Retailers Turn To The Experts

Consultants share how leasing strategies and capital restructuring are setting retailers up to win post-pandemic.

John Nelson

Many retail real estate professionals refer to the COVID-19 pandemic as the "Great Accelerator" for their industry as it hit fast forward on many trends already in motion, such as the use of mobile takeout ordering for restaurants, more drive-thrus at quick-service establishments and growth in the home improvements retail sector.

Matt Garfield, a managing director at Washington, D.C.-based FTI Consulting, says the best example of an accelerated trend was the robust growth of online shopping for apparel and other soft goods.

"We saw five to 10 years of gains for e-commerce in six months," says Garfield referring to the second and third quarters of 2020 when e-commerce sales leaped by 43.8 percent and 36.1 percent year-over-year, respectively. "That was not contemplated in anyone's five-year plan."

Sonia Lapinsky, managing director in the retail practice at AlixPartners LLP, a global, multi-industry consulting firm, says the pandemic has also altered the power structure away from the retailers and landlords to the consumer.

"The retailer, and to a degree the mall, used to set trends, pricing and experience," says Lapinsky. "Today, it's the consumer who calls the shots — virtually all the shots — and their expectations have never been higher."

The pandemic also hit pause on very reliable retail categories such as fitness and entertainment-based venues that chose to temporarily close their doors, including movie theater chains such as Regal Cinemas which reopened its theaters en masse in April.

Sadly many retail and entertainment concepts did not survive the pandemic while others remain on borrowed time as consumer-shopping patterns have

Women's specialty apparel retailer Chico's has tapped A&G Real Estate Partners to advise the company on its real estate footprint. Chico's announced in March plans to close 40 to 45 Chico's and White House Black Market stores in 2021.

pivoted away from several retailers' core offerings during the past tumultuous 14 months. These retailers are choosing to restructure their business plans and reconfigure their portfolios of assets for the ultimate goal of returning to profitability and minimizing their corporate debt.

As retailers navigate post-pandemic life, retail real estate consultants are advising them on various strategies available, including bankruptcy court and other means of restructuring. Everything from a company's online platforms, key personnel and even corporate office leases are all being put under the microscope.

REAL ESTATE STRATEGIES

Andy Graiser, co-president of New York-based A&G Real Estate Partners, says the first thing that his firm advises their struggling retailer clients to do is drill down on their real estate. The old adage "location, location, location" is stressed the most because the demand for good retail real estate is as high as ever.

"We're pretty focused on telling our retailers to look at their good real estate and lock it in for a longer period of time," says Graiser. "We would've also talked about it last year, but it clearly wasn't as important as this year just because the market has changed so dramatically."

A&G has been instrumental for many retailers looking to rightsize their store portfolios, including Mattress Firm, GNC, Chico's, Guitar Center, Tuesday Morning, Tailored Brands and rue21.

Graiser says that right now he's advising clients to do shorter term leases at their mall locations with anchor vacancy issues, as well as for their rural and even urban core locations because a return to pre-pandemic daytime office traffic remains uncertain.

The good news is that because of the painstaking process of landlords working with their tenants on rent relief and abatement since the onset of the pandemic, landlords are more cooperative on lease negotiations than ever. The two parties can typically find a middle ground that is custom-made for the retailer but also works for the landlord.

"Landlords are being a lot more nimble than ever before and are probably going to be a lot more realistic on how long this turnaround is going to be," says Graiser. "It used to be they would only want to do a 10-year lease. Now they're okay with doing a three- or five-year lease. "

One of the trends that came out of the pandemic when it comes to lease negotiations is the use of variable rent, where the retailer pays an adjustable rate that's based on sales. Robert Del Genio, a senior managing director at FTI Consulting, says the strategy was useful because it allowed landlords to share in either the success or failure of the retailer but that ultimately it's probably not an option that retailers can expect to see going forward.

In November 2020, Guitar Center announced plans to file for Chapter 11 bankruptcy protection. The Westlake Village, California-based instrument retailer tapped A&G Real Estate Partners to help advise the company about its 297-store portfolio.

