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## REAL ESTATE

# What Is Your Real Estate Worth?

## Healthy and not-so-healthy retailers scrub their portfolios

By Katherine Field

**A**s the nation's retail vacancy rates reach decade highs, both healthy and struggling retailers are asking the same question: "What is our real estate worth?"

The answer: Nowhere close to what it used to be.

Tallying real estate values is a painful exercise—especially when the end goal may be store disposition—and one that shouldn't be restricted, say the experts, to unhealthy retailers. Case in point: Mervyns, which announced on July 29 that it had filed for Chapter 11 bankruptcy protection. The Hayward, Calif.-based discounter's filing has led analysts to question if the chain's leadership shouldn't have seen the handwriting on the wall.

Brian Kilcourse, managing partner of RSR Research, reported in a weekly analysis that, though Mervyns blamed the economy for its descent into bankruptcy-dom, the problems stemmed from issues quite outside the foreclosure epidemic. "...There are three market disciplines for any company to pursue, and it must be great at one of them," Kilcourse wrote. "Those disciplines are product leadership, operational excellence and customer intimacy. Mervyns didn't exceed the competition in any."

The negative results that would have been generated from Mervyns unexceptional performance in key areas wouldn't have evidenced themselves overnight. The company would have seen it coming and perhaps pre-empted crisis not only by addressing market disciplines but by analyzing its stores' individual performances and shedding the bottom layers.

Proactively managing real estate and using disposition tools to ensure long-term health of a company is "a burning hot trend," Nina Kampler, executive VP of strategic retail and corporate solutions for Chicago-based Hilco Real Estate, told *Chain Store Age*. "The troubled companies featured in our headline news today are almost by definition closing layers of their locations and perhaps shuttering entire concepts. But now even the healthier retailers are being compelled by this economic environment to scrub their portfolios

and ascertain what is not working for them.

"They then can reposition their real estate holdings by closing the under-performers so that, rather than dragging down the profitability of the entire portfolio, they are trimmed away like pruning the dead branches off the bottom of an otherwise good tree to allow it to continue growing onward and upward," Kampler said.

**The value of disposition:** To dispose of real estate, you have to first know what it is worth. "There is a delta between what the retailer thinks its real estate is worth and what the marketplace thinks it's worth," said Kampler. "Real estate is a tangible asset. When it is time to translate its perceived value into actual dollars, when we actually monetize the owned or leased asset, then the harsh truth must be grappled with as the market forces reveal today's realities."

Today, a retailer may be 12 years into a 20-year lease at \$20 per foot. Two years ago, at year 10, the market for that \$20 space may have been \$32. So it would make sense that a retailer, in calculating the real estate's value, would assume that the landlord might take back the space and give the retailer the \$12 per foot difference times the eight years remaining on the lease. Or that the retailer could sublet the space for a tidy profit. No longer so, said Kampler.

"The reality is that, with the exponentially growing number of retail vacancies, retail space rental rates are being impacted by declining occupancy levels," she explained.

**Partnering for success:** Just because real estate values are determined by a confluence of the market rents that are driven by current economic situations (and that confluence is generally sending values in a downward direction) doesn't mean that everyone will be a loser. With a crunch comes opportunity.

"This is a very opportunistic time for retailers that want to expand on a selective basis," said Ivan Friedman, president and CEO of New York City-based RCS Real Estate Advisors, which handled the real estate disposition for bankrupt retailers Sharper Im-

age, Friedman's Jewelers, Domain, Wickes and Tower Records. "Because of the slowed expansion and closings, there are some very good mall locations available." For example, explained Friedman, mall spots that used to house bankrupt retailers Sharper Image and The Bombay Co. are now up for grabs. And the landlords need to fill those vacancies.

"Landlords are more amenable than ever before in terms of rent rates and buildout allowances, so there are some great opportunities for a healthy retailer to be a selective buyer," said Friedman.

The teaming of landlord and tenant, whether for the purposes of negotiating entry or planning an exit, is a strategy that Friedman recommends. In fact, a negotiated settlement can, and often does, serve as an alternative to Chapter 11 bankruptcy.

"Even the healthiest companies have 10% to 15% of their stores that are under-performing," said Friedman. "Retailers should actively address that lowest percentile in the portfolio at all times, whether that means teaming with landlords toward rent relief or opting not to renew leases when they come up or embarking on a disposition plan." And, said Friedman, this should be done as part of a maintenance program, reviewing the stores and the alternatives routinely to avoid the crisis of an overwhelming liability.

Andy Graiser, co-president of Melville, N.Y.-based DJM Realty, a Gordon Bros. company, makes it a practice to team his company's retail clients with landlords toward problem-solving. "It's important to create a strategy by landlord," said Graiser, "and to do that you need to deal with the entire portfolio and not just the unprofitable stores." Graiser recommends first evaluating the portfolio (the good, the mediocre and the ugly) and developing strategies that include all parties involved.

"Retailers will accomplish a lot more by working together with landlords than by working solo," said Graiser. "Forcing a situation on a landlord is only addressing part of the problem and it's not going to help your go-forward position." ■