RETAIL CONSOLIDATION IN EASTERN MASSACHUSETTS: TRENDS AND IMPLICATIONS FOR SHOPPING CENTERS

by

Jeffrey S. Nolan

B.A.. Economics
Colby College 1984

M.B.A. in Finance
Boston College 1995

Submitted to the Department of Urban Studies and Planning in partial fulfillment of the requirements for the degree of

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Signature of Author: ____________________
Department of Urban Studies and Planning
July 31, 1996

Certified by: ____________________
William Wheaton
Professor of Economics
Thesis Supervisor

Accepted by: ____________________
William Wheaton
Chairman, Interdepartmental Degree Program in Real Estate Development

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ABSTRACT

Two of the most frequently heard descriptions of the retail industry today are "over-stored" and "consolidation". The most common explanations for these phenomenon are that during the past decade, a more time-pressed, savings conscious, value-oriented, and multi-ethnic America has demanded superior value and convenience from retailers resulting in tremendous pressure on profit margins and record retail failures. Retailers lacking access to capital, buying savvy, efficient distribution and inventory systems and pricing leverage with suppliers are unable to compete with the Walmarts, Home Depots and other "Category Killers" of the world which possess these advantages.

This thesis analyzes the current outlook of major publicly traded (and two major private) "distressed" retailers operating in Eastern Massachusetts. Among the topics covered are the amount of space they occupy in relation to the total market(s), the formats they operate in, the likelihood of their space becoming vacant, the potential for re-use of this space by Walmart, Target and other "growth" retailers and the implications of these issues for the retail property markets in eastern Massachusetts.

Thesis Supervisor: William Wheaton
Title: Professor of Economics

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TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION

Objective:

This thesis first studies changes in the demographic makeup of our country and the ensuing emergence and financial performance of "category killers" and other dominant retailers in various segments of retailing. A particular emphasis is made in the home improvement, consumer electronics and discount department stores segments. The effect of this evolution in terms of the ongoing consolidation of retailers, the decline in the market share of department stores, other general merchandisers and the mall as a retailing venue are discussed.

The extent to which retailers in these three segments which operate in eastern Massachusetts are subject to the same trends observed at the national level is then analyzed. The analysis then focuses exclusively on the current outlook of four major publicly traded (and two major private) discount department stores retailers operating in eastern Massachusetts. Among the topics covered are the amount of space they occupy in relation to the total market, the formats they operate in, a projection of how much of this space is "excess selling space" (in light of their inability to compete effectively in this new environment) and therefore is likely to become vacant, the potential for re-use of this space by Walmart, Target and other growing retailers and the implications of these issues for the retail property markets in eastern Massachusetts.

Methodology:

One of the key objectives of this paper is to estimate the amount of "excess selling space" currently being occupied by distressed discount department store retailers in the eastern Massachusetts region and secondly, to predict the increase in the amount of this excess space over the next six years as Walmart increases its presence in the region and Target makes its predicted entry. This analysis depends heavily on the development of a model which utilizes the company-wide sales productivity of national and regional discounters, adjusted for regional factors, to estimate total discount department store sales for the state of Massachusetts.

A key assumption heavily relied on in this analysis is the observed historical increase in productivity experienced by Walmart stores during their "life cycle" and the assumption that this increase in store productivity occurs in this region despite the stiff competition that currently exists. The growth in total sales and the share of those sales captured by each of the major chains is then estimated. Next, an analysis is performed which estimates the sales levels which the various retailers must achieve to obtain a healthy operating margin of 4.50%. The current sales productivity of the regional discounters and the required sales to achieve healthy margins are then used to determine the ultimate output of the model- the amount of "excess selling space" (i.e. the required reduction in the amount of gross selling area needed to restore a healthy balance of between total sales and total selling area).

Another key objective is to analyze the potential for reuse of this space. As a precursor to this analysis, the characteristics of the shopping centers which these retailers occupy are discussed, as they will have a direct bearing on the effects of store closings and the types of retailers which could potentially occupy this space. Next, the recent historical reuse of discount department store space is analyzed, particularly the status and reuse of stores vacated by Stuart's Department Stores and Ames (including Zayre) in the past few years. Finally, a look at the prospect of Walmart, Target and other category killers reusing this space is analyzed.

Summary Conclusions:

On the national level, a significant consolidation is clearly underway with Walmart, Home Depot and Circuit City entrenched as obvious winners in their respective segments. The outlook for the second tier of retailers in these segments is less certain. While Lowe's is a relatively strong company in the home improvement segment, the outlook for Kmart and Best Buy, in the discount department store and consumer electronics segments, are unclear. Kmart suffers from low store sales productivity and both companies have seen their gross profit margin seriously eroded in the past year.

Retailers in these segments operating in eastern Massachusetts are now experiencing these same trends of consolidation and extreme competitive pressure. In the past year, four regional discount department store chains with aggregate sales of approximately $4.7 billion and 85 stores in Massachusetts filed for bankruptcy protection. One has since liquidated. The model projects that in 1995, the 20 Walmart stores operating in Massachusetts average sales of $207 per square foot and captured approximately $456 million or 20% of the estimated $2.3 billion in total sales of the eight major discounters. Walmart's market share is then projected to increase to 41% by the year 2002. Over the same time period, the market share of the remaining discounters in total is projected to decline from 80% to 59% with a resulting projected "excess" of approximately 2.8 million square feet of selling space by 1997. This should, in theory, result in the need to close up to 35 stores to restore a balance between the supply and demand for discounter selling space.

The analysis of the 100 shopping centers these discounters occupy in eastern Massachusetts (not including the Cape and Islands) determines that the average discount department store unit occupies 84,117 square feet of a 235,926 square foot community shopping center with 1.48 additional anchor tenants. A total of approximately 23 million square feet of shopping centers are occupied by these retailers. In 20 centers, totaling approximately 2.2 million square feet, these stores represent the sole anchor tenant. In 53 of these 100 shopping centers, supermarkets are additional anchors. Brockton and Danvers have the greatest exposure (400,000 or more square feet) to these retailers in terms of gross selling space while in Milford and Chelmsford these retailers occupy greater than 15% of the total retail market.

While little data is available, the historical reuse of vacant discount department store space appears to have been largely by other department stores and supermarkets. Of the twenty vacated units studied in this report, only six have been fully re-leased at this time. Three were leased by other discounters, one by a supermarket and one by an off-price clothing store and home goods store (the sixth tenant is not known).

Reuse of the subject space by current and future growing retailers in the region is difficult to predict due to the rapidly changing environment of retail and the increasingly short life cycle of both retailers and store formats. Nonetheless, among the most likely scenarios for reuse are the acquisition of these regionals by Walmart or, more likely, Target Discount Stores as a means to gain rapid market penetration of the region and reuse by an expanding supermarket already occupying the center.

An important variable in this strategy, however, is the evolution of the supercenter, which will likely dominate growth going forward. A supercenter consists of both a full line department store and a grocery store and dictates the immediate need for a minimum of 110,000 square foot stores with 60,000 square foot expansion ability for the grocery component. This implies that newer, larger (100,000+ square foot) stores with the ability to expand will be the likeliest to be reused in the near future. The hardest hit discounters and shopping centers will be in the rural locations where Walmart is beginning to build a dominating presence and where the likelihood of finding major replacement tenants is the least. The older, smaller units in outpost locations will most likely be in the first markets surrendered to Walmart and are more likely be downgraded in use, torn down or be converted to non-retail uses.