"Some of the things we saw in 2020 we won't see again in regular workouts because this was a unique period," says Del Genio. "The outright forgiveness that happened was worked through the process and long-term relationships were deepened because of it."

Consultants are advising their retailer

Tailored Brands, parent company of Men's Wearhouse and Jos. A Bank, announced in July 2020 plans to shutter up to 500 stores and cut staff by 20 percent.

clients to also weigh heavily the co-tenancy of each individual store. Locations in urban and suburban markets that have a strong grocer on a long-term lease should extend their lease for several years while retailers with rural locations at unanchored strip centers are advised to go shorter on their leases, or shutter the store altogether.

"Co-tenancy has always been important, but it's never been as important as it is today," says Graiser. "Things are so fluid and changing so quickly, so we are encouraging our clients to look at the co-tenancy at their centers quarterly instead of once a year."

Jon Graub, principal at A&G, says that a common practice for their clients is to pare down their store footprint by closing the bottom 10 to 15 percent of stores based on sales and profit performance.

"Now is the time to do that and replace them with better stores in better locations," says Graub.

Whether a retailer needs to "hold 'em or fold 'em" is a byproduct of how well the store performs relative to its location and expected sales volume. Retailers have been using technology to compile data such as predictive sales and geospatial analytics to make their determinations.

"The data that companies now have is so much more robust than what they had in the past," says Graub. "It's becoming a more significant part of the decision-making process."

In addition to looking at their co-tenants within the shopping center, mall or other settings, advisors are also keeping an eye on the competition as part of the analysis. Stores with competitors that are expanding in the trade area could negatively impact individual store performance.

"There is competitive analysis to consider as stores suffered because competitors have come into the market or there's a new channel they're competing against," says Del Genio. "There is a lot of analytics to go through, then you have to analyze any characteristic that makes the store something worth keeping."

Consultants are imploring their clients to not just read the data results blindly but to give them proper context. Garfield of FTI Consulting says that even with the vast amount of data available, retailers and their consultants have to use their instincts because predicting future success is much more of an art than a science right now.

"We've seen a push for data to run the ship, but we are sitting in the worst nightmare for forecasters and merchandisers," says Garfield. "There is no formula that will tell us what the recovery is going to look like."

"The past has so much richness to inform us normally, but right now we're in a state of disarray that looking back isn't going to chart the course," adds Christa Hart, a senior managing director at FTI Consulting. "The retailers with a strategic vision that can visualize what consumers are going to want in six to nine months are going to be the real winners."

GETTING CREATIVE

Outside of lease restructuring or store closures, retailers that are looking to rightsize their real estate footprint are getting creative with their existing locations. Graub at A&G says that one method gaining traction for bigger retailers is to use unproductive space at their stores as fulfillment and distribution hubs to process inventory and service e-commerce customers and nearby stores. Examples of big-name retailers to do this include Whole Foods Market, Kohl's, Hibbett Sports, Walmart and Target.

"Some companies are opening stores that are a little larger in select markets to create these mini hubs to get products to their customers," says Graub. "That gets the product off the floor of the store and shipped to the consumer much quicker than they could if the customer buys an item in a distribution center, which could be located hundreds of miles away."

Lapinsky of AlixPartners warns that this last-mile approach requires more than just some empty space at an existing store. The omnichannel strategy boils down to integrating merchandise purchasing and inventory management across a whole network of stores and distribution centers.

"It also requires consideration of critical tradeoffs between profit margin and the true cost to fulfill orders, as well as speed to service the consumer," says Lapinsky. "It's definitely not easy."

Leveraging stores' physical locations that are proximate to population centers is the only choice that retailers have if they want to compete, according to Garfield of FTI Consulting. He says that companies that aren't doing using their stores as fulfillment hubs are damaging their revenue exponentially as e-commerce becomes more prevalent.

