

Leasing real estate in the new economy



Jerry Merola

*Market corrections
may open doors
for entrepreneurs
in the world of
entertainment.*

By now, the effects of a sunken economy have been felt through all walks of life. As of this writing, the stock market is off its highs by almost 50-percent, the unemployment rate is well on its way into the eighth percentile, and the national banks are struggling to avoid nationalization.

One would think the sky is falling. As it may turn out, though, all of these indicators speak to one key element—market correction. The unprecedented run-up of our markets since 2001 has ultimately proven to be built on a faulty foundation, leaving little to write home about.

As with everything, there is a silver lining to consider. That silver lining is well documented in our history. Market corrections have been known to be the catalysts that create opportunities for new entrepreneurs, who would normally not be capable of penetrating markets controlled by well-established firms. Such is the case with commercial real estate today.

When times were good, national chain retailers were opening new venues by the truckload. Land developers could barely keep up with demand, as strip mall after strip mall began to replace open space. However, now the tide has turned remarkably quick, with retail tenants disappearing faster than anyone could imagine.

Between Chapter 11 filings, and general “going out of business” eliminations, just about every mall, strip center, and lifestyle center is pocketed with dark boxes that once housed the likes of Circuit City, Linens ‘N’ Things, and a host of medium-sized regional retailers.

LEASE FOR LESS

A few years ago, prime real estate locations such as these were well

beyond the financial capabilities of most entertainment proprietors. Rents were hovering in the high teens and low-20s, with common area maintenance charges adding another \$3 to \$6 on top of that.

Even if an entertainment venue could make a decent business case for affording such space, it was unlikely that landlords of this caliber would ever approve the use. After all, entertainment properties are high risk, aren't they? Funny, but I think the commercial real estate sector might have misunderstood where the real risk truly was.

Fast forward to 2009. The landlords that manage these empty boxes are facing a multitude of pressures, including: a) strained cash flows resulting from a loss of tenant income; b) impending covenant violations with their lenders as a result of their inability to maintain a minimum occupancy level in their centers, c) impending lease violations with their anchor tenants, whose leases mandate that the landlord maintain a minimum percentage of tenant occupancy within the affected retail complex (often 70-percent or more), and d) rising operating costs resulting from an inability to collect property expense reimbursements from the dormant retail spaces.

These elements alone have been enough to push many commercial landlords to the edge, particularly those that used debt to leverage the purchase of their complexes.

TRYING TIMES CREATE NEW OPPORTUNITIES

Just about every market in the U.S. has been impacted by the closing of a chain retail store. As a result, landlords are currently re-listing these boxes for



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lease in hopes that a prospective user will quickly capture the 30-50,000 square feet of available space.

Some of these offerings may fall under a sublease condition, whereby the original lessee will remain obligated to the landlord for the full amount of the lease, but may be permitted to offset some of its costs through subleasing to a new party.

In other cases, the original lease is no longer valid, and as such the landlord is seeking a new tenant. Whatever the condition, these dormant boxes are typically well located along high traffic roadways, and often share parking areas with other well-known retailers.

Now for the good news: There’s not much tenant competition in the leasing world these days. The zoning of these dormant boxes often dictate that they be used for retail purposes, eliminating other user styles, notably office or warehouse formats.

Few, if any, traditional retailers are considering expansion or relocation, as most are still reeling from disappointing holiday and first quarter sales performance. That leaves us—the entertainment user—as the likely tenant for these boxes.

Having outfitted several over the years, here’s why I believe they represent an ideal match for today’s entertainment operator:

■ **Size:** Most of these units range from 30-50,000 square feet, and are nearly square in configuration. This affords the opportunity to develop the space for use as either a traditional family entertainment center (FEC), or a bowling hybrid venue.

■ **Ceiling Height:** Most units will be found with ceiling heights in excess of 18 feet, which allows for the placement and operation of multi-tiered

attractions, or large media video units (bowling).

■ **Front-load Parking:** The location and the shared nature of the parking field allow for direct visualization by consumers driving within the complex’s access ways.

■ **Signage:** The relative size of the space often allows for the prominent display of signage along the main structure’s facade, as well as within the complex’s pad markers along bordering roadways. As a result, consumer identification improves remarkably.

■ **Location:** The majority of these larger complexes are situated along major thoroughfares, and are often identified as “power centers,” since they tend to draw a high volume of consumers. The steady flow of patrons arriving and leaving the center present marketing opportunities for the entertainment retailer, as the strength of adjoining tenants’ marketing programs often enhance the entertainment center’s capture rate of area patrons.

■ **Systems:** The relative newness and design of these mid-box spaces often incorporate important features, such as high-power electrical services, loading docks, extended span structural supports, and large, custom entry-

ways. The existence of such systems could save the operator substantial upgrade costs, and reduce the time necessary to activate the business.

THE TIME TO ACT IS NOW

Good things don’t last forever. I believe there’s a small window of time whereby the commercial real estate market will trade well below market standards. The ability to negotiate and sign a 10-year or 20-year lease at favorable terms will probably never be better than the present day.

If you’ve been thinking about starting a new entertainment business, or relocating your existing enterprise, the temporary collapse of the commercial real estate market may be your ticket forward.

After all, we have the opportunity to greatly reduce one of the two largest expenses our industry must endure: occupancy costs. Combine that savings with a triple-A location, solid infrastructure, high-powered adjacent tenants, and easy zoning approvals, and I think you’ll agree that entertainment’s future just got a whole lot brighter. ▲

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