One of the ultimate implications of the retail consolidation for landlords on both a national and local level is the likelihood of fewer, and potentially stronger, tenants in the future. This may result in the shifting of negotiating leverage to the tenants.[1] The slow or flat sales environment resulting from the changing lifestyles and demographics of Americans should limit the amount of rent retailers are willing to pay. Finally, the shortened lifecycle of retailers and retail formats is likely to increase the risks of tenant turnover and quicken the obsolescence of retail formats.

[1] Ron Pastore, Aldrich, Eastman & Waltch

CHAPTER 2:

RETAIL INDUSTRY TRENDS AND IMPLICATIONS/ NATIONAL LEVEL

Trends:

Most retail analysts agree that the difficult environment which retailers face today is the result of several secular and demographic trends. These major trends include the fact that consumers are growing older and more value conscious. The free spending baby boomers of the '80's are now less focused on image (apparel) and more focused on finding good values. This is a result of a greater preoccupation with saving, paying college tuition and maintaining and improving their homes.

Low interest rates and the increasing emphasis on the home are contributing to the rapid growth in sales of "big ticket" durable goods such as computers and other electronic goods. The growth rate in U. S. households has slowed considerably due to a higher percentage of the population being single. In the 1960's, 63% of households fit the traditional mold of two parents and children. Today fewer than 25% of households fit this mold[2]. While population growth is an important determinant of food and drug demand, general merchandise growth (including apparel) is more closely correlated with household growth[3].

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[2] Merrill Lynch, Shopping Center REITs, March 1996
[3] Merrill Lynch, Shopping Center REITs , March 1996

Consumers are more time pressed than ever before, which dictates the need for convenience and selection which are the cornerstones of the phenomenal success of the "category killers" and explains an observed decline in the number of mall visits.

At the same time, the population is becoming increasingly multi-racial, multi-ethnic and polarized economically. In 1973, 58% of U. S. households were considered the middle class (as defined in 1996 dollars by income in the $25-75,000 range) while the percentage fell to 48% in 1991 and is projected to be 39% in 2000.[4] This has negative implications for retailers catering to the white middle class and opportunities for retailers catering to the growth in minority, low-income and high income consumers.

Response:

In response to these demand side changes, the high cost of real estate in malls and the poor execution of most department and discount stores, the supply of retail formats and economics of retailing have changed significantly over the past few years in many significant ways. There has been a tremendous growth of value-oriented mass merchants and category killers such as Walmart, Toys "R" Us, Circuit City, Home Depot, Price/Costco and Bed Bath & Beyond which are able to offer low prices and huge

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[4] AEW: Retail Industry Trends

selections as a result of their highly efficient distribution systems, inventory control systems and superior pricing leverage with suppliers.

Category killers match or beat their traditional competitors on commodity items and make their profit on higher margin, lower turn items that a discount store cannot afford to carry. They now account for approximately one-third of all retail sales. The top 20 firms accounted for over $50 billion in sales in 1994 and opened 1,200 stores.[5]

The huge inroads "Category Killers" have made in the market share of hard goods formerly held by department stores and other general merchandisers has resulted in department stores having to re-dedicate themselves to apparel which, in turn, has taken market share from smaller specialty stores. As a result of the success of these new formats, profit margins in all segments of retailing are under extreme pressure. This, in turn, has resulted in a flurry of bankruptcy filings and failures of regional retailers which do not posses the advantages of the national "value" retailers and generally lack the capital to renovate enough stores to convert to more successful formats. In 1995, no fewer than seven discounters with combined sales of more than $6 billion, were forced to file bankruptcy.[6] Of those, four are currently in liquidation. In 1995 a record 2,700 stores closed nationally. [7]

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[5] Stores: November, 1995
[6] Goldman Sachs: U.S. Research "The Discount Industry: Three's a Crowd", April 30, 1996
[7] Forbes "The Year the Stores Closed Their Doors", February 1996

Due to this extreme competition and price pressure, the life cycle of retailers and formats has shortened considerably. As Carl Steidman, chief economist at Management Horizons explains: "It took 100 years for the department stores to hit maturity, 10 years for the warehouse stores. Now it's just 5 to 6 years for a new concept to get tired".[8]

Implications:

The retail industry is in the midst of a consolidation process. Not too long ago, the differences in performance between the best players and second best players were minor with the difference between great results and good results at stake. Today the differences between retailers are often extreme with the differences between the best and second or third best determining survival. For example, in 1985 both Walmart and Kmart had sales of $165 per square foot. In 1995, Walmart's discount stores (including supercenters) performed at approximately $300 per foot while Kmart was at $144 per foot.[9] Similarly, Home Depot performs at over $380 per foot while Kmart's failing Builders' Square concept produces in the $200 per foot range.[10]

The chart below lists shows several basic performance and financial ratios about several category dominant national retailers.

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[8] Forbes : "Big Boxes. Too much of a good thing?", May 1996

[9] DLJ: "Category Killers: Still The Best Retail Investment", April 1996
[10] Merrill Lynch "Shopping Center REITS", March 1996

Table 1 FINANCIAL RATIOS OF CATEGORY KILLERS

	STORE SIZE (SQ. FT.)	SALES/ STORE ($ MILL)	SALES PER SF	GROSS PROFIT/ STORE	GROSS PROFIT PER SF	GROSS MARGIN	STORE OPER PROFIT
PETsMART	25,000	$ 5.8	$ 232	$ 1.3	$ 53	23.0%	$ 0.9
AUTOZONE	6,500	$ 2.3	$ 308	$ 1.0	$ 147	41.5%	$ 0.4
GENERAL NUTRITION	1,800	$ 0.5	$ 289	$ 0.2	$ 101	35.0%	$ 0.1
HOME DEPOT	103,000	$ 40.0	$ 388	$ 11.0	$ 107	27.6%	$ 4.0
OFFICE DEPOT	30,000	$ 10.5	$ 350	$ 2.6	$ 88	25.0%	$ 0.9
STAPLES	20,000	$ 7.5	$ 375	$ 1.9	$ 96	25.7%	$ 0.7
OFFICE MAX	23,500	$ 7.5	$ 319	$ 1.8	$ 77	24.0%	$ 0.6
WALMART (SUPERCENTER)	188,000	$ 75.0	$ 399	$ 16.1	$ 86	21.5%	$ 4.9
WALMART (DISCOUNT)	110,000	$ 30.0	$ 273	$ 7.2	$ 65	24.0%	$ 2.4
PRICE/COSTCO	130,000	$ 85.0	$ 654	$ 9.4	$ 72	11.0%	$ 3.9
LOWE'S	115,000	$ 35.0	$ 304	$ 8.4	$ 73	24.1%	$ 2.5
BORDERS	30,000	$ 9.3	$ 310	$ 2.6	$ 86	27.9%	$ 1.0
BED BATH & BEYOND	42,000	$ 9.6	$ 229	$ 4.0	$ 96	42.0%	$ 1.1
CIRCUIT CITY	33,000	$ 23.0	$ 697	$ 5.6	$ 171	24.5%	$ 1.4
COMPUSA	26,000	$ 40.0	$1,538	$ 5.4	$ 208	13.5%	$ 1.9
BARNES & NOBLE	26,000	$ 7.2	$ 275	$ 2.2	$ 84	30.5%	$ 0.7
TOYS 'R' US	46,000	$ 11.0	$ 238	$ 3.4	$ 73	30.7%	$ 0.9
BEST BUY	58,000	$ 50.0	$ 862	$ 7.3	$ 125	14.5%	$ 2.5
SPORTS & RECREATION	48,000	$ 8.4	$ 175	$ 2.8	$ 58	33.0%	$ 0.7
AVERAGE	55,884	$ 24	$ 432	$ 5	$ 98	26.3%	$ 1.7

Source: DLJ Category Killers (4/96) and Discount Store News (6/96)

As is evident from the above chart, these companies operate in a wide variety of store sizes. As a group these stores report sales productivity which is vastly superior to more traditional mall and community based retailers when compared to national averages.

