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REAL ESTATE

It's Deal Time

Retail real estate abuzz with disposition activity

By Katherine Field

Retailers and developers talk a lot more these days. The recession-driven business of shedding stores and adjusting leases is throwing landlords and tenants together, forcing them to sit eyeball to eyeball (or at least e-mail to e-mail) to hash out real estate strategies that both parties can hopefully live with.

Some liken the process to doing battle.

"Restructuring commercial real estate has morphed from fencing to hand-to-hand combat," said Tom Mullaney, a founding partner of real estate and financial restructuring firm Huntley, Mullaney, Spargo & Sullivan, whose offices are in Roseville, Calif., and St. Charles, Ill. "Tenants who want to renegotiate leases in a way that really improves their profitability must go in swinging."

From 2006 to 2008, HMS restructured 89 leases for OfficeMax and saved the retailer in excess of \$102 million.

Over the last 12 to 18 months, chain retailers have closed hundreds of underperforming stores, restructured as many or more leases and curtailed growth; some 40 major chains have shut down entirely.

The result has been spiraling shopping center vacancy rates that have spawned some pretty evident trends in real estate disposition, among them an increasing number of non-retail tenants and a landlord hair-trigger when it comes to rent rate cuts. Among the key trends to take into account:

• **Base rents are flattening**

Data released in early July by real estate researcher Reis Inc. showed that the average lease rate at shopping centers in the top 77 U.S. markets declined in the second quarter—for the fifth consecutive quarter.

In the almost three decades that it has tracked lease rates, Reis said it has never seen a stretch of declines this long.

And don't expect change anytime soon.

"When you look at the back half of 2009 and on into 2010, I don't think we'll see anything substantially different from where we are today," said Spence Mehl, senior VP of New York City-based RCS Real Estate Advisors. "And today we're seeing base rents around the country flatten."

The move to close under-performing locations isn't going anywhere, either. And that will further strain landlord-tenant relationships.

"Right now, landlords are more reluctant to agree to a termination with a retailer because it is more important for landlords to maintain the value of their centers—on a cash-flow basis—than

to worry about 'control' over tenant mix, quality of tenants, etc.," said Mehl.

He added that landlords will continue to be reluctant to work out termination deals into 2010, leaving retailers to subsidize a portion of the lease in order to stop some of the bleeding.

• **Regional players are coming to the forefront.**

As the store closures continue, there is at least one group of retailers that stands to gain some ground.

"Watch for small regional players to increasingly pop up in some of the malls and strip centers," said Andy Graiser, co-president of Melville, N.Y.-based DJM Realty, a Gordon Bros. company. "The vacancies are creating great opportunities for growing retailers." Regional retailers and other healthy concepts now have the opportunity, said Graiser, to enter difficult markets where the barriers of entry would normally be several years.

This is a time for non-retail concepts to shine. "As we continue to see dark stores remaining dark, non-retail concepts will find homes in malls and shopping centers just to create the traffic," said Graiser. "Landlords are going to do what they can to limit co-tenancy violations, which is becoming a bigger problem every day."

• **Landlords and tenants are working together and getting creative.**

A palpable shift happens when the economy crashes. The division of power, normally so clear, is difficult to discern. The result is a just-as-evident change in attitude.

"Landlords are losing model tenants and nationals are going dark," explained Alvin Williams, principal of Huntington Beach, Calif.-based Excess Space Retail Services. "When that happens, a mental shift occurs on both the landlord's and the retailer's part—and there is a new desire to bridge the gap and strengthen the symbiotic relationship that exists between the two."

Newly opened lines of communication have led to more favorable and creative deals. "By working together, landlords and tenants have used the climate to rework the economic and legal sides of the existing leases to make them more reasonable," Williams said.

2009 has been the year of the lease restructure, rather than the year of the store closure that most expected. Hence, "We are predicting in the first and second quarters of 2010, as these dialogues conclude on the lease-restructuring side, we'll see more store closures," said Williams. The glut of space will require creativity to fill.

"You'll see all types of interesting conversions become more prevalent, from bingo parlors and churches to indoor storage facilities, flea markets, schools and theatrical production houses." ■