

Execs analyze the Steve & Barry's failure

By Steve McLinden

NOTHING HAS GENERATED greater scrutiny of tenant allowances than the failure of retail wunderkind Steve & Barry's. The Port Washington, N.Y.-based discount-apparel seller, a popular space-filling staple in shopping centers for the past decade, is closing roughly 100 of its 276 stores as part of its Chapter 11 restructuring and sale to a New York City investment partnership.

Among the markets most affected are the Chicago metro area, where five of a dozen Steve & Barry's stores are to shut, and northern Ohio, where six will close, according to BH S&B Holdings, the new affiliate of investment firm Bay Harbour Management that assumed control of the company in late August. BH S&B says its store-closing decisions were based largely on renegotiation of leases.

Steve & Barry's, founded by Steven Shore and Barry Prevor, childhood friends from Long Island, opened its first store in 1985, near the University of Pennsylvania, in Philadelphia, selling discount university apparel. The Steve & Barry's University Sportswear concept grew to a chain of nine college-town stores by 1998, when Taubman Centers noted the brisk trade the retailer enjoyed on campus and offered space in its Great Lakes Crossing Center mall, in Auburn Hills, Mich. Other mall and lifestyle center grand openings followed for Steve & Barry's, which

went on to open in 39 states. The stores featured wooden fixtures and floors and multiple TV monitors tuned to sports shows. The chain won an ICSC Hot Retailer Award in 2005.

Prevor told the press in 2006 that the chain had virtually unlimited growth potential and that the U.S. could eventually support up to 5,000 stores. The company dropped "University Sportswear" from the name in 2007, as more celebrity custom brands were added.

Clues that the company's financial performance was softer than the industry believed began appearing late this spring. As the number of Steve & Barry's stores jumped from 75 in mid-2005 to 276 in mid-2008, and as store sales volumes climbed about 300 percent during that time, the company was posting losses in the tens of millions, according to published reports. Other reports noted that Steve & Barry's posted a \$53.3 million loss on sales of \$405.7 million for 2006.

Gauging Steve & Barry's fiscal health has been an ongoing challenge, because nearly all its private-label suppliers were located overseas, and if they were not getting paid, few knew about it, credit analysts have said. Moreover, media reports indicated that the brunt of the retailer's earnings actually came in the form of tenant improvement

allowances from landlords, ranging from \$2 million to \$7 million per store, money that was apparently used to fuel rapid growth.

"The feeling out there is that out of the tenant allowances landlords were giving, 30 to 40 percent of that was used for construction and the rest was banked," said Ivan Friedman, who heads New York City-based RCS Real Estate Advisors.

Steve & Barry's filed for Chapter 11 bankruptcy protection in July. In the months preceding that, the retailer obtained a \$197 million asset-based loan from GE Capital Corp., of which \$135 million was outstanding at filing time, and an additional \$30 million loan from PrenSB. In August the company announced that the Bay Harbour affiliate, in partnership with New York City-based York Capital, agreed to acquire most of the firm's assets for \$168 million. The purchase included retail inventories, rights to store leases, the chain's distribution center in Columbus, Ohio, and its brand and celebrity licenses.

Bay Harbour, with \$1.25 billion under management, previously rescued retailer Barneys New York from bankruptcy before reselling it to Jones Apparel Group. The firm also helped turn around the former Aladdin Casino, in Las Vegas, which now operates as Planet Hollywood Resort & Casino.

Expectations are that Prevor and Shore will remain minority investors in the reorganized company.

The \$168 million that Bay Harbour paid was “absolute rock-bottom dollar” for a 276-store national chain, says Howard Davidowitz, chairman of Davidowitz & Associates, a New York City-based retail consulting and investment banking firm.

While Steve & Barry’s was adding more than 3 million square feet of space between fiscal years 2005 and 2007, it was striking numerous branding deals with such celebrities as the NBA’s Stephon Marbury and Ben Wallace, actresses Sarah Jessica Parker and Amanda Bynes, tennis star Venus Williams, pro surfer Laird Hamilton and pro golfer Bubba Watson. The retailer was paying celebrities royalties of up to 4 percent on sales of their name-brand lines.

