected in terms of 20 to 30 years. Some shopping center industry men feel that the lenders are doing a great disservice in being so strict in placing so much emphasis on high percentage chain-store leasing. It is felt that the success of a shopping center lies in a good representation of both chain and independent merchants. Wallace E. Agnew, vice president of the Walker & Dunlap, Inc., mortgage banking firm once made a statement which should be taken into consideration by the lending agencies:[32]

> "The experienced, local merchant with adequate financing and a good following, but without an AAA balance sheet, will considerably out-merchandise the major chain. His total sales

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[31]"Marketing--The Top 20 Retailers: 1958 Score," Business Week, (April 11, 1959), p. 45.

[32]U. S. Congress, Committee on Small Business, Shopping Centers--1959, op. cit., p. 167.

> will be larger per square foot and his percentage rental payments at a higher rate. By his following he will develop traffic and business not only for himself but for the center as a whole. A capable, successful local merchant is far from the rarity which most insurance lending officers seem to think he is. He can be located; he can be replaced if he dies or is incapacitated; and he can do a great job of making a center really financially successful instead of only modestly so."

The problem of the "discrimination" toward the independent will probably work itself out as time goes on. Since it appears that the days of the amateur developer are coming to a close, the professional developer, will no doubt gain the respect of the lending institutions to the point that the developers judgment of tenants will carry considerably more weight than it does at the present time. In other words, instead of the mortgage men relying on the signature of 75-80 per cent AAA tenants, more assurance will rest with the "professional" developer. Thus in the future, the experience, reputation, ability, and equity position of the developer will become increasingly important. Developers should take every possible measure to insure themselves of esteem in the eyes of the money lenders.

<u>What Measures Can Be Taken to Aid the Independent in His "Crisis."</u>

The problem of "discrimination" against the independent merchant in the shopping center industry can hopefully work itself out over time as indicated in the previous chapter of this report, or there are possible courses of action, taken either by private or government activities, which could alleviate this problem. The methods available, some not condoned or even considered feasible by the writer, represent the alternative solutions to this current problem facing the industry. Some possible solutions are as follows:

1. Government providing financing. One suggestion is that the Government provide financing at reasonable rates as a second charge on the center, in proportion to the space rented to tenants of nonapproved credit. In doing this, it is hoped that the owners or developers of the shopping center might be inclined to rent a somewhat larger share of space to the tenants who cannot otherwise gain admittance to shopping centers. Obviously, this method of financing would involve Government intervention, plus aid that is not really practical and needed. There is financing presently available for shopping centers, certainly some means other than Government financing would be more realistic.

2. Suppliers cosign retailer leases. Under this system, for example, a super market operator desirous to enter a center would arrange with one of his suppliers who had AAA qualifications to guarantee his lease with the developer. In return, the super market operator would than make his purchases from that supplier. The supplier might conceivably be a wholesale grocer or even a dairy company.

There are various other methods used to aid the retailer in the form of cosigning of leases. One wholesale cooperative, the Associated Grocers of Seattle, has established a subsidiary company in order to have funds available to back up its member stores who wish to enter shopping center locations. In the shoe industry, Shoenterprise Corp., of St. Louis, which is a subsidiary of the International Shoe Company, has a unique plan which has underwritten some 60 independent shoe stores that are now in shopping centers.[33]

While some individuals probably view this arrangement as a means of the retailer losing some of his independence, it must be remembered that the retailer is protected by a Federal Trade Commission ruling which prohibits a manufacturer or wholesaler from forcing a retailer to handle the underwriting suppliers merchandise exclusively.

3. Small business investment companies. Another possible aid to qualified local tenants would be the use of the newly created Small Business Investment Corporation. It is possible that a SBIC loan could be made available under certain circumstances, to aid a tenant by lending funds to pay the last years rent or for an advancement loan purpose which often are required by mortgage men. However, the Small Business Investment Corporation was not created for this type of activity, therefore, it is not considered too feasible unless it is a desperate situation.

