USAA Real Estate Company

LOCATION, LOCATION… AND TENANT MIX?

RESEARCH ARTICLE

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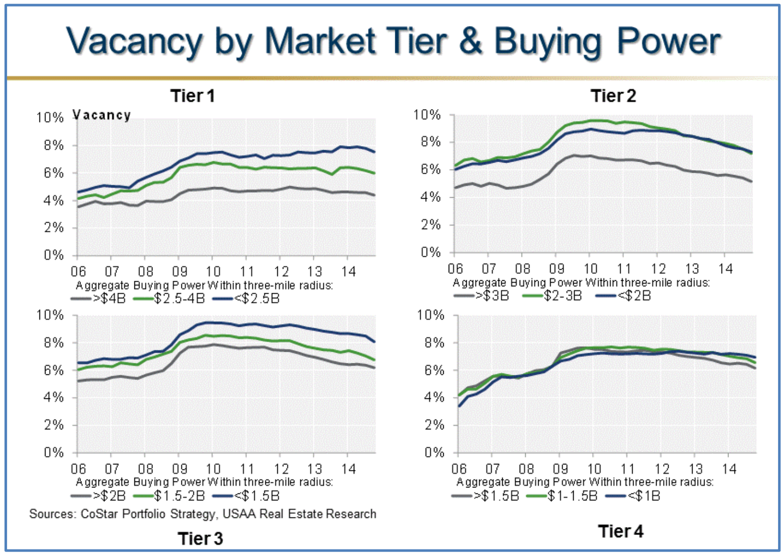
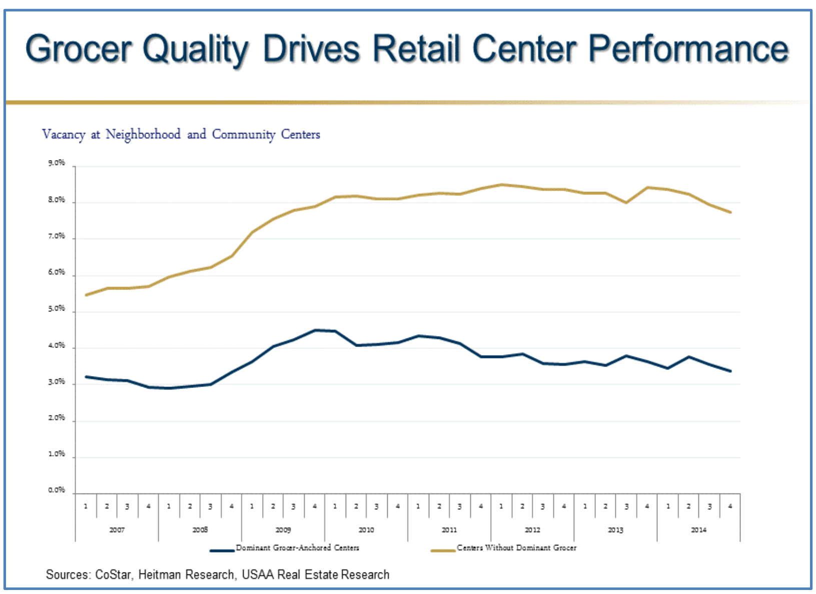
Investors often cite location as the sole driver of real estate performance, but having a sustainable tenant mix has become essential, particularly for retail properties. In recent years, retail centers have been under pressure as e-commerce sales have surged. Our research suggests, however, that a large number of centers have thrived by choosing a location with the right income demographics and a strong tenant roster.



Location is still an essential factor in determining a property's investment performance. Retail centers, for example, that are in a trade area with strong buying power (the amount of cash available for retail spending after deducting household expenses) have significantly lower vacancy rates versus similar assets in inferior locations. Furthermore, properties within these upscale areas typically cost 115% more than comparable assets in less affluent regions, which is substantially higher than the 45% premium in 2007. This trend is consistent across all markets, indicating that a location's aggregate buying power plays a critical role in determining the best retail real estate.



The recent expansion in online sales has threatened some retail centers. As of 2014, more than 6.5% of total sales occurred online, a $305 billion shift over time from traditional stores. E-commerce resistant tenants can be critical to investment performance, as shown by the recent struggles of many traditional retailers (e.g., certain books, electronics, and department stores). Dominant grocers are ideal lessees because, thus far, they have been relatively immune to internet sales. They also generate reoccurring foot traffic that benefits surrounding merchants. As a result, centers with a dominant grocer have vacancy rates near 3.5%, while those without a dominant grocer have rates near 8.0%.[1]

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[1] A dominant grocer is defined as one whose market share exceeds its share of stores in an MSA.

In the end, location still plays a critical role in the retail investment process. However, we expect other variables, such as tenant mix and aggregate buying power, to influence retail performance as consumer behavior and market conditions evolve.

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