"Successful retailers are packing their stores with inventory rather than holding them in the warehouse, and then being able to support shipping it from store or BOPIS [buying online and picking up in store]," says Garfield "It helps with the product life cycle because retailers are able to clear inventory via online channels to clear out a store rather than marking merchandise down heavily, which was the previous practice."

"This isn't something that retailers are going to forget, they're going to use this as part of their playbook," adds Del Genio.

Other creative means in retailers' playbooks include doing pop up locations in target markets as a means to test and also going after second-generation space that has design elements outside of their typical prototypes, including end caps, outparcels or freestanding locations.

Graiser at A&G says the name of the game for retailers going forward is flexibility and trying new approaches.

"It's not one size fits all, the market has changed so dramatically," says Graiser. "Depending on the retailer, we advise some to take outparcels or freestanding buildings with the sole purpose of giving flexibility for their BOPIS strategy. They can do drive-thrus and gain more flexibilty for the parking and curbside pick-up than they would relative to being in a strip retail center."

Consultants are advising their retailer clients to not settle and also not aim for pre-pandemic norms as its uncertain if those will return, or at least it's likely it will look different. One constant is that retailers want to get customers in their physical locations, and Lapinsky says it will take same moxie to make it happen.

"Many companies were agile and scrappy during the early months of the pandemic to connect with consumers and improve profitability in what felt like overnight," says Lapinsky. "Post-pandemic, consumer expectations will likely shift again. This scrappiness and agility needs to be, in many cases, institutionalized."

BALANCING THE BOOKS

Businesses that have heavy debt loads are feeling pressure to re-balance their leverage and pivot their business model for the new-look world of retail. First and foremost, consultants advising their retailers say that they need to maximize their liquidity before they make any company-altering decision like filing for Chapter 11 bankruptcy protection.

Metro Pittsburgh-based women's apparel and accessories retailer rue21 emerged from bankruptcy in 2017. The company recently arranged a new credit and refinancing to boost liquidity. There are approximately 700 stores in 45 states.

"We tell our retailers that planning earlier and having liquidity gives them a better outcome than waiting until the last minute and becoming liquidity-constrained," says Del Genio.

Del Genio says that the most successful retailer restructurings are planned out in advance and there's an ultimate end game in sight. Retailers can decide that they want to shutter a certain number of stores, exit certain markets or spin off assets as part of the restructuring process.

Retailers will often sign a restructuring support agreement (RSA) with their lenders ahead of time, which signals to employees, vendors and customers that the company will come out of the other side of the restructuring.

If the retailer decides to sell the company and its assets, they'll approach their stakeholders and oftentimes have one of the providers be the stalking horse bidder pursuant to the Chapter 11 proceedings.

"Maybe the buyer will be topped in the competitive process, but there will be no doubt in the marketplace that the retailer will survive and it won't turn into a liquidation," says Del Genio. "If there's not a line of sight to the end, it can be a challenge to reorganize."

For retailers that do file for Chapter 11, they'll have access to debtor-in-possession (DIP) financing, which gives the retailers funds to keep their operations going during the bankruptcy process. The debt is used to fulfill obligations to their vendors, pay their employees and fund other aspects of the overall business.

Del Genio says that 90 percent of the time the DIP financier is already a stakeholder in the company, even though the DIP financing is shopped to third parties as part of Chapter 11 court mandates.

Private equity firms are an active participant in DIP financing and asset-based lending (ABL), which can be part of the bankruptcy process or outside of it. Hart of FTI Consulting says that private equity players are comfortable with bankruptcy proceedings and are skilled at making wholesale business decisions such as layoffs to boost the bottom line.

Garfield says a prominent reason why private equity firms are ubiquitous for retailers during bankruptcy and other restructuring arrangements is they have a lot of capital available to them that is chasing yield.

"We are sitting at near-record levels of dry powder in the private equity market," says Garfield. "Despite last year being a different year to put it lightly, the fundraising efforts across private equity really didn't see a large hit. As a private equity firm, you don't make money by holding it. You have to make investments and go after deals." **SCB**