SAVANT REPORT

ISSUE 36 - APRIL 22, 2016

THE SLOW AND PAINFUL DEATH OF BIG BOX RETAIL...

By Jordan Wirsz - Savant Investment Partners

Over the last several years, I have continued to warn real estate investors to stay away from mid or big box retail investments. I also cautioned equity investors to be careful of companies with large amounts of mid or big box spaces. The evolution of technology in the retail industry is just beginning. Years ago, Amazon entered the market and virtually destroyed the big box retail business model. Best Buy, for example, has largely become a showroom for consumers looking for electronics and appliances. After viewing and testing out the equipment in a local store, the consumers then hop onto Amazon or any number of other online retailers and buy the item for a discount. This trend has permeated every facet of consumer buying, including clothes, shoes, electronics, tools, and even specialty goods.

I am overwhelmed with emails from commercial real estate brokers around the country trying to sell me Guitar Center leased buildings. Guitar Center has been one of the most publicly forecasted and publicized "on the verge of bankruptcy" stories over the last couple of years, teetering on the line of going out of business. Best Buy has tried to "reinvent" themselves to find a way to capture the sale while consumers are in the store, and also by trying to capture online market share.

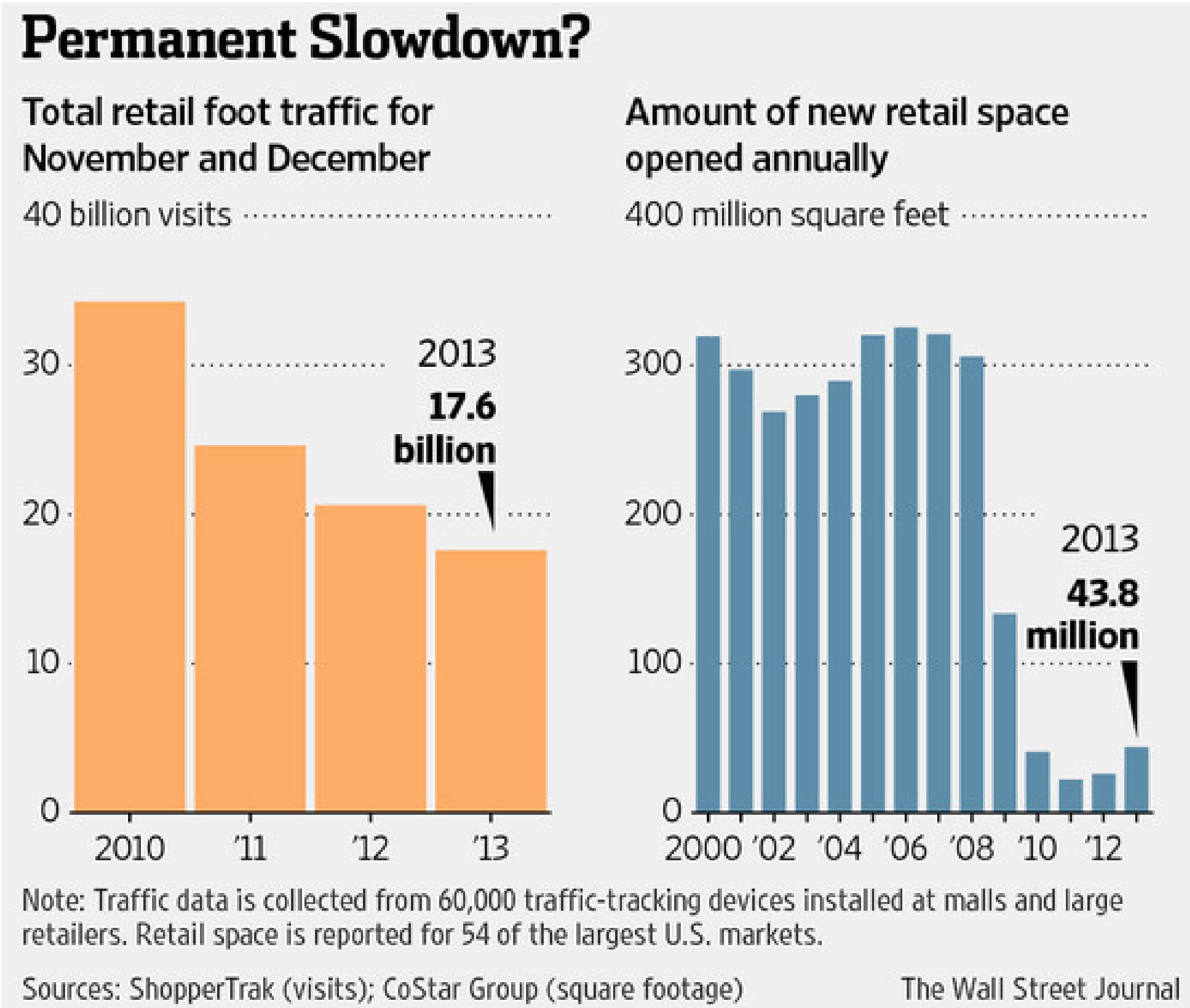
A slew of other big box retailers has long embattled the fight to stay alive. Sears Holdings just announced that it will close 68 of its Kmart stores across the country in addition to 10 Sears stores in an attempt to stay solvent and regain profitability. One positive note for those of us in Las Vegas, is that none of the planned closures are in Nevada, as our economy keeps on growing post-recession.