Table 2: MEDIAN STORE SIZE AND SALES PER S/F

	MEDIAN STORE SIZE	MEDIAN SALES PER SF
Top Category Killers (above Sample)	55,884	$ 432
Community Shopping Centers (National)	160,000	$ 212
Discount Department Stores (National)	56,000	$ 155
Discount Department Stores (Top 20 Metro)	60,000	$ 187

Source: DLJ: Category Killers Rest: ULI/Dollars and Cents of Shopping Centers 1995

By all measures, the sample of category killers' average sales productivity is at least twice that of the median shopping center tenants.

The chart below shows evidence of the overall consolidation and increasing concentration (as evidenced by market share) of retailers in each industry segment on a national level.

Table 3: NATIONAL MARKET SHARE OF TOP RETAILERS

SEGMENT	1995 SALES ($BILLIONS)	1995 SALES GROWTH	MARKET SHARE TOP 3 COS.	TOP COMPANY	2ND COMPANY	3RD COMPANY
HOME IMPROVEMENT	$ 131.7	6.4%	18.8%	HOME DEPOT	LOWE'S	HECHINGER
OFFICE SUPPLY	$ 80.0	5.0%	9.9%	OFFICE DEPOT	OFFICE MAX	STAPLES
CONSUMER ELECTR.	$ 60.0	4.5%	16.6%	CIRCUIT CITY	BEST BUY	THE WHIZ
COMPUTER	$ 74.0	15.0%	10.8%	COMP USA	BEST BUY	TANDY
FURNITURE	$ 32.0	0.0%	N/A		HELIG-MYERS	ETHAN ALLEN
SPORTING GOODS	$ 32.0	4.0%	6.5%	SPORTS AUTH.	SPORTS & REC.	SPORTMART
TOYS	$ 19.0	0.0%	21.0%	TOYS 'R' US		
BOOKS	$ 18.9	7.0%	21.2%	BARNES & NOBLE	BORDERS	CROWN
MUSIC	$ 12.0	4.0%	N/A		TOWER	TRANSWORLD
DISCOUNT STORES	$ 120.0	0.0%	80.0%	WALMART	KMART	TARGET
	$ 579.6					

Source: DLJ: Category Killers (4/96)

On a national level, in many retail segments, one or two clear winners have emerged with the third company in retreat and closing stores.

For example, in Home Improvement, Home Depot and Lowe's are the dominant companies. Hechinger's Home Quarters stores are generally unable to profitably compete in markets in which Home Depot or Lowe's has a strong presence (including Massachusetts) and, as a result, are closing stores and retrenching.[11]

Consumer Electronics is another segment where one or two winners will emerge. Circuit City is the dominant national company. Best Buy, the second largest firm has experienced a significant decline in gross profit margin. The Whiz, is a relatively dominant regional player in the New York area but does not have a national presence as of yet.

Walmart is the dominant national discount store chain. Target is the third largest discounter but clearly the second strongest. Kmart is the second largest in terms of stores and sales but is clearly losing the battle against Walmart and Target, and was considered by many industry professionals likely to file for bankruptcy until it showed some modest improvement in the first two quarters of this year.

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[11] Forbes: "Goofus and Gallant", December 1995

CHAPTER 3: RETAIL INDUSTRY TRENDS IN EASTERN MASSACHUSETTS

Introduction:

Eastern Massachusetts has experienced a pattern of consolidation and emerging dominant national firms similar to that occurring on a national level. The local effect of the growth in category killers on regional department stores as well as general merchandisers has been widely felt as is evidenced by the chart below.

Table 4: Massachusetts Business Failures

	1988	1989	1990	1991	1992	1993	1994	1995
Department Stores	1	2	6	4	3	0	5	4
Misc. General Merchandise	0	0	3	3	1	4	5	0
Household Appliance	1	1	4	4	6	1	5	5
Radio, TV, Consumer Electronics	2	3	5	5	11	7	2	2
Totals	4	6	18	16	21	12	17	11

Source: Dunn & Bradstreet

In this chapter, a summary of the regional home improvement, consumer electronic and discount department store segments will be described. Then a more detailed look at the financial performance, market presence, and competitive outlook of the regional discounters and Kmart is presented.

Home Improvement:

The Massachusetts area was dominated by Grossman's, and to a lesser extent, Somerville Lumber until the mid '80s when national firms, predominantly Home Depot entered the market. Home Depot has rapidly become the dominant player with 13 stores and together with the presence of Home Quarters (5 stores) resulted in the bankruptcy and liquidation of nearly all of Grossman's operations. Somerville Lumber was acquired by Payless Cashways and has closed all but 7 stores. Home Depot then focused its competitive attention on Home Quarters, locating several stores virtually next to existing Home Quarters (In Danvers, Framingham, and Shrewsbury). Home Quarters has since stopped expansion in the area and is rumored to be exiting the market.

Consumer Electronics:

In this segment, Lechmere, a subsidiary of Montgomery Ward, was traditionally the strongest local player with approximately 11 locations in eastern Massachusetts. Over the past 8 years, Circuit City has established an equally strong presence and currently has 13 locations. The result has been the closing of two weaker companies, Highland Superstores, and Fretter Superstores, which had as many as 12 location at its peak in the late 80's.

Discount Department Stores:

The department store segment of the retail industry in the eastern Massachusetts region has been historically dominated by regional chains. The largest discount retailers are Bradlees (Braintree, MA), Ames (Rocky Hill, CT) and Zayre, which merged in the late '80s, and Caldor (Norwolk, CT). Rich's Department Stores (Salem, MA) is a small regional chain. Stuart's Department Stores was an even smaller regional chain which went out of business in 1995. Kmart is the only national chain in the region (other than the failed WT Grant) until the arrival of Walmart in 1990. Kmart's presence in the region peaked in the early 80's after which it closed several stores. The regional firms have engaged in a spirited competition over the years without any one particular firm dominating the market.

This relative equilibrium all changed in the early '90s with the entrance of Walmart into the region. Since 1990 Walmart has opened, 22 stores in Massachusetts, 14 stores in eastern Massachusetts. While state level sales figures are not available, some real estate practitioners believe that these stores have not achieved sales productivity comparable to the company's national averages [12] They nonetheless have rapidly grown market share. Based on a sales projection model which will be discussed below, Walmart may already have become the region's second largest discounter behind Bradlees. The entry of Walmart into this already intensely competitive region in the past five years has already contributed to the bankruptcy and liquidation of one of the regions smaller chains, Stuart's

[12] John McWeeney, Vice President of Development, Tedeschi Realty

Department Stores and the bankruptcy of the larger regionals (Caldor, Bradlees, Rich's).

The consolidation in discount stores is also evident from the following chart:

Table 5: Number of Stores/Discount Retailers in Massachusetts

E=Est.	WMT	A/Z	BR	CAL	KMT	RICH'S	A & H	TOTAL MAJORS	ALL OTHERS	TOTALS
1989	-	51	35	25E	28E	11E	5E	155	115	270
1993	10	32	37	28	26	11	5	149	88	237
1994	14	31	37	28	25	11	5	151	82	233
1995	18	32	38	27	25	11	4	155	80	236
1996(PRO)	22	33	36	25	26	11	4	156	61	217

SOURCE: Annual Reports/Chain Store Directory

As is evident from the above data, as of 1995 there has been a 13% decline in the number of discount stores in the state since 1988. With the closing of 13 Stuart's stores, two Bradlees stores and two Caldor stores in 1996 and an estimate of seven additional smaller stores, the total decline in stores since 1988 could be 20% or more.