4. Utilization of the Sherman Act and the Robinson-Patman Act. Under the Sherman Act there have been cases which involved a merchant being denied space in a building used by his competition and also being owned by his competitors. Under the Sherman Act, the latent monopolist must justify the exclusion of a competitor from a market which he controls.[34]

While the number of occurrences of this situation is limited, it may become of importance in the future. Some business firms, such as Food Fair

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[33] *Ibid.*, p. 96.

[34] U. S. Congress, Committee on Small Business, Report No. 1016, *op. cit.*, p. 23.

Center, a case may be established proving exclusion. In addition, the problem could occur between department stores and smaller merchants. Department stores are becoming significant factors in shopping center development. If clothing merchants or other direct competitive merchants are denied leases because of exclusion, the above-named acts may be effectuated, thus shedding new light on the problem.

5. Tax aids to beginning businessmen. Leonard L. Farber, president of the International Council of Shopping Centers, is on record as suggesting that the government might give a liberal tax exemption to a businessman during his first years of business operations when the pressures are greatest and when he runs the greatest dangers of failure. With this arrangement, only the beginning merchants would be aided; the already established merchant would not be aided in his attempts to gain entrance into a shopping center.

Actually, the idea of tax aids to beginning businesses seems impractical and unrealistic. It would be most difficult for tax agencies to control such a system or to establish the rules to make it function.

6. Lease insurance. A lease insurance program, either by a private insurance company or by the Government may be a solution. By lease insurance, an insurance policy could be written to cover the conditions of a tenants lease for the period of the lease. Under this program, the financing institutions would seemingly have the security they seek and there

would thus be no need for the AAA tenant requirement. Possibly, the developer of a proposed shopping center could then solicit prospective tenants into his center on the basis of their merchandising ability rather than on their net worth.

This type of arrangement, while on the surface appearing as an ideal measurement, is more on the natu of a surety contract, such as a lease bond, as described in insurance terminology. In actuality, it is impractical because, as voiced by the Life Insurance Association of America,[35]

> "Without attempting to examine all aspects of the problem, we express the opinion that it would not be possible for life insurance companies to engage in such a program of lease insurance under their existing charters or under the regulatory laws governing the coverages they may issue."

7. Lease bonds. The surety industry for many years has had available lease bonds for business concerns. Lease bonds are written with the indemnity of the principal, and a financial guarantee of this type is generally underwritten in accordance with the financial standing, business experience, and reputation of the principal.[36] The practice of bonding the performance of leases is not widespread, and most of this type of financing has been found to have been written in connection with Federal leases. Lease bonds are not prominent in the shopping center industry.

One thing in particular, lease bonds are usually written for a one-year period only and are subject to close scrutiny on the part of the surety industry. They are not geared to a mass production basis, therefore, it

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[35] Ibid., p. 24.

[36] Ibid., p. 25.

is doubtful if they could be utilized by potential desperate tenants. Since the surety industry is quite particular when writing lease bonds, it appears that the person most able to qualify for such a bond is the person least likely to need it, the converse probably being true also. Many variables enter into a business over the years, therefore, lease bonds which are for short-term periods are not too helpful to a tenant that needs a 10-20 year coverage.

8. Use of FHA system of insuring mortgages. It is felt by the writer that if some artificial measures are taken to insure the independent merchants entrance into shopping centers, the FHA type system should be inaugurated. Such a program could operate under the supervision of the Small Business Administration who would have the task of evaluating the abilities and potentialities of the applicants. While this would probably aid the independent in his fight for survival in shopping centers, the complications arising from the plan might not be encouraging.

There seems to be no barriers left to eliminate the overbuilding of centers if many merchants who otherwise would be nonfinancible, would now be able to enter into shopping centers as tenants. In turn, the success of standing centers and the number of independents already in those centers would be seriously jeopardized. Therefore, as a solution to the independents dilemma, it is the writers opinion that nothing be done. Time should solve the problem. The lending institutions will most likely change their attitude in the near future by permitting the able local independent space in the center if he is recommended by the "professional" developer, as was previously discussed.

What About the Innovator?