JC Penny has been the "turn around" story that never happened. They keep trying, but the business continues to struggle.

Walmart, perhaps the greatest consumer goods and food retailer ever created, is closing 269 stores worldwide in 2016. Most people, including myself, believed that Walmart was just too big to pair anything back, including its locations. Having dealt with Walmart in the past on real estate deals, they are generally very smart and specific about where they build and open stores.

The latest casualty of the big box retail model demise is Sport Chalet, which is closing ALL of its stores after filing bankruptcy this week.

The fundamental model of big box retail has evolved from the once traffic heavy destinations into an online marketing competition, both in pricing and ease of purchasing (such as Amazon's one-click checkout strategy). So what is to come of all the massive big box spaces in shopping centers? I believe that as time goes on, those space will be demised into smaller spaces (costing the landlords/owners hundreds of thousands, even millions of dollars to do). The smaller spaces may get filled with non-traditional uses such as charter schools, trade schools, ethnic specific grocery stores, gyms, paint-ball enthusiast spaces, etc.…All of which are "low rent payers." Bringing alternative uses to a shopping center is usually the "kiss of death" for a once busy, well-anchored property. Retail shopping center investors will lose millions of dollars, and will begin feeding vacant centers with lots of capital trying to keep it looking good. Once the big boxes go dark, the surrounding retail will suffer horribly. Most big box anchors bring about lots of smaller "in-line" type tenants such as restaurants, nail salons, and others…But for the privilege of being near the busy anchors, they pay top dollar rents. The financial strain on the little guys will turn many centers into ghost towns.



Even shopping malls are having challenges competing with online sales. In the end, consumers are choosing to shop from their home or office computer rather than brave the traffic, parking and crowds often associated with going to malls. "Experiential retail therapy" is perhaps the one continual driver for shopping malls… Attracting consumers who enjoy the shopping experience on the weekends, perusing stores and making an afternoon out of the event.

The one area that I continue to be very bullish on, is what we call "neighborhood retail" which are smaller, in-line retail centers with maybe a fast food restaurant and coffee shop on pads in front of the center. The reason I am still bullish on these types of centers is because regardless of online shopping habits, consumers still need a place to go to have coffee, dine out, get their nails done, see a dentist, etc. Even better, these neighborhood retail centers don't rely on Best Buy, Guitar Center, or Walmart to bring traffic. They rely on other immediate service need tenants to help bring traffic…Starbucks for example.

The bottom line?

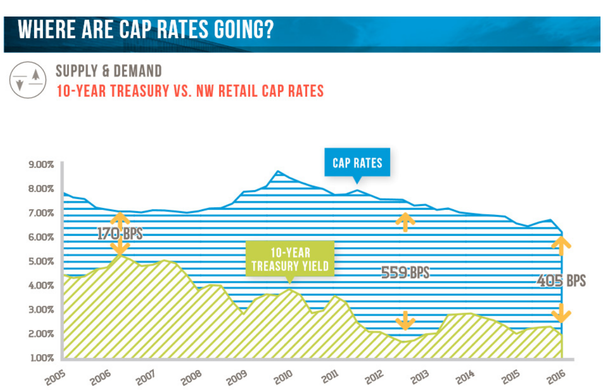
1. Avoid buying or investing in "big box"

or "mid box" retail shopping centers.

2. Avoid investing in companies (equities/stocks) that rely on big box space to drive big portions of their revenue.

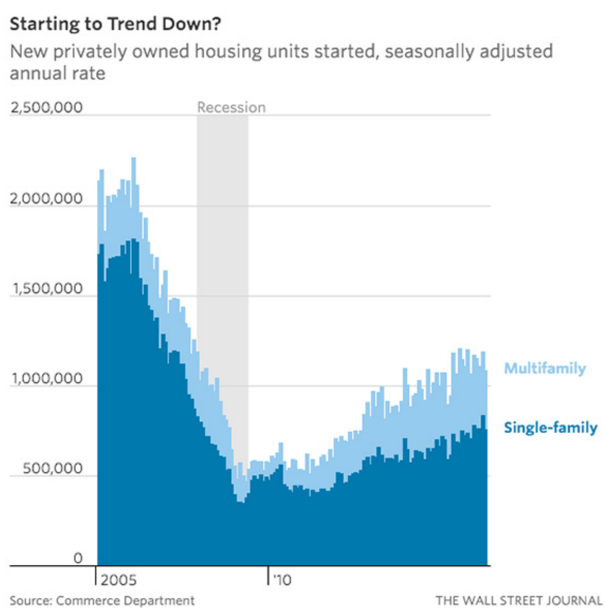
One measure of commercial real estate market health is the spread between 10 year treasuries and the actual CAP rates that these properties are selling for. The smaller the spread, the higher the price from a historical perspective. The bigger the spread, the more opportunity there is. The chart below depicts the bottom of the market CAP rate to treasuries spread at 559 basis points (5.59%) which is massive. Today, as the real estate recovery strengthens, we have taken off about 150 bps in spread.

