

# Big deals

## on big box space



Jerry Merola

*High profile store closings are on the rise and now is the time to take advantage of great deals in the commercial real estate market.*

Not long ago, I was bantering about the incredible volume of available commercial retail space lying dormant throughout the country. Just about every shopping center today has an unoccupied retail bay that was the former home of one national brand or another.

Truth be told, there's still more than 300 million square feet of "big box" space that lies vacant across the U.S., 120 million square feet of which has been vacated since January 2008. However, the dark days appear to be coming to an end, particularly as a significant grouping of national retailers lay out their expansion plans for 2011 and beyond.

Household names such as JCPenny, PetSmart, Staples, Walmart, Bed Bath and Beyond, Best Buy, Dick's Sporting Goods, and a host of mid-level retailers have all revised their national growth strategies for 2011 based upon greater-than-expected sales volumes during the first half of 2010. How does this affect you? Read on.

### JUST THE FACTS

Despite what we hear in the media about the imploding commercial real estate market, the winds of change have already begun to pave the way for recovery. According to Colliers International, one of the most notable commercial real estate brokerage firms in the country, a full one-third of the nation's top 500 retailers have increased their growth plans for 2011.

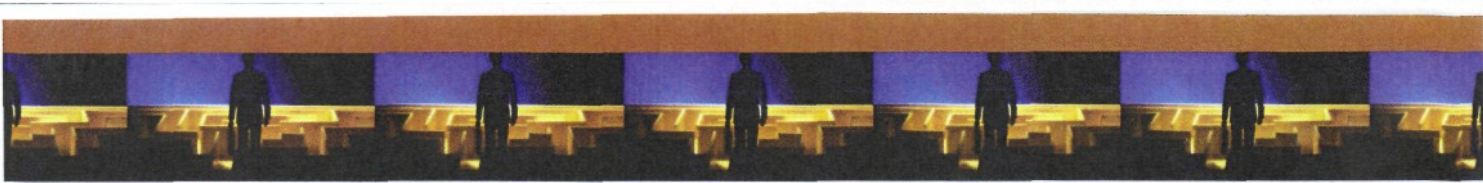
Some typical and atypical allocators have already committed to new built-to-suit commercial contracts

and re-use of second-generation commercial space on a national level. Some of these include Walgreens, Fifth Third Bank, and CVS. Others, such as A&P, are continuing to pare down their inventory of store locations, particularly in the Northeast. Retailers like Blockbuster video and Barnes and Noble may follow suit, as their brick-and-mortar sales volumes are now heavily challenged by increased Internet purchasing from consumers.

Perhaps the most notable vacancies in the U.S. revolve around two key players: Circuit City was the country's second largest consumer electronics chain with 567 stores located throughout the country, each ranging from 15,000-25,000 square feet. Mervyn's, a predominantly Western-region department store chain, closed 189 stores in 10 states, some of which were as large as 100,000 square feet.

While these high profile store closings might have been seen as a black eye for the otherwise bludgeoned commercial real estate market, Colliers reports that it anticipates re-leasing about 50 percent of the Mervyn's 5.5 million square feet of space within the next 12-24 months.

As it turns out, the "second generation's" space is proving to be quite attractive to those national retailers that are on a growth course. As for the Circuit City sites, their tidy building footprints and central locations have attracted the attention of a host of alternate retailers, including the entertainment and hybrid bowling center developers.



## WHAT DEALS LOOK LIKE

At the present time, Colliers confirms that second-generation space is selling at about 60 percent of its 2006 and 2007 levels, with similar reductions seen in the pricing of short-term lease contracts. Tenants that are capable of funding their own site improvements are seeing lease rates as much as 50 percent below stabilized levels from the same time period. This translates into an incredible opportunity for a project developer to reduce the second greatest fixed cost (aside from labor) while securing a site that is more than likely to be identified as a "power center" location.

ditional) personal guarantees, and extended rate reset periods, often three to five years.

When negotiating real estate transactions, it's important to consider the responsibilities of each party. Frequently, landlords would pass the responsibility for roof and HVAC repairs on to the tenant. While this was previously understood as common practice within the industry, the current trend shifts these responsibilities back to the landlord.