Could it be that the reason why lending institutions insist on bringing the chains into the center is simply to prevent them from coming into the developed trade area afterwards in competition with the shopping center? No matter what the tenant selection policies of the shopping center are, there is always room in the merchandising world for the aggressive, non-conventional, low margin mass retailer.

If the center is successful in freezing local retailing into a mold which is immune to change, new retailing forms or concepts will probably develop outside the center.[37] This is because the retailers outside the center somehow have to compensate the shopper for giving up the conveniences of the center. Evidence of this is seen by the various discount houses which are springing up throughout the country, often times in direct competition with a big shopping center.

The "discount" innovator has disturbed the "status quo" of many centers. At one time the discount operator was refused as a tenant in shopping centers; now, he is welcomed. Possibly in the future, a new type retailing institution will arise, composed of innovating entrepreneurs who were restricted from the traditional shopping center or who would not subscribe to the high rent and controls which are imposed on shopping center merchants. If the new type institution results in increased efficiency and bringing

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[37] Morris L. Sweet, "Tenant Selection Policies of Regional Shopping Centers," Journal of Marketing, (April, 1959), p.62.

merchandise to the consumer at a lower price, it most likely will be socially desirable and well patronized by the consumer. Then maybe these merchants will be able to "discriminate" against the traditional chain shopping center retailer who desires to be a tenant in their institution.

CHAPTER V

IMPORTANT ASSOCIATIONS...

NECESSARY OR NOT?

A problem which has been in existence since the formation of the first shopping centers and which has increasingly progressed as a matter of conflict, is that of the merchants' associations.

Since many leases written between the developer and tenant specify that additional rent shall be paid over the minimum rent when sales reach a certain amount, it is well for the developer to be interested in promotional devices to increase his income. In addition, any measures that the merchant can take to increase his sales and profits is highly desirable. In many situations, it is an absolute necessity that the developer be interested in building sales volume inorder to justify the low rental lease agreements that are often written with the chains and leading department stores.

Today, the development of shopping centers is much more in the nature of a merchandising venture than a real estate speculation.[38] Along with increased interest in merchants associations, many conflicts have developed between developers and tenants in finding the "right mix" in their attempt to have a functioning merchants association. In this chapter, the writer will search into some of these problems and suggest measures to help alleviate some of them.

Merchants Associations.

In the early days of the shopping centers, many fellow merchants carried on active trade battles against one another at various times, even

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[38]David Carlson, "What Next in Shopping Centers," Architectural Forum, (April, 1960), p. 162.

though they were not always directly competing against one another in trade lines. To complicate matters, it was not uncommon to hear of the continued tensions between the landlord and his tenants. Conflicts as to hours, snow removal, parking, and improvements all seemed to occur exactly as it was borrowed from the retailers and realtor's relations on Main Street. The fact is, in the first few years of larger center history, a properly financed, well-located development, coupled with good road access was almost certain to be assured of success. Its immediate rivalry was limited and even internal conflict among the tenants and landlords was insignificant to the shopping center's success.

This situation is rapidly changing. As competing centers are constructed and failures begin to arise among some centers, there is evidence of need for better cooperation between the tenants and developers. Leonard L. Faber, president of the International Council of Shopping Centers commented as follows on the issue:[39]

> "The center merchants have recognized that, as tenants in a revolutionary new kind of merchandising development, their inherent interests make it both desirable and necessary that they join forces harmoniously in common promotional efforts. Tenants, both large and small, have begun to work together with a spirit of cooperation and common purpose that chambers of commerce and downtown merchants have never been able to achieve."

In a great many shopping centers, if one was to inquire as to the effectiveness of its merchants' association, the reply would no doubt, be unfavorable. It is a common practice of both the developer and the tenants

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[39]Samuel Feinberg, What Makes Shopping Centers Tick, (New York: Fairchild Publications, Inc., 1960), p. 28.

to accuse each other of the lack of effective planning or interest. It is often voiced by developers, that the main problem of the merchants' association is that chains will not cooperate in the association or center-wide promotions. However, it is found that the overwhelming majority of chains will go along with a sensible, carefully planned, budgeted program. Developers who work hard to promote sales, and who are willing to participate financially in promotions, have no trouble getting chains to cooperate.[40] Western Tire Auto Stores state that its most successful stores are in centers with the most active merchant associations. Another large volume chain, the W. T. Grant Co. is on record as follows: "In the past, we weren't sold on merchants' associations in centers, today, we want them. We feel everyone should join a centers' merchants' association."