Ames, Bradlees, Caldor, Kmart and Rich's were classified, for purposes of this thesis as "distressed retailers" because each of these firms has each of these firms are either operating in or recently discharged (Ames) from bankruptcy with the exception of Kmart. Kmart and Ann and Hope do not fit these categories but are included for reasons outlined below.

Ames, Rocky Hill, CT:

Ames is a regional discount general merchandise chain of 302 stores operating in 14 northeast states. The company experienced financial difficulties in the early '90s after their highly leveraged 1988 acquisition of Zayre. The Ames/Zayre combined company totaled over 700 stores (75 of which were closed upon completion of the merger)[13]. After filing bankruptcy in 1992, the company began closing additional underperforming stores and eventually reduced its total store count by over one-half to 302 today. The company emerged from bankruptcy in 1993 and has shown some improvement in performance over the past two years. However, the company continues to close underperforming stores including 17 in 1996 (none in Massachusetts).

Ames recently completed the acquisition of eleven Jamesway stores in New Jersey and are reportedly in discussions with Rich's Department Stores about acquiring several of their stores. The store formats in Massachusetts range from 44,000 square feet to 93,000 square feet and average approximately 65,000 square feet.

Ames reported a loss of $1.6 million for the fiscal year ending 1/27/96 on revenues of $2.13 billion. Sales declined by 1.0% from the previous year during which a net income of $17 million was earned. The majority of the decline in net income was attributable to a $20.9 million restructuring charge associated with the 17 store closings. Gross Margin

[13] Ames, Investor Relations Department

and SG&A remained almost constant. At 1/27/96, the company reported assets of $506 million, liabilities of $423 million and a net worth of $83 million.

Although Ames has experienced some stabilization of performance over the past three years, the company competes directly with Walmart particularly with respect to its predominantly rural locations. This does not bode well for their long term survival.

Bradlees, Braintree, MA:

Bradlees is a regional discount general merchandise chain of 134 stores operating in eight northeast states. It is the largest discount retailer in eastern Massachusetts in terms of stores (37) and current sales level (based on an estimate of its Massachusetts sales). Bradlees has had a major presence in the region since the early 60's.

Since the arrival of Walmart in the region, Bradlees has struggled to upgrade its stores and has experienced a large deterioration in margins. In pursuing a self-described recent strategy of "walking away from Walmart" Bradlees has increased its percentage of apparel in its merchandising mix. While this strategy has the benefit of increasing the focus on a higher margin product, it has predictably resulted in lackluster sales. The company filed for bankruptcy protection in June of 1995.

The store formats in eastern Massachusetts range from 48,000-107,200 square feet with an average of 89,630 square feet. Bradlees reported a loss of $207.4 million for the fiscal year ending 2/3/96 on revenues of $1.78 billion. Total sales declined by 7.0% from the previous year during which a net income of $5.3 million was earned. Comparable store sales fell an alarming 14.0%. The majority of the loss was attributable to a 320 basis point decline in gross margin, a $55 million increase in selling, general and administrative expense and a $65 million restructuring charge associated with the 12 store closings.

At 2/3/96, the company reported assets of $799 million, liabilities of $844 million and a net worth of negative $45 million. The company list $540 million in liabilities as "subject to settlement under the reorganization case". For the first quarter ending 5/3/96, the company reported a $53.7 million loss. Bradlees has completed the closing of 12 stores in 1996 (2 in eastern Massachusetts) and the opening of 3 new stores (one in eastern Massachusetts: Danvers).

Bradlees is undoubtedly the weakest of the regional discounters. The company's sales and margin trends are sharply negative and most analysts expect they will be forced to merge or liquidate in no more than two or three years.[14] While little actual data is available, some local real estate practitioners believe that several of Bradlees leases, particularly on older stores, have significantly below market rental rates. To the extent that this is accurate, these leases are potentially attractive acquisitions for other end users.[15] This could ultimately result in a greater demand for the current locations if the company were to liquidate (see Chapter on reuse).

[14] Douglas Tigert, Babson College
[15] John McWeeney, VP Development, Tedeschi Realty

Caldor, Norwalk, CT:

Caldor is a regional discount general merchandise chain of 170 stores operating in ten northeast and Mid-Atlantic states. Caldor was spun off by The May Department Stores in 1989. The company's stores are located primarily in urban and suburban areas with high population densities. The company was considered one of the stronger regional chains until it filed for bankruptcy in October of 1995.

In eastern Massachusetts, Caldor operates 24 stores ranging from 46,000 to 126,700 square feet with an average of 85,633 square feet. The company reported a loss of $301 million for the fiscal year ending 2/3/96 on revenues of $2.77 billion. Total sales increased by 0.6% from the previous year during which a net income of $44.4 million was earned. However, comparable store sales fell 5.2%. The majority of the loss was attributable to a 580 basis point decline in gross margin, a $93 million increase in selling, general and administrative expense and a $171 million restructuring charge associated with the 12 store closings, lease rejections and write down of assets.

As of 2/3/96, the company reported assets of $1,174 million, liabilities of $1,137 million and a net worth of $37 million. The company list $531 million in liabilities as "subject to settlement under the reorganization case". Caldor has completed the closing of 12 stores in 1996 (2 in eastern Massachusetts) and the opening of 6 new stores (none in

Massachusetts). The company reports having rejected or terminated by agreement a total of 26 leases to date.

All of the typical disadvantages which face the other regionals (i.e. lack of capital, less efficient systems and technology) apply also to Caldor. However, some believe that Caldor is the likeliest of the regionals to be acquired by Target or Walmart due to its large store formats and the reasonably high productivity of its newer stores.[16]

Kmart, Troy, MI:

Kmart is the nation's second largest discount general merchandise chain with approximately 2,161 stores, including 87 Super Kmart Centers, operating in all fifty states.

Kmart has had a significant presence in the region since the 70's. Today the company has 26 stores in this state, 18 of which are located in eastern Massachusetts. 1995 was an extremely difficult year for the company nationally as the margins of its discount operations came under enormous pressure from the two strongest discounters, Walmart and Target. In addition, Builder's Square, its home improvement subsidiary, reported an operating loss of $387 million.[17] Rumors of an impending bankruptcy filing have dissipated in the first two quarters of this year as the company completed a major refinancing of its debt and has seen some improvement in results. Nonetheless, the

[16] John McWeeney, VP Development, Tedeschi Realty
[17] 1995 Annual Report

problems facing the retailing giant have not changed (i.e. low store productivity, severe competition, margin pressure).

The store formats in eastern Massachusetts range from 48,500 to 114,000 square feet with an average of 87,778 square feet. The company reported a loss of $571 million for the fiscal year ending 2/3/96 on revenues of $34.4 billion. Total sales increased by 5.8% from the previous year driven by a 4.3% increase in comparable store sales.

The majority of the loss was attributable to a 200 basis point decline in gross margin, a $178 million increase in selling, general and administrative expense and a $171 million restructuring charge associated with the store closings and the write down of assets. As of 2/3/96, the company reported assets of $15.4 billion, liabilities of $10.1 billion and a net worth of $5.3 billion.

Despite the recent improvement in the near term outlook for Kmart, the company's long term ability to survive and compete effectively with Walmart and Target remains uncertain.

Rich's Department Stores, Salem, MA:

Rich's is a privately owned regional discount general merchandise chain of 26 stores operating in Massachusetts, Vermont, New Hampshire and Maine. The company filed for bankruptcy protection in March of 1996. In its bankruptcy filing it reported assets of $63.4million and liabilities of $51.3 million. Little other financial information is available due to the privately owned nature of the company. Based on bankruptcy court documents the company is in the process of closing one store in Nashua, NH.[18]

Based on its size and rural locations, it is unlikely that Rich's could survive in the long run. Its rural store base is in direct competition with Walmart and like other regional chains lacks the technology and capital to compete effectively. It is rumored that the company is in discussions with Ames about selling some stores.

