

## Attention K Mart Shoppers...

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A down-spiraling economy sure has a way of sorting out the winners and losers. Take the retail sector, for instance. While the home improvement stores are booming, the sale of retail goods, particularly apparel, is suffering. Does this mean that men prefer power tools to power suits and women desire gardening gloves to leather ones? I suspect both of these conditions might be true, at least for now, or at least until the economic indicators alert consumers that it's okay to start spending money again. As regular readers may already know, I tend to find a silver lining in most every aspect of our society, so the retail slump will be no exception.

The decline of the lower-end "big box" retailer, notably the Bradlees, Service Merchandise, Kmart, and Montgomery Ward organizations, has presented a unique opportunity for new and growing entertainment businesses. Most of these fallen retailers occupied large-scale indoor facilities ranging in size from 25,000 to 60,000 square feet. The large majority of these buildings were built when real estate parcels were readily available and were often positioned along major traffic arteries. Construction style was similar among these structures, with 16-20 foot ceilings, wide expanses between column supports, more than adequate parking, and wide-open floor areas. The most exciting part is that virtually all of these former retailers are still paying rent on the buildings they no longer occupy!

### A Diamond In The Rough

The vast majority of these retail sites have infrastructure improvements that I only dream about when developing a new center. Large multiple-bay loading docks, heavy electrical power, large pad signs along the roadway frontage, and multi-use electrical raceways below the floors. What they typically don't possess is attractive storefront appearances or the ability to be easily subdivided. In most cases, the cost to sectionalize HVAC and electrical systems will outweigh a good portion of any lease savings. So unless another subtenant is willing to foot the bill for the division of space, leasing a big box is an all or nothing proposition.

Why the interest in these dormant sites? Well, for one thing, the price can be very attractive. My firm has completed negotiations for four such sites during 2002 and 2003, and in each case, the rent paid by our client ranged from 50-65% of the current lease/market price. Essentially, the former retailer is still on the hook for the full lease amount but has agreed to accept a smaller portion from our client to offset their expenses. So, if Kmart is paying \$10.50 per foot under a lease that runs for another nine years, our client might be paying \$5.25 - 6.75 under a sublease agreement for the same period. In rare cases, you might even be able to get the retail lessee to contribute funds toward the modification of the site, but more than likely any negotiation will focus on reduction of rents.

From a timing standpoint, the big box sites can be hard to beat. Entertainment usage is generally considered a lower density usage in the eyes of a municipality, so zoning approvals are rarely a problem. And since most of these structures are of an open design, little demolition is necessary to return the site to "vanilla box" format. Finally, with parking lots that surpass the needs of most entertainment users coupled with giant existing sign boards that would take a year and a day to gain approval from today's zoning committees, leasing of an existing big box structure can save a great deal of time navigating the municipal juggernaut. Plus, significant dollars can be saved on architectural and engineering fees, as the superstructure is already complete.

### Finding The Right Site

You might be amazed at the number of newly abandoned retail sites that are cropping up this year. Just last month I took a short drive into an area that was under consideration by a client, and low and behold, no fewer than four sites were found. There were "available" signs on only two of the sites but with a little digging, I obtained the number for the retailer's corporate real estate department for the other two sites. The two unlisted sites had not been transferred to a broker for re-marketing, however, the real estate department was more than happy to discuss a sublease option. Now, one month later, our client has a pending lease deal at a per square foot lease cost that is 40% below market. Even the owner of the real estate has agreed to provide some new curbing and landscaping on the exterior and repair a few roof leaks within the building.

Not every deal goes this smoothly. There have been times where we've negotiated for months only to reach an impasse over who would pay for deferred maintenance on the structure. Fortunately, we've only encountered two instances where our "sweetheart" deal was tabled in favor of another bidder, the most recent of which came from Sam Walton's

organization. And as it turned out, Walmart leveled the structure in its entirety to build an even bigger box.

Is a big box right for you? Well, that depends largely on the needs of your entertainment facility. Do you plan to install large attractions? Are you including indoor go karts or an extreme skate park? If so, you'll be happy to find that much of the necessary infrastructure for these items is already in place within these former retail sites, allowing you to direct more of your capital resources toward the marketing program and staffing budgets.

### **Pay Attention To The Details**

For the most part, the big box sites can be extremely worthwhile for an entertainment concept that spans in size from 25,000 - 50,000 square feet, but there are a few items to consider. First, most leases require the lessee to cover the costs of all ongoing building maintenance items, which can add up quickly if the building is old or in disrepair. Second, the "common area maintenance" charge, or CAM, is added to the base rent to reimburse the landlord for the costs of snowplowing, landscaping, striping and sealing the parking lot, electrical utilities that service the outdoors and common areas, and - get this - management of the site. That's right, more and more real estate landlords are incorporating management costs AND benefits of their management personnel as part of the overall CAM charge. So, while you might have cut yourself a great deal at \$4.50 per square foot for the base lease, the CAM charge may end up being \$3.50 foot! I've seen CAM charges as high as \$6.00 in some mall complexes, so it's important to ask the question early in the discussion and to also obtain an accounting of how the current fee is assessed.

Other issues that require close scrutiny is the extent of the power grid, the need (if necessary) to remove existing fixtures (storage cases, counters, etc), and the sufficiency of the restrooms. All of these issues can be dealt with effectively provided you're aware of the condition early in the negotiation. In most cases, the retailer will agree to remove the fixtures or bring in a consignment company to handle their removal. Additionally, the vast majority of landlords recognize that restroom facilities will need to comply with ADA standards regardless of the type of tenant selected, and as such, may offer a contribution toward their rehabilitation.

You could say we've reach the point at which all the good variables collide. Astonishingly low interest rates, languishing demand for large structures, and the ideal formatting of these units all help to make a sublease decision a lot easier. So if you're ready to pull the trigger on a new entertainment center concept, don't forget to look at the big boxes in your area. Who knows, your new lease deal might prove to be the best blue light special you've ever encountered.

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