In a survey by a chain as to the effectiveness of existing merchants' associations, it was found that some 60 per cent are not particularly effective.[41] Some of the reasons given were lack of strong leadership, inequities in determining contributions, unwillingness of a department store to participate financially, lack of interest by the developer, and the expense incurred by double ads by some of the chain operators who already advertise in the metropolitan area through other media. These are some of the main merchants' association problems.

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[40] S. O. Kaylin, "Centers in High Gear," Chain Store Age, (May, 1959), p. E36.

[41] *Ibid.*

What Can Merchants' Associations Do for the Tenant?

Merchants associations, backed up with enthusiasm and interest by both the developer and tenants can be one of the greatest assets that a shopping center can have. It can create a sense of cohesiveness and good-will within the center that will affect all the people in the area and help to generate the good public relations so vital to a center. A "personality" of the center can be established through these means. When this is created, it will play an important part in converting the consumers shopping habits in the particular trading area. It must be remembered, that a center laid down in a vacant field with beautifully built stores on it, doesn't insure a shopping centers success. The consumers shopping patterns must be influenced and changed in order to help it prosper.

Besides being an organization for promotions, the merchants' associations could be a service to all the center's stores by having specific programs such as shop-lifting and sales-training films available to those that want them. It seems feasible, that a system could be established for the control of bad checks that might be passed among the various stores. Another worthwhile service could be that of having consulting services to aid the tenant that is in need of such aid or requests this service. Any measures possible that can make a merchant out of a tenant is highly desirable.

Sometimes the association can be more influential than the owner in securing favorable treatment in matters such as public transportation, street lighting, police protection and the like. Communications, which are often lacking between tenants and developers, could be created giving each

the opportunity to consult the other, and together, correct operational problems before they become a serious obstacle to progress.

The tangible and intangible benefits are too numerous to mention. Their result means more profit for the developer and the tenant.

Recommendations:

In an attempt to realize the full potential which shopping center merchants' associations hold, there are a number of suggestions which, if followed, might eliminate the noneffectiveness and misconceptions concerning merchants' associations.

1. Make all membership compulsory. A compulsory membership in a merchants association should be part of the lease terms of every shopping center agreement. This appears to be a coercing recommendation, however, it is felt that if a merchant cannot agree to join an association and realize the benefits of such an agreement, he may be a troublemaker later on as a tenant. To have an effective functioning merchants association, every tenant should participate.

While chains and department stores appear on the surface as offering the greatest resistance to such an agreement, their history is such that they will take part in a proper share of the associations activities and costs once it is a part of the agreement.[42] The independent merchant probably will be the biggest objector to such compulsion. It is the independent merchant who, from the writers observations, has contributed the

[42] Nelson, The Selection of Retail Locations, op. cit., p. 280.

least to the merchants associations in the way of cooperation and support, even though it is he who usually is in most need of the services which the association can provide. It is felt that any chain objection to a compulsory agreement would be eliminated if the developer had the by-laws, stipulations, and rate of payment ready for the tenant to see at the time the lease is signed rather than at a later date. "In 90 per cent of the cases, the associations' by-laws aren't ready when leases are ready to be signed, a major chain points out."[43]

Some developers may fear that merchants will stay away from such centers when merchants' associations are compulsory. However, there was an example in California in which a developer stated that if the chain didn't join the association, the chain could not enter into the center. This particular chain has since entered five shopping centers under such agreement and is a most active member in the associations.[44]

2. Leadership must rest with the tenants. One main objection to merchants associations is that the promotional activities are controlled by the developer rather than the tenants. Often the developer is ignorant of promotional tactics and the results were discouraging. Possibly the developer may help organize the association, however, it should be self-sustaining and self-functioning. Depending upon the size of the center, the ideal situation would be that of hiring a professional merchandiser to coordinate the association and to direct its promotional plans. If the center is small,

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[43]Kaylin, "Shopping Centers--Hotter Than Ever, op. cit., p. 232.