Ann & Hope, Cumberland, RI:

Ann & Hope is also a privately owned regional discount general merchandise chain. The inclusion of this company in the group of "distressed" retailers which are the subject of this thesis is not warranted in terms of actual financial data. It is included because, in theory, it should be subject to the same industry pressures being experienced by the other discount retailers. It operates 6 stores, 4 in Massachusetts and 2 in Rhode Island. The writer has no knowledge of the company's finances other than a reported 1995 sales figure of $295 million, which translates into an estimated sales per square foot of well over $200.

The company's Massachusetts locations are very large in relation to the other discounters, averaging approximately 160,000 square feet. Based on its large store sizes and mall locations (Liberty Tree, Arsenal, Seekonk) the company would appear to make an attractive acquisition for Target.

The charts below summarizes some of the pertinent financial performance figures of seven of the major discount department stores operating in the region in 1995 (Stuart's has since liquidated). It is evident that the sales productivity and operating margins of these retailers are significantly lacking in relation to the category killers ($434 SPSF average), Walmart, Target and the national median for discount department store chains ($160 SPSF median).

Table 6: Financial Summary

	1995 SALES	COMP STORES	TOTAL	SALES PER/SF	5 YEAR GROWTH	GROSS MARGIN	OPER. INCOME
WALMART	$ 54,330	5.0%	14.4%	$ 297	20.9%	20.3%	$ 5,194
TARGET	$ 15,800	5.6%	16.2%	$ 230	14.1%	25.5%	$ 960
KMART	$ 26,779	5.6%	7.2%	$ 144	5.0%	21.4%	$ (181)
OTHER DISC (6)	$ 23,899		-0.3%		4.3%		
TOTAL	$ 120,808	4.4%					
BRADLEES	$ 1,840	-14.0%	-7.1%	$ 146	0.1%	27.6%	(122)
CALDOR	$ 2,766	-8.0%	0.6%	$ 163	11.3%	22.3%	$ (28)
AMES	$ 2,121	-1.0%	-1.0%	$ 113	-27.6%	26.6%	$ 28
RICH's	$ 90	N/A	N/A	$ 130	N/A	N/A	N/A
STUART'S	$ 70	N/A	N/A	$ 102	N/A	N/A	N/A

Source: Goldman Sachs, Discount Store News

[18] Bankruptcy Court Documents

In terms of measuring market share and competitive strength one of the key indicators is the increase in comparable store sales. Store openings can create overall sales growth when comparable stores growth is flat or declining. The following graph shows the severe decline of comparable store sales at Bradlees and Caldors. Kmart, on the other hand, achieved comparable sales growth at the expense of profit margins which had a disastrous effect on their bottom line.

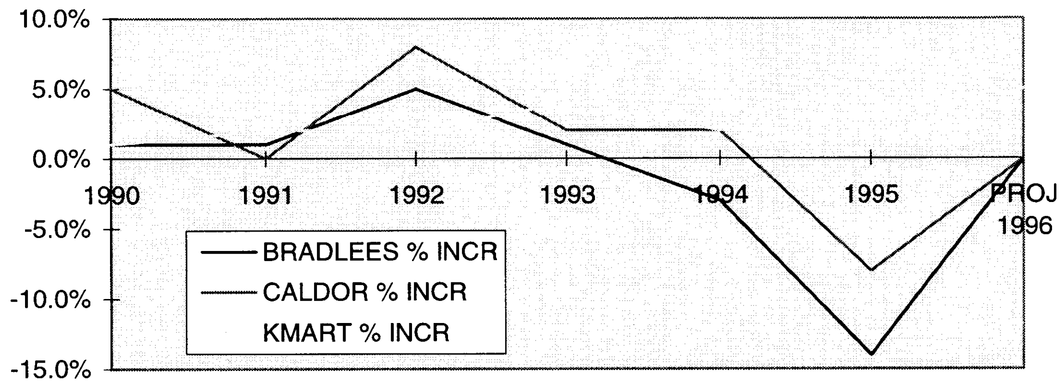

Figure 1: COMPARABLE STORE SALES INCREASES
Source: Goldman Sachs: U. S. Research

Finally, the bar graph below depicts the decline in sales productivity of Bradlees and Caldor.

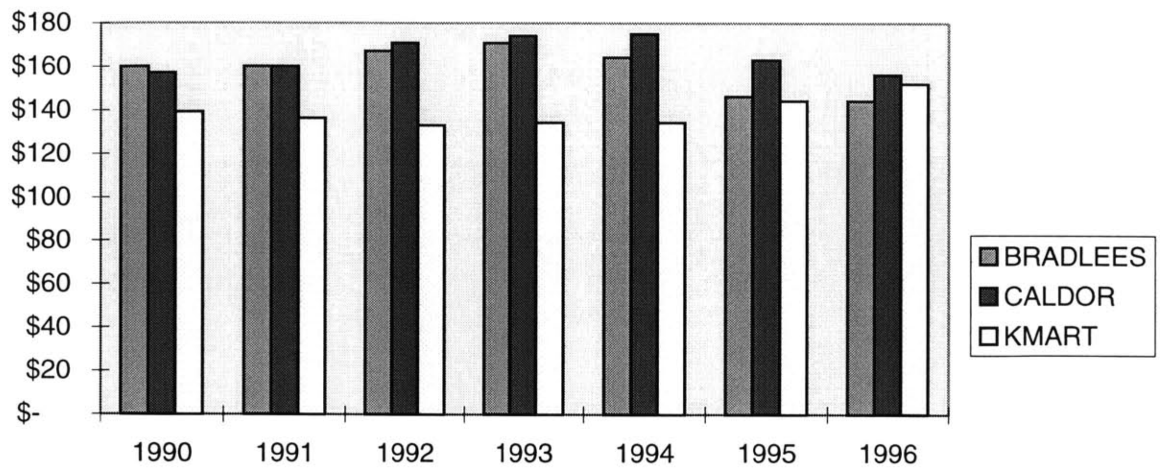

Figure 2: SALES PER AVERAGE SQUARE FEET OF GLA
Source: Goldman Sachs: US Research

Summary:

Six discount department store chains which have a significant presence in eastern Massachusetts are experiencing a sharp decline in comparable store sales and profit margins and remain highly vulnerable to the growing presence of Walmart. The filing of bankruptcy often "buys time" for retailers by allowing companies to avoid lease obligations, compromise a substantial amount of trade and other unsecured debt and emerge smaller and more competitive. Nonetheless, these firms continue to have long term competitive disadvantages in terms of technology, inventory control, leverage with suppliers and access to capital.

CHAPTER 4: POTENTIAL IMPACT ON THE EASTERN MASSACHUSETTS RETAIL PROPERTY MARKETS

For the purposes of this thesis, "Eastern Massachusetts" will be defined as all areas of the state east of and including the City of Worcester with the exception of Cape Cod, Martha's Vineyard and Nantucket.

Overview of Eastern Massachusetts Retail Market:

In the opinion of several local real estate investors, the eastern Massachusetts retail property market is very strong overall with a low vacancy rate in relation to most other major metropolitan markets. The 1996 Finard & Company survey, which included over 116,000,000 square feet of retail space reported a vacancy rate of 7.1%. The Finard survey encompassed virtually every square foot of retail space in 174 cities and towns in eastern Massachusetts with the exception of the urban core of Boston, and the Cape and Islands.