Marbury, who is a star point guard for the New York Knicks, has since sued Steve & Barry’s, saying he has not received a royalty check since January and that the company owes him nearly \$2.2 million and improperly registered two of his trademarks. Parker has said she has been paid all royalties for her Bitten clothing line.

Additionally, of the \$320 million minority investment that Boston-based private equity firm T.A. Associates made in Steve & Barry’s in 2005, about \$170 million apparently went directly to Shore and Prevor, according to published reports—or \$2 million more than what the Bay Harbour affiliate paid for the entire company in August. The balance of the T.A. Associates money was farmed into operations, reports say.

Joseph Brady, managing director of retail outsourcing services for Jones Lang LaSalle, likens the Steve & Barry’s bankruptcy and business model to a game of musical chairs “where the music stopped and all the chairs were gone.”

Steve & Barry’s ill-aimed use of tenant improvement allowance money for growth capital has been an eye-opener for the industry, says James Bieri, who heads the Detroit-based Bieri Co., a retail real estate consultant firm. “This is the first time I can recall someone building a scheme around tenant allowances,” he said. “Usually, landlords are very cautious with tenant allowance money.” In most cases, such allowances work well for landlords, because tenants are taking spaces that are very difficult to rent, bringing life back to the property, he said.

Typically, tenants must present bills to the landlord as their site-improvement work progresses, but Steve & Barry’s concession arrangements were significantly more lax, says Friedman. Though there have been isolated instances in the past of retailers misallocating tenant improvement dollars, “nothing of this scale has ever happened before,” Friedman said.

Several mall operators complained during bankruptcy proceedings that Steve & Barry’s closing sales would likely conclude before the 2008 holiday shopping season begins, reducing foot traffic. A few Steve & Barry’s stores, such as the one in Randhurst Mall, Mount Prospect, Ill., closed almost immediately after specific closings were announced in early September. At press time no dates were set for the balance of the store closures, but those that were closing had commenced their clearance sales, a spokeswoman said.

The retailer’s anchor and junior anchor spaces ranged from 25,000 square feet to 125,000 square feet in a variety of ‘A’ and ‘B’ malls and lifestyle and neighborhood centers. In the Dallas–Fort Worth area, for example, Steve & Barry’s pre-bankruptcy portfolio included General Growth Properties’ enclosed Parks at Arlington

mall, Simon Property Group’s enclosed Irving Mall and Grapevine Mills, and Macerich Co.’s 35-year-old Valley View Center, in Dallas.

The company said in 2007 that its stores typically employed 100 full- and part-time workers, but stores were operating with significantly fewer workers before the bankruptcy.

Shore and Prevor said in a statement on the retailer’s Web site after the filing that difficult credit markets “caused delays in store openings and [withdrawal] of landlord reimbursements for store-opening expenditures,” which created cash shortages and inadequate store-operating money. “Even with our strong growth and sales performance which far outpaced the industry, tough economic times, the credit crisis and a landscape of other troubled retailers reduced the appraised value of our inventory and our access to funding... so we have had no alternative but to file Chapter 11 to enable continued operations.”

Davidowitz calls Steve & Barry’s strategy of selling every item in the store for about \$10 in a mall setting “totally irrational and unsustainable.” But retail consultants say Steve & Barry’s deep-discounting model is tailor-made for today’s challenging economic environment and that remaining stores should become profitable, particularly if they can slightly raise price points.

The Steve & Barry’s bankruptcy left many in the industry wondering how such a seemingly sudden implosion could occur and how such future lease-revenue losses could be prevented or minimized. “There is a saying in this business,” said Mez R. Birdie, director of NAI Realvest’s Retail Investment Services, of Maitland, Fla., “that the best deals are the ones we didn’t do.” SCT