[44]Faber, op. cit., p. 124.

advice could be utilized on a consulting basis to aid in the effective promotion of the center. The developer would take an active part but should not hold a leadership position. The merchants themselves would probably put more effort into the association if they were not subject to the leadership and active participation of the developer.

3. Fair contribution of funds must be arrived at. The assessment of individual merchants for the association budget has been arrived at by a variety of ways, among them; on the basis of the ratio of the individual store's gross area to the total in the center; dollar volume to total dollar volume; front feet to total front feet; voluntary contributions; straight and arbitrary assessments. Many of these methods have been subject to extensive debate among merchants. It is easy to see that merchants would not want to reveal their sales figures to their fellow merchants, nor would it seem fair to contribute funds on a percentage of sales basis. A supermarket will have high sales figures but low profit margin in comparison to a speciality clothing shop that would have lower sales and higher margin of profits. In order to be fair, the writer feels that the contribution should be based on a formula of so much per year per square foot of sales space, plus the factors of the merchants profitability and his contribution to the center traffic.

It is a common occurrence for the owner of the center to contribute towards the budget of the merchants association. While some owners may contribute up to 50 per cent of the total budget of a center, a more realistic means would be to have the owner contribute about 1/3 and the

merchants themselves, 2/3's. If the owners participation is 50 per cent or over he may tend to dominate the association. If his contribution is under 30 per cent, it would appear to be inadequate and create an unfavorable feeling.

Without investigating the specifics of merchants associations, in summary it can be said that merchants associations can mean extra profits for both the developer and tenants if properly conducted. The trend appears to be favorable for associations to play a significant part in shopping centers. Management has become aware that centers are merchandising ventures, not real estate ventures. The key to success appears to be compulsion of membership, coupled with professional leadership delegated by the tenants themselves. The merchants association rules must have teeth in them and should cost the merchant something so that interest will be stimulated. Such problems as the duplication of advertising can easily be worked out.

While it is difficult to answer yes or no to the question of whether merchants' associations are necessary or not, most publications point out that tenants and developers alike are desirous of seeing 100 per cent participation in the associations by both parties in the future. I would say, that the increasing competitive situation being formulated by the influx of new shopping centers is making merchants' associations a mandatory factor. It appears that merchants' associations are necessary.

CHAPTER VI

THE SUPERMARKET...

SHOULD IT BE IN THE CENTER?

Supermarket operators seem to be overwhelmingly enthusiastic about shopping centers. The Supermarket Institute, a trade association which is the spokesman for the supermarket industry, found that more of its members opened stores in shopping centers than in any other locations during the past seven years.[45] Many were pleased with the results of being in such a location. In fact, the same study indicated that the highest sales per supermarket occurred in stores located in the new large shopping centers. One chain in particular, the Kroger Company stated that they are able to do a much better job in shopping center stores than in most other stores.[46]

To the public, shopping centers and supermarkets seem to be not only synonomous, but also something that will have a lifetime of existence. Developers, and even some supermarket operators, may agree with this, however, the future may hold other considerations of the role each will play in the market structure.

In this chapter the writer will relate the supermarket's position in the shopping center, its problems and alternatives.

What is the Supermarket's Place in the Shopping Center?

While supermarket operators have been one of the most "devoted" shopping center tenants since the end of World War II, there are various roles which the supermarket has in the center. It is easily seen that the super-

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[45]Supermarket Institute, op. cit., p. 7.

[46]Kaylin, "Shopping Centers--Hotter Than Ever," op. cit., p. 545.

market is the core of any neighborhood center. In fact, the below listed chart indicates that 35 per cent of the supers opened in 1959 were located in the small shopping center. In such centers there is often justification for two supermarkets, particularly when the neighborhood center is located in a densely populated residential section.