There are several fundamental reasons for the current health of this market. On the demand side, the region enjoys high average per capita income in relation to national averages.[19] Most importantly, however, are the structural barriers to new supply. These include, high land costs (in relation to national averages), lack of available sites and perhaps most importantly, the high cost and lengthy permitting processes associated with development in the region.[20] It was agreed by virtually all sources interviewed that this last factor has resulted in the region traditionally being "understored" in relation to national averages.[21]

However, despite the current strength of the region's retail property markets, eastern Massachusetts is and will continue to feel the effects of the ongoing national consolidation of retail companies. Among the firms with a significant presence in eastern Massachusetts that are most effected by the intense pressure on profit margins are the regional discount department store chains and Kmart.

Table 7: 1996 STORES AFTER COMPLETION OF SCHEDULED CLOSINGS

	AMES	BRADLEES	CALDORS	KMART	RICH'S	A & H	TOTALS
Total Stores	302	124	170	2,316	26	6	2,944
							-
Stores in MA.	33	37	24	26	11	4	135
Stores in E. MASS	22	27	20	18	9	4	100
Average Store Size	64,702	89,630	85,633	87,778	63,226	158,000	83,371
Store S/F in MASS	2,070,452	3,226,667	2,140,818	2,282,231	695,487	632,000	11,047,654
Store S/F in E. MASS	1,423,436	2,420,000	1,712,654	1,580,006	569,035	632,000	8,337,131

Sources: Finard & Company, NRB, Chain Store Directory

[19] Craig Schmidt, Merrill Lynch
[20] McWeeney, Tigert, Schmidt
[21] McWeeney, Tigert, Schmidt

As the above chart depicts, these six discount retailers occupy approximately 11 million square feet of selling space of which approximately 8.3 million is located in eastern Massachusetts. Based on the Finard market estimate of 116 million square feet in eastern Massachusetts and estimating an additional 10 million square feet of space within the urban core of Boston and the City of Worcester (which were not surveyed by the Finard survey), this space represents approximately 6.5% of the total retail space in this region.

Potential Store Closings and Vacancy:

The probability that a retailer in bankruptcy will reject its lease on a store is a function of the profitability of that store to the firm. Lease obligations on unprofitable locations with weak sales will be the first that a bankrupt retailer will seek to avoid. In bankruptcy, a landlord receives a claim for only the lesser of one year of rent or one-third of the remaining lease payments on a lease that has been rejected with the approval of the court.[22]

The two major variables therefore are sales volume and the economics of the lease. The value of the location in terms of the efficiency of the distribution system is an important variable, however it is beyond the scope of this thesis.

A long-term, below market lease contract is an asset to a retailer and may offset lower than expected sales volume. It is also a transferable asset which can generally be sold to a

[22] Annual Reports

third party.[23] On the other hand, as a retailer's rent is typically less than 10% of sales (and in many cases less than 5%) its value may not be enough to offset weak sales.[24]

1995 Massachusetts Major Discount Retailer Sales:

Store level sales figures for the subject retailers are unavailable to the general public as they are considered proprietary information by both landlords and retailers. Similarly, publicly-held retailers will not provide sales broken by state or geographic region.

As a result of the inability to directly analyze sales productivity at the store level, this thesis uses an indirect approach to project the amount of retail space currently occupied by troubled retailers that is currently "excess" selling space and therefore likely to become vacant over the next six years. The steps used in this approach were as follows:

1) Estimate the current total Massachusetts sales of all major discount retailers;

2) Estimate the growth in Walmart sales/ market share;

3) Estimate the net sales remaining for the other major discounters;

4) Estimate the sales productivity of the other discount retailers needed to achieve an "economic profit" or net operating margin of 4.50%; and

5) Project the reduction in the amount of selling space required to achieve a healthy balance between total sales and selling space.

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[23] Annual Reports
[24] Bill Beckeman, Managing Director, Finard & Company

Estimation of the Massachusetts sales totals of the various retailers is accomplished by using company average sales productivity per square foot and multiplying this by the selling space they occupy in the state. This methodology is likely to bear the best results with the regional discounters which operate exclusively in the northeast (as any anomalies attributable to the northeast are fully captured). This method is likely to be less accurate with the national retailers, such as Kmart, which is generally considered to have higher productivity stores in the northeast, and Walmart which believed to be experiencing less than average productivity to date in the northeast.[25] Therefore, the national averages of these retailers have been adjusted to reflect these peculiarities. The chart below summarizes the data and assumptions used in this model.

Table 8: ESTIMATED MASSACHUSETTS SALES

($ million)	1995 Sales	# Stor (1/95)	Avg. GLA	TOT GLA	SALES/SF	AVG VOL/ STORE
WALMART (excl. Sams)	$ 456	20	110	2,200	$ 207	$ 22,770
KMART	$ 402	25	88	2,363	$ 170	$ 15,450
CALDOR	$ 363	26	86	2,226	$ 163	$ 13,960
AMES	$ 235	32	65	2,070	$ 113	$ 7,338
BRADLEES	$ 513	39	90	3,516	$ 146	$ 13,162
ANN & HOPE	$ 181	4	158	632	$ 287	$ 45,346
RICH'S	$ 90	11	63	695	$ 130	$ 8,219
STUART'S	$ 70	13	53	689	$ 102	$ 5,406
TOTAL SALES	$2,310	170	85	14,392	$ 161	$ 13,591

Source: DLJ, Finard, Discount Store News, Chain Store Directory

The model estimates the total 1995 sales captured by the eight largest discount department store retailers in business in Massachusetts at approximately $2.3 billion.

[25] Craig Schmidt, Merrill Lynch

Estimate of Walmart Sales:

The estimate used for Walmart's sales levels ($207 per square foot) is based on the national average sales productivity of all its discount stores, weighted for the actual store ages of its Massachusetts stores (see Table 9). For example, first year stores do an average of $150 per square foot nationally. There were five stores less than one year old in Massachusetts in 1995.

The weighted average for the 20 stores ($259 per square foot) was then adjusted downward by 20% for the observed below average productivity the stores have experienced in the northeast and adjusted upward by 5.0% until it reached the national average by the year 2000.[26] Using this approach, an estimate for 1995 sales of $456 million was reached.

[26] McWeeney, Schmidt

Table 9: Estimated Walmart 1995 Store Productivity in Massachusetts.

STORE AGE	SALES/SF	# STORES	1995 SALES ('000s)
Year 1	$ 150	4	$ 66,000
Year 2	$ 240	4	$ 105,600
Year 3	$ 264	3	$ 87,120
Year 4	$ 298	3	$ 98,340
Year 5	$ 336	3	$ 110,880
Year 6	$ 309	3	$ 101,970
Year 7	$ 318	-	$ -
Year 8 or older	$ 323	-	$ -
TOTAL SALES		20	$ 569,910
AVG STORE SALES			28,496
AVG SALES/SF			$ 259
LESS REGIONAL ADJ.			80%
ADJ TOTAL SALES			$ 455,928
ADJ AVG STORE SALES			$ 22,796
ADJUSTED SALES/SF			$ 207

SOURCE: DLJ: Category Killers (4/96)

The estimate used for Kmart sales was simply its national average of $144 per square foot adjusted upward by 20% to reflect what is generally perceived as a regional anomaly for their stores.[27]

The next step was to project the growth in Walmart's sales over the next six years. Assumptions also needed to be made about the growth in sales productivity (per square foot) and the number of new stores opened annually. Walmart has slowed its expansion into New England over the past year.[28] This is generally believed to be due to a combination of unexpectedly low sales productivity and high real estate costs.[29] As a result, the assumption is made that Walmart will continue its slowdown in growth in the

[27] Craig Schmidt, Merrill Lynch
[28] Tigert, McWeeney

region, adding one store per year. It is assumed that Walmart' comparable store sales increases also lags its national average of 5.0%. A growth rate of only 1.0% annually is utilized in the first scenario. The resulting model output is summarized below.