Imagine leasing a building, only to find out that the roof is in need of replacement four years into the lease. Re-roofing a commercial structure

## TIMING THE MARKET

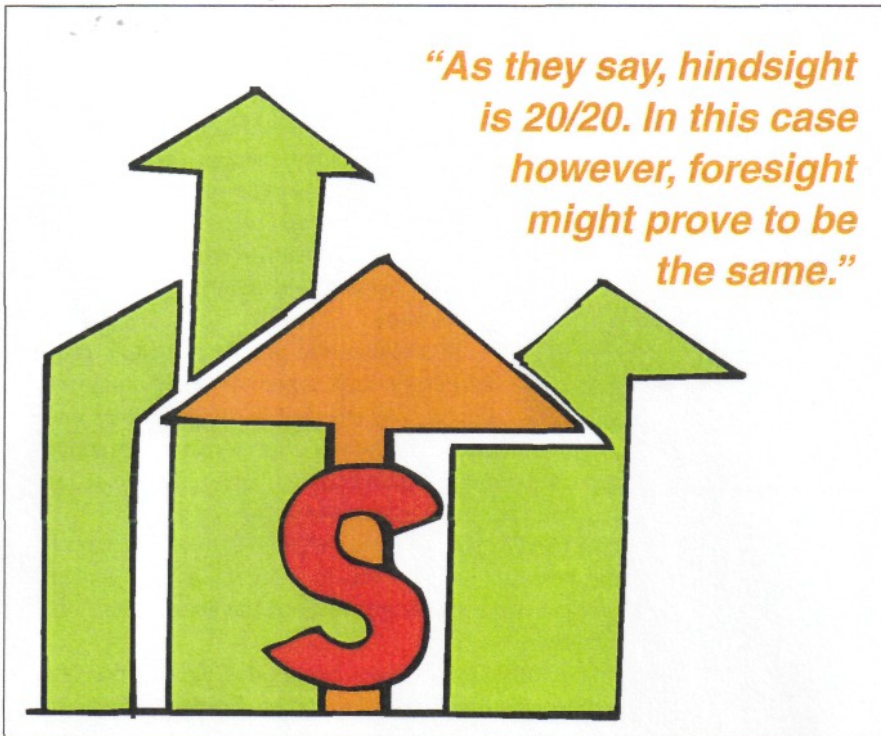
I'll go out on a limb and state that the door on this once-in-a-generation real estate pricing opportunity will likely close within 24 months. Why? For starters, the level of new box space construction has all but trickled to a halt since 2008. That means that very little additional inventory has been added to the overall commercial real estate portfolio.

Second, our nation appears to be pulling out of the economy's dark days of late 2008, with more retailers and manufacturers reporting profitable operations. While consumers aren't quite back into full recovery mode, their spending habits are trending upwards; a sign that improved consumer confidence has taken root. On the national front, retailers are more frequently seeking market opportunities, particularly in markets that continue to perform well and were previously unattainable due to a lack of spatial options.

Even the landlords have learned to play ball, offering up tenant improvement allowances that further offset project costs and timelines.

How long will it last? I can't say for sure, but what we do know is that the party will end when demand catches up with supply. As an individual who's constantly in the marketplace, I can share firsthand that there's a lot more competition out there than there was a year ago. Some properties are once again achieving multiple bids, and buyers/lessees are more intent than ever to lock in attractive deal terms and financing options.

As they say, hindsight is 20/20. In this case however, foresight might prove to be the same. ▲



Clearly the roles have reversed. Gone are the days when landlords dictated price points and terms. Today's developers, in fact, have significant expectations of landlords, including: landlord allowances for tenant improvements, often up to \$20 per foot, creation of "caps" on common area maintenance charges, free rent during installation and early-stage operational periods, reduced security deposits, limited (as opposed to uncon-

could easily cost \$60,000 to 100,000. A major HVAC replacement could be more than double that amount. What might have originally been seen as an attractive rent deal is now soured by an unavoidable expense! With this issue in mind, a buyer/lessee would be wise to fully understand the condition of the premises being leased or purchased as well as the responsibilities of both parties to maintain it.

Jerry Merola is the CFO of Amusement Entertainment Management (AEM) LLC, a subsidiary of Alpha-Omega Amusements. He has conducted feasibility studies in almost all regions of the United States and Canada. He can be reached at (732)254-3773; fax (732)254-6223; e-mail (profit wizz@aol.com).