	Supermarkets Opened in[46]				
Types of Location	1959	1958	1957	1956	1955
New small shopping center	35%	26%	20%	30%	20%
Neighborhood	22	23	26	21	29
New large shopping center	20	20	21	17	23
Highway	13	23	21	19	18
Old large business center	10	7	12	13	10
All Supermarkets	100%	100%	100%	100%	100%

The community center is also considered a favorable location for supermarkets, however, as the size of the center increases, the super's role becomes less important, sometimes reaching the degree of being insignificant, which often occurs in the larger regional center. It is doubtful whether the super in a large regional center will achieve as great an impact on the typical supermarket trade area as it would being outside or away from the center. "The regional centers' function is offering of shopping goods in depth and variety, subordinates the role of food items and convenience items."[47] Because of this, most regional centers include but one supermarket

[46] *Ibid.*

[47] McKeever, *op. cit.*, p. 30.

in order to complete their image of "one-stop" shopping. It appears that the supermarket is very significant in the neighborhood center because a center of this type is often situated in nearby residential areas, thus accommodating both automobile and walking traffic. As the size of the center increases, the time required to reach the center is often extended because of traffic congestion, distance, etc.

It is important for the supermarket operator to be cognizant of the fact that housewives like to buy their groceries near their homes, which is one of the reasons supermarkets have been a key factor in neighborhood centers. The perishability of many items on the grocery list is one factor causing this. In addition, it has been found that women shoppers rarely engage in food and department store shopping at the same time.[48] A different frame of mind is exhibited because shoppers tend to dress more casually when they are shopping for food as contrasted with department store shopping.

While the ideas expressed in this chapter might infer that a supermarket in a regional center encounters a problem, the opposite is usually true. Supermarkets in regional centers have generally been profitable ventures for their owners. Supermarket operators' seem to locate in the large shopping centers extensively as the previous chart indicated. It shows that 20 per cent of the supers opened in 1959 were in a center of this size. In fact, new large shopping center locations averaged the highest sales per supermarket, nearly $40,000 a week.[49]

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[48] Feinberg, op. cit., p. 30.

[49] Supermarket Institute, op. cit., p. 8.

Though there are many reasons given as to why consumers perfer the neighborhood center for their supermarket shopping, there appears to be room in each regional center for at least one supermarket. However, caution should be exerted when considering the number of units economically sound in the center. Many experts have claimed that one unit was the appropriate number to have in a regional center. This view was expressed by such developers as Food Fair Properties and Strouse, Greenberg & Co., leading east coast developers.[50] Naturally there are areas where two supermarkets in a regional center have been profitable. This is possible, for example, in an area with a large close-in population for which the supermarkets act as neighborhood stores, or with a widely dispersed regional population having few local centers appealing enough to persuade the consumer to buy food supplies nearer home. Often a supermarket operator may be enticed into opening a store in a regional center even though the profitability is questionable. Among them is the prestige motive. A store in a shopping center can present a "sign-board" effect to the many shoppers which the larger center attracts. Besides fulfilling institutional advertising commitments, it is likely to generate enough sales volume to make the unit profitable. Though it is not advisable to operate marginal stores, exceptions can be made if the tangible values seem feasible and if the operator can afford to operate a marginal store because his other stores are profitable.

What Problems Confront the Supermarket in the Shopping Center?

A controversy which has existed for many years between supermarket

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[50]Feinberg, op. cit., p. 23.

owners and shopping center developers is the problem of location within the center. There are some operators and developers who are insistent that the best place for the supermarket is at an end, while others may want a center location, others near specific establishments. In the west coast there is a trend toward the supermarkets wanting to get out of the center of the mall. They have even reached the point where some of them are physically relocating. "They like either their own building at the edge of the parking lot or their own building at the end of the mall."[51] This seemingly would aid in cutting down impulse buying at next door shops, which may result in more impulse buying in the supermarket.