Table 10: PROJECTED WALMART STORES, SALES, AND SALES/SF

($ millions)	1996	1997	1998	1999	2000	2001	2002
STORES	21	22	23	24	25	26	27
ADJ TOTAL SALES	$ 562	$ 656	$ 755	$ 846	$ 887	$ 38	$ 988
AVG STORE SALES	$ 26.8	$ 29.8	$ 32.8	$ 35.3	$ 35.5	$ 36.1	$ 36.6
AVG SALES/SF	$ 243	$ 271	$ 298	$ 321	$ 323	$ 328	$ 333

Source: Model

The projected increase in Walmart sales is a function of the increase in the number of stores, the increased productivity of the stores as they age, and the assumption that the stores reach national productivity levels by 2000. The next step is to estimate the growth in sales for all of the subject discount department stores for Massachusetts and subtract out the projected Walmart sales to arrive at total sales for the all the other major discount department stores. This sales figure is then divided by the total GLA to arrive at an average sales per square foot figure.

[29] McWeeney

TABLE 11: ALL OTHER MAJOR DISCOUNTER SALES, REQUIRED REDUCTION IN GLA, REQUIRED STORECLOSINGS

SCENARIO 1: WALMART ADDS 1 STORE PER YEAR/1% COMP STORE INCREASES/REGIONAL ADJUSTMENT 80%-100%

TOTAL DISC. DEPT. STORES	1995	1996	1997	1998	1999	2000	2001	2002
PROJECTED GROWTH IN SALES/SF		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
TOTAL DISC. DEPT STORE SALES	$ 2,309,907	$ 2,379,204	$ 2,450,581	$ 2,524,098	$ 2,599,821	$ 2,677,815	$ 2,758,150	$ 2,840,894
WALMART	$ 455,928	$ 561,794	$ 656,030	$ 754,634	$ 846,250	$ 886,968	$ 938,458	$ 987,705
ALL OTHER DISC. DEPT. STORES	$ 1,853,979	$ 1,817,411	$ 1,794,550	$ 1,769,464	$ 1,753,570	$ 1,790,847	$ 1,819,692	$ 1,853,190
AVG STORE GLA	81.3	83.1	83.4	83.4	83.4	83.4	83.4	83.4
TOTAL STORE GLA	12,192	11,216	11,342	11,342	11,342	11,342	11,342	11,342
AVG SALES/SF (ALL OTHER DISCT)	$ 152	$ 162	$ 158	$ 156	$ 155	$ 158	$ 160	$ 163
PV SALES/SF (ALL OTHER DISCT)	$ -	$ 162	$ 154	$ 147	$ 141	$ 140	$ 138	$ 137
TOTAL STORE GLA	12,192	11,216	11,342	11,342	11,342	11,342	11,342	11,342
AVG SALES/SF (ALL OTHER DISCT)	$ 152	$ 162	$ 158	$ 156	$ 155	$ 158	$ 160	$ 163
PV SALES/SF (ALL OTHER DISCT)	$ -	$ 162	$ 154	$ 147	$ 141	$ 140	$ 138	$ 137
SALES TO ACHIEVE 4.5% OPER. MARGIN		$ 193	$ 197	$ 201	$ 205	$ 209	$ 213	$ 217
TOTAL SALES		$ 1,817,411	$ 1,794,550	$ 1,769,464	$ 1,753,570	$ 1,790,847	$ 1,819,692	$ 1,853,190
MAX GLA TO MEET BREAKEVEN		9,417	9,116	8,812	8,562	8,572	8,540	8,526
REQUIRED REDUCTION IN GLA		1,800	2,227	2,530	2,781	2,770	2,803	2,816
REQUIRED STORE CLOSINGS		22	27	30	34	33	34	34

Other Major Discount Department Store Sales:

The 1995 average sales per square foot for the eight other discount retailers was estimated at $152. Based on the model, this figure will increase sharply to $162 in 1996 despite the fact that total projected sales for these discounters is projected to fall. This is the result of the net reduction in selling space of approximately 850,000 square feet which represents the elimination of the 13 Stuart's stores (689,000 square feet), the closing of the two Bradlees stores in Shrewsbury and Westboro (123,400 square feet), and the closing of the two Caldors stores in Brockton and Canton (174,515 square feet). Additions to selling space consisted of a new Kmart in Plymouth (113,000 square feet) and a new Ames in Lowell (51,650 square feet). The only other announced store opening of note is the scheduled completion of the Kmart Superstore in Braintree in late 1996 (considered 1997).

The overall reduction in supply is projected to result in a $10 per square foot gain in sales. This projected growth in sales is consistent with the rebound in sales growth of most discount retailers experienced in the first two quarters of 1996.[30] Assuming margins have stabilized, this should result in a short term movement toward break-even sales levels.

However, based on this model, the projected sales growth will be short lived as the as the increasing productivity of the maturing Walmart stores absorbs virtually all of the growth

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[30] Wall Street Journal, June 1996

in sales in this segment. The model assumes that store closings equal store openings from 1998 through 2002 for the purposes of measuring the effect of Walmart's increased presence without a commensurate reduction in selling space by the distressed discounters. As is evident from the output, sales levels immediately fall again in 1998 and continue downward. Furthermore, adjusting these sales figures for inflation to arrive at real sales per square foot shows an even sharper downward trend.

Required Reduction in Selling Space:

The implications of this analysis is that the approximately 1million square foot reduction in selling space which has occurred in '96 is not nearly enough of a reduction in selling space given the reduced sales levels which the regional discounters are facing as well as their need to further reduce selling space to achieve an economic return. The increasing franchise presence and market share of Walmart will ultimately require that a much greater reduction in selling space occur.

The first step in modeling this required reduction in space is to estimate the level of sales required for the regional discounters to earn a normal or "economic" profit. This economic profit is assumed to be an operating margin of 4.5% which is considered healthy for the industry.[31]