The definition of a CAP rate is the net income after all expenses on a property, divided into the property value or purchase price as it may be. As you can see from the chart below, cap rates have been compressing…which can be depressing, except for those of us that own commercial real estate, it means that we are in an appreciating asset class. Additionally, we get the great benefits on top of the CAP rate returns, including leveraged returns, capital appreciation, and tax benefits.



But not all the recent news in real estate is rosy, even apart from big box retail's challenges. The housing market is also showing signs of softening. Last week I wrote about the Miami meltdown (or correction). This week, we got the March housing start numbers which fell 8.8% from February to an annualized rate of 1.089 million. Single family homes fell -9.2% and multi-family fell -8.5%. This is the perfect "softening" that I have been forecasting in 2016/2017 that will be a great opportunity maker.

When you compare the housing numbers to pre-crash levels, we still see that year over year housing starts are up, and yet still way below the pre-recession highs. The housing market is "healthy" right now, and the ebb and flow of housing numbers is expected to be up and down in a normal market mid-way through the cycle.



I remain bullish on real estate in general, with the exception of big box retail and mid box retail spaces. Multi-family I remain conflicted with the incredibly low CAP rates and the extremely hot state of that sector of the market.

ABOUT THE AUTHOR

Jordan Wirsz, CEO
Savant Investment Partners

Jordan Wirsz serves as the founder and CEO of the Savant companies (2011-present) including Savant Investment Partners. Mr. Wirsz brings with him more than 14 years of real estate investment experience in a wide variety of real estate assets representing hundreds of millions of dollars of transactions. Mr. Wirsz is responsible for overseeing Savant's real estate investments including locating and negotiating real estate transactions, asset management, property management, leasing strategies, portfolio strategies, partnerships, investor relations, and administration. In the course of the Savant's business, Mr. Wirsz has spearheaded more than $100 million of real estate investments since 2012.

Prior to Savant, Mr. Wirsz served as CEO of a private capital finance firm (2002-2009) that managed more than $100 million of capital including a private investment fund. As a real estate investment manager, Mr. Wirsz has been a real estate investor and investment manager in many areas across the United States, which includes commercial and residential assets, land entitlement and development projects, industrial properties, office projects, retail shopping centers, and build-to-suit transactions. Mr. Wirsz is a very active commercial real estate investor and has served the roles of investor, developer, lender, fund manager, consultant, and broker. Mr. Wirsz is a nationally recognized real estate expert who has been recognized by members of the U.S. Senate, U.S. Congress, Nevada state government, and has been featured on numerous national television networks including CNBC, NBC, and Fox News. Mr. Wirsz was awarded the prestigious "Young Entrepreneur of the Year" award by the Small Business Administration in 2007. Mr. Wirsz is also a notable author and speaker, and in the past has devoted considerable time to those endeavors through his company Jordan Wirsz International Inc. (2009-2011). Mr. Wirsz continues to speak on investment and business topics when his schedule permits.

DISCLAIMER: Savant Investment Partners is a publisher. This website and all content published therein (collectively, the "Content") is strictly intended for general informational and entertainment purposes only and may not be relied upon for any other purpose. Reproduction of the Content by any means is prohibited without prior written permission of Savant Investment Partners.

The views expressed in the Content are the authors' own opinions only and do not necessarily reflect the views of Savant Investment Partners. None of the Content constitutes a recommendation that any particular investment, security, portfolio of securities, transaction or investment strategy is suitable for any specific person. Further, none of the creators or providers of our Content or their affiliates will advise anyone personally concerning the nature, potential, value or suitability of any particular investment, security, portfolio of securities, transaction, investment strategy or other matter. Accordingly, do not attempt to contact them seeking personalized investment advice, which they cannot provide. To the extent any of the Content may be deemed to be investment advice, such information is impersonal and not tailored to the investment needs of any specific person.

Any performance data in the Content is supplied by sources believed to be reliable, that the calculations therein are made using such data, and that such calculations are not guaranteed by these sources, the information providers, or any other person or entity, and may not be complete. In addition, past performance is not an indication of future results.

None of the Content is intended to be nor shall be construed as an offer to sell or a solicitation to buy any security which may be referred to from time to time in general informational contexts. Savant Investment Partners, its employees, officers and directors are not investment advisors and do not offer such services. The Content is intended solely for consumers residing in the United States. We make no representation that any Content is appropriate for other locations. Those who choose to access the Content from other locations do so on their own initiative and at their own risk, and are responsible for compliance with local laws, if and to the extent applicable. We reserve the right to limit the availability of the Content to any person, geographic area, or jurisdiction we so desire, at any time and in our sole discretion, and to limit the quantities of any such Content that we provide. Savant nor its affiliates are registered investment advisors. They do not in any way construe themselves to be investment advisors, nor do they provide such services. Please consult with a professional advisor before making any investment.