Actually, there does not appear to be one best answer to the store location problem. There are success stories of profitable supermarkets operating in various positions within a shopping center. It is recommended, however, that the supermarket should not be placed next to department stores, because families generally buy food at different times than they make department store purchases. Another factor to consider is the objections which might arise from the customers of the department store, if they are inconvenienced by trucks delivering food into the supermarket.

High rent, long-term leases, and the restrictions such as the limited use of identification signs and window displays, are often imposed on the supermarket by the developer. These represent additional problems that the operator may be confronted with.

It has been noted by the writer that the average length of leases for

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[51]U. S. Congress, Committee on Small Business, "Shopping Centers 1959," op. cit., p. 168.

supers in shopping centers has been approximately 15 years. This is comparable to the length of leases for supermarkets that lease in the conventional locations. However, the problem of high rents will probably continue especially for those markets in the regional shopping center because of the lesser role and unfavorable bargaining position which it assumes. Few abuses of high rents are voiced by supermarket operators located in the neighborhood center since the super is the dominant tenant and therefore in an excellent bargaining position when facing issues not only of rent, but those of the previously mentioned restrictions.

There are other conflicts that many arise between the supermarket operator and the developer, one of them being the "domineering" approach that the developer may exhibit. It is a common occurrence for the developer to approach a prospective supermarket tenant by stating the X spot is where your 30,000 square foot store will be. These specific considerations are something the experienced operator should help to determine with the developer. The supermarket operator usually is more versed in the specifications which will yield the most profitable return to the store and the developer. The expense of fixtures and added inventory costs can create a decided hardship on the supermarket operator who has to equip a store that is built to excessive dimensions. The supermarket operator, particularly chain owners, through their experience and studies of market areas should be well versed on their own needs. The experience of both the developer and tenant should be recognized when planning shopping center stores.

A more positive approach that a supermarket operator can take to exempt himself from the various problems of shopping centers is to build his own centers. Food Fair Properties, a subsidiary of Food Fair Stores of Philadelphia, was one of the leaders in this movement. Obviously, the number of operators financially capable of developing their own shopping centers would be very limited.

The Discount House and the Super

It appears that supermarkets are progressively expanding into non-food lines to the extent of actually duplicating the merchandise lines of the discount house, department store, and hardware store. The converse is seemingly also true with the expansion of the discount house into food products. The various expansions of these two types of operations are developing into a marketing conglomeration which is comparable to a wedding or marriage between them. The marriage is actually completed in some localities as evidenced by the operations of such names as Grand Way Discount Centers, Sav-Fair, and Korvette. These operations account for one of today's current innovations in marketing. Impressive to some, this new type of retailing has broken the barrier of the sophisticated shopping center, which at one time did not recognize the discount house.

It is impossible to determine what the future of this combination venture will be and the part it will play in the future of shopping centers, but it is a market innovation which could play an important role in future shopping center development.

Does the Supermarket Have a Future in the Shopping Center?

Many authors state that there is a strong tendency toward bigger stores in all fields. This, however is questionable, especially in the supermarket industry. New supermarkets opened in 1958 and 1959 showed a steady decline in total store area.[52] This, coupled with the previously mentioned fact that 35 per cent of the supermarkets opened in 1959 were located in new small shopping centers, (increase of 8 per cent over 1958) leads the writer to believe that the greatest future for the supermarket lies in the neighborhood center. It seems that consumers want to shop for groceries at a nearby shopping center, rather than being subjected to the congestion and confusion of the larger centers. It would be wise for the supermarket operator to investigate his future store planning with these thoughts in mind.

Besides the advantage of consumer preferences, the supermarket in the neighborhood shopping center, as was previously discussed, is the dominating tenant and therefore will likely to have a significant voice in that centers overall operation. This will appeal to the supermarket operator who undoubtly will continue to locate extensively in that size center. The future of the supermarket in the community center seemingly is also good, however, the plans of supers in the regional center are uncertain due to the various problems which are usually encountered. Whether the food-discount type of operation will occupy the larger centers, or whether the present trend of approximately 20 per cent of the supermarkets being in the regional center will continue is unknown. The decision rests entirely with the operator who should economically justify the existence of his store in a location, whether it be in the shopping center, across from the center in a "satellite" area, or in a conventional supermarket location.

