Investments:

Shadow-Anchored Shopping Centers

If you have reviewed for-sale listings of strip type shopping centers, you may have seen the term "shadow anchored." This month, I'll talk about what this means. It's not necessarily a bad thing, but it does describe a risk that you should be familiar with.

The term "shadow anchor" can describe a tenant in several types of properties. Most individual investors will encounter this term when reviewing small strip centers, so this article will focus on these properties. A strip center probably describes the shopping center that you go grocery shopping at. There are usually one or two "anchor" tenants; a grocery store or a grocery store and a pharmacy. The anchor is then surrounded by what is called the "in-line" tenants: smaller stores like sandwich or donut shops, a hallmark cards store, a nail salon or a barber's shop.

What Anchor Tenants Do

In a strip shopping center, the anchor tenant draws shoppers to the center. These shoppers, in turn, will patronize the smaller shops adjacent to the anchor. If you see an anchor tenant close in a strip shopping center, you will likely see the smaller tenants closing shortly afterwards. Choosing a strong anchor tenant is an essential part of shopping center management. Recognizing the value that the anchor tenant's continued operation provides, their lease will often require that the store remains open a minimum number of hours: with monetary penalties if these rules are not followed.

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Christopher Miller is a Managing Director with Specialized Wealth Management in Tustin, California and specializes in tax-advantaged investments including 1031 replacement properties. Chris' real estate experience includes work in commercial appraisal, in institutional acquisitions for a national real estate syndicator, and as an advisor helping clients through over two hundred 1031 exchanges. Chris has been featured as an expert in several industry publications, and on television, and earned an MBA emphasizing Real Estate Finance from the University of Southern California. Call him toll-free at (877) 313 – 1868.

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What a "Shadow Anchor" Is

The term "shadow anchor" refers to an anchor tenant that has a different landlord than the inline tenants. For example: a shopping center has 6 stores; one anchor and 5 in-line tenants. A small investor is looking to buy the 5 in-line tenants: another owner controls the "shadow anchor" supermarket building.

Benefits of a Shadow Anchor Arrangement

A grocery-anchored shopping center can be much too expensive to be within the reach of an individual investor. This is due to the large value created by a long-term lease to a large company with good credit. (Kroger's, for example.) With a shadow-anchor arrangement, investors can purchase some or all of the in-line stores with a lower capital outlay. These landlords can then enjoy the benefits of the customers drawn in by the anchor without having to buy the anchor property.

Disadvantages of a Shadow Anchor Arrangement

If the in-line stores owner does not own the shadow anchor store, he does not have control over that tenant. Therefore, there probably won't be any clauses in that lease requiring the anchor tenant to remain open and operating. After all, the anchor owner only cares about collecting his rent. It doesn't matter to him if the anchor tenant is open and drawing customers to stores he doesn't own. (the in-line tenants.) In an extreme example, the anchor tenant can simply move out of an unprofitable space. A large grocery company, (like Ralph's); when faced with an money-losing store, may make a business decision to close the store. Ralph's is stuck paying the rent on that store for however long their lease runs for. (I have seen Ralph's pay rent on an empty store with 15 years left on the lease.) Ralph's may be paying $400,000 per year in rent on that vacant store, but it is not paying employees, buying supplies, paying utilities, etc. Without financial incentives to keep the store open, they may just close it and walk away.

When Ralph's (in this example) leaves; as I mentioned earlier, the in-line tenants will likely start to struggle and experience increased vacancy as well. If a landlord owns the anchor tenant space, he can work directly with a vacated anchor to effect a sublease or a new lease to a replacement tenant. He can also use the rent the anchor tenant is paying to re-lease vacated in-line spaces when necessary. In a shadow-anchored arrangement, there is little that the in-line landlord can do to fix things.

What to Look for in Shadow Anchored Arrangements

If you are considering a purchase of some retail space that features a shadow anchor, remember how important the continued operation of that anchor space is to the financial health of your property. Look at the shadow-anchor's arrangement with its landlord. How long does the lease run for? What is the financial health of the tenant? How profitable is that store? Is it more or less profitable than the average store in their company? If the seller can not (or will not) provide this information, consider looking for a different property. The risk posed by a shadow anchor with unknown lease terms may be too great.

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