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[52] Supermarket Institute, op. cit., p. 8.

CHAPTER VII

SUMMARY

This study has attempted to point out and to analyze some of the major current problems that are facing tenants and developers in the shopping center industry.

Throughout this report, the history and growth of the industry was traced down to the present time, as were the factors which have aided in the growth of centers. These included the increase in population, shifts to the suburbs, and the influence of the automobile. The criteria used to establish the type of tenants which normally enter into the various sizes of centers were also examined.

The section investigating whether the tenants are assured success in shopping centers, pointed up the need for caution that must be exerted when dealing with the amateur developer. A thorough analysis by tenants before they enter into a shopping center location was recommended. The problem of overbuilding, which has been the cause of many failures was not considered a real problem by the writer because of the increasing population in most market areas of the country. However, it was recommended that a trade association might act as a "go-between" among developers, financiers, and merchants to eliminate some of the duplication and overbuilding of centers in the future.

The next problem examined was the financial requirements of the independents and the possible elimination of the independent from the retailing world because of the remoteness of their being qualified as an AAA tenant in shopping centers. It was shown that the independent will not be eliminated and that the problem should solve itself in the future by the recommendations of the professional developer. Devices were listed that

could aid the independent in his "crisis," among them, cosigning of leases, lease insurance, and government backing. The "innovator" was discussed as another means that the independent might take to insure his survival.

The need of merchants' associations was established when it was realized that shopping centers are a merchandising venture rather than a real estate speculation. The role that the merchants' association should assume was discussed, in addition, "rules" were prescribed in an effort to realize the full potential of merchants' associations in shopping centers.

One of the most "devoted" tenants of the shopping center, the supermarket, was examined. It was shown that supermarkets are most profitable and widely accepted in the neighborhood center because of the dominant part they assume in that particular size center. The writer suggested that the future of the super seems to rest in the neighborhood center, whereas in the regional center, the supermarkets' future is not seen as highly favorable. High rent, restrictions, and consumer disapproval were thought to limit the supermarkets' future in the regional center. It was suggested that possibly the 'marriage' of the supermarket and the discount house may shed new light on the future of shopping centers.

Through the evidence presented to the reader throughout this report, one should be well aware of the potential which the shopping center holds open to merchants in America today. Never in history have our population and retail outlets seen such an expansion.

Shopping centers appear to be what many consumers want in the way of shopping facilities. Therefore, regardless of the nature of the retailing organization one is associated with, he should investigate the potentialities open to him through this facility.

The tenant and developer must realistically face the problems of shopping centers as they arise, analyze them, and solve them in such a manner that the industry will live on as long as the consumer demands its existence. An industry of this magnitude should not only be prepared to satisfy the consumer's newly created desires, it should inaugurate them.

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IN CONSIDERATION of the services to be performed by Hyland Associates under the terms of this agreement, the undersigned applicant hereby employs Hyland Associates to procure a commitment for a mortgage loan to be secured as a first lien on premises known as:

____

Said commitment shall provide, basically, for a loan in the principal amount of not less than $______________, for a term of not less than ________ ____________years, and with interest not exceeding__________________________ per cent per annum but may contain other loan conditions prescribed by Lender.

If Hyland Associates obtains, procures, or issues a commitment of a Lender ready, willing and able to make a loan on the terms hereinbefore stated or on such different terms as may hereafter be authorized by applicant, the applicant shall pay to Hyland Associates for its services a fee equivalent to _______ ____________per cent of the principal amount of the loan committed, due and payable at the time of delivery of the commitment. In the event applicant for any reason whatsoever, and with or without the consent of Hyland Associates, fails to pay such fee when due, applicant authorizes and directs whomever makes settlement for the Lender to pay the same directly to Hyland Associates simultaneously with the disbursement of the proceeds of the mortgage loan.

In the event that the applicant, prior to the date of termination of this Agreement, fails or neglects to complete the loan commitment as aforesaid for any cause or in any manner, the applicant agrees to pay to Hyland Associates