[31] Walter Salmon, Harvard Business School

TABLE 12: REQUIRED SALES INCR @ CURR MARGINS w/FLAT SG&A

	1995 KMART			1995 BRADLEES			1995 CALDOR			1995 AMES		
	$ MILLIONS	PER SQ FT	PERCENT	$ MILLIONS	PER SQ FT	PERCENT	$ MILLIONS	PER SQ FT	PERCENT	$ MILLIONS	PER SQ FT	PERCENT
DISCOUNT STORE SALES	$ 34,389	$ 198	100.00%	$ 1,781	$ 146	100.00%	$ 2,766	$ 160	100.00%	$ 2,121	$ 113	100.00%
COST OF GOODS SOLD	$ 26,966	$ 155	78.41%	$ 1,289	$ 106	72.39%	$ 2,148	$ 124	77.65%	$ 1,557	$ 83	73.43%
GROSS PROFIT	$ 7,423	$ 43	21.59%	$ 492	$ 40	27.61%	$ 618	$ 36	22.35%	$ 564	$ 30	26.57%
LEASED DEPT/OTH OPER. INC.				$ 14	$ 1	0.79%	$ -	$ -		$ (30)	$ (2)	-1.40%
				$ 506	$ 41	28.40%	$ 618	$ 36	22.35%	$ 593	$ 32	27.97%
S G & A	$ 7,554	$ 43	21.97%	$ 575	$ 47	32.30%	$ 698	$ 40	25.23%	$ 553	$ 30	26.06%
DEPRECIATION/AMORTIZATION				$ 53	$ 4	2.97%	$ 61	$ 4	2.21%	$ 12	$ 1	0.58%
OPERATING PROFIT	$ (131)	$ (0.75)	-0.38%	$ (122)	$ (10.02)	-6.87%	$ (141)	$ (8)	-5.09%	$ 28	$ 2	1.32%
INTEREST AND DEBT EXPENSE (NET)	$ 220		0.64%	$ 25	$ 2	1.42%	$ 41	$ 2	1.48%	$ 24	$ 1	1.14%
IMPAIRMENT OF LONG-LIVED ASSETS				$ 99	$ 8	5.58%	$ 8	$ 0	0.30%	$ (6)	$ (0)	-0.29%
RESTRUCTURING CHARGES				$ 65	$ 5	3.65%	$ 171	$ 10	6.17%	$ 12	$ 1	0.56%
INCOME TAX EXPENSE (BENEFIT)				$ (105)	$ (9)	-5.87%	$ (60)	$ (3)	-2.16%	$ -	$ -	
NET INCOME	$ (351.0)		-1.02%	$ (207.4)	$ (17)	-11.65%	$ (301.0)	$ (17)	-10.89%	$ (1.6)	$ (0)	-0.08%
TARGET OPERATING PROFIT	$ 1,548	$ 9	4.50%	$ 80	$ 7	4.50%	$ 124	$ 7	4.50%	$ 95	$ 5	4.50%
REQUIRED IMPROVEMENT	$ 1,679	$ 10	4.88%	$ 202	$ 17	11.37%	$ 265	$ 15	9.59%	$ 67	$ 4	3.18%

The estimated improvement in sales required to achieve the desired operating margin of 4.5% is calculated by dividing the required improvement in operating profit (in dollars) by the current gross profit margin. This is obviously a simplistic method as it assumes no increase in selling, general and administrative expenses.

Table 13: REQUIRED IMPROVEMENT IN SALES (ASSUMING 1995 SG&A AND MARGINS)

	4.5% OPERATING MARGIN		BREAKEVEN OPERATING MARGIN	
KMART	$ 6,055	$ 35	$ 473	$ 3
BRADLEES	$ 733	$ 60	$ 122	$ 10
CALDOR	$ 1,187	$ 69	$ 141	$ 8
AMES	$ 207	$ 11	$ -	$ -
TOTAL	$ 8,182		$ 736	
AVERAGES	$ 2,046	$ 44	$ 184	$ 5

SOURCE: Model

This model suggests that the discount department stores as a whole need to improve sales per square foot by $44 from the current estimate of $152 to $196 to achieve a 4.5% operating margin. This is consistent with some interviewees general belief that a store performing at over $200 per square foot is a healthy store.[32] Whereas a rough average of $170 per square foot in 1993 was enough to assure the reasonable profitability of the regionals, the significant deterioration in margins experienced in the past two years dictates that sales today need to be sharply higher to achieve the same result.

[32] Craig Schmidt, Merrill Lynch

The final calculation of the model is to project the required reduction in selling space needed to meet the sales per square foot target, given the projected overall level of sales. Again, the assumptions are simplistic in that the model does not attempt to factor in the negative effects of store closings on franchise value.[33] Nonetheless, the model projects that by 2002, a reduction in selling space of approximately 2.8 million square feet of the roughly 11,000,000 square feet utilized today by discount retailers other than Walmart will be required in order to achieve a healthy balance of supply and demand.

Sensitivity Analysis:

In order to test the sensitivity of the excess selling space to various growth assumptions about Walmart, two other growth scenarios were considered. In the second scenario, a 4.00% growth in comparable store sales was assumed as well as increasing the regional adjustment factor to 110% of the national average by 2001. These adjustments increased the projection of excess selling space by approximately 1.0 million to 3.8 million square feet by the year 2002.

In the third scenario, both a 4.00% growth in comparable store sales and the addition of 2 new stores per year were assumed as well as increasing the regional adjustment factor to 110% of the national average by 2001. These adjustments increased the projection of excess selling space by approximately 2.0 million square feet over the second scenario to a total of approximately 5.8 million square feet by the year 2002.

[33] Goldman Sachs, U. S. Research:"Staying Power: How Long Can Retail Franchises Last?", April, 1996

TABLE 14: SENSITIVITY ANALYSIS SUMMARY

Scenario 1:	Reduction in GLA	Store Closings
1996	1,797,000	22
1997	2,224,000	27
1998	2,527,000	30
1999	2,778,000	33
2000	2,767,000	33
2001	2,800,000	34
2002	2,813,000	34

Scenario 2:	Reduction in GLA	Store Closings
1996	1,883,000	23
1997	2,425,000	29
1998	2,811,000	34
1999	3,136,000	38
2000	3,400,000	41
2001	3,725,000	45
2002	3,758,000	45

Scenario 3:	Reduction in GLA	Store Closings
1996	1,959,000	24
1997	2,637,000	32
1998	3,255,000	39
1999	3,889,000	47
2000	4,548,000	55
2001	5,318,000	64
2002	5,807,000	70

TABLE 15: SCENARIO 2: WALMART ADDS 1 STORE PER YEAR/4% COMP STORE INCREASES/REGIONAL ADJUSTMENT 80-110%

TOTAL DISC. DEPT. STORES	1995	1996	1997	1998	1999	2000	2001	2002
PROJECTED GROWTH IN SALES/SF		3.0%	3.0%	3.5%	3.8%	4.0%	4.3%	4.5%
TOTAL DISC. DEPT STORE SALES	$ 2,309,907	$ 2,379,204	$ 2,450,581	$ 2,536,351	$ 2,631,464	$ 2,736,723	$ 2,853,033	$ 2,981,420
WALMART	$ 455,928	$ 578,481	$ 695,581	$ 823,896	$ 951,364	$ 1,078,096	$ 1,230,494	$ 1,333,532
ALL OTHER DISC. DEPT. STORES	$ 1,853,979	$ 1,800,724	$ 1,754,999	$ 1,712,455	$ 1,680,100	$ 1,658,627	$ 1,622,540	$ 1,647,887
AVG STORE GLA	81.3	83.1	83.4	83.4	83.4	83.4	83.4	83.4
TOTAL STORE GLA	12,192	11,216	11,342	11,342	11,342	11,342	11,342	11,342
AVG SALES/SF (ALL OTHER DISCT)	$ 152	$ 161	$ 155	$ 151	$ 148	$ 146	$ 143	$ 145
PV SALES/SF (ALL OTHER DISCT)	$ -	$ 161	$ 150	$ 142	$ 136	$ 130	$ 123	$ 122
SALES TO ACHIEVE 4.5% OPER. MARGIN		$ 193	$ 197	$ 201	$ 205	$ 209	$ 213	$ 217
TOTAL SALES		$ 1,800,724	$ 1,754,999	$ 1,712,455	$ 1,680,100	$ 1,658,627	$ 1,622,540	$ 1,647,887
MAX GLA TO MEET BREAKEVEN		9,330	8,915	8,528	8,203	7,939	7,614	7,582
REQUIRED REDUCTION IN GLA		1,886	2,427	2,814	3,139	3,403	3,728	3,761
REQUIRED STORE CLOSINGS		23	29	34	38	41	45	45

TABLE 16: SCENARIO 3: WALMART ADDS 2 STORE PER YEAR/4% COMP STORE INCREASES/REGIONAL ADJUSTMENT 80-110%

TOTAL DISC. DEPT. STORES	1995	1996	1997	1998	1999	2000	2001	2002
PROJECTED GROWTH IN SALES/SF		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
TOTAL DISC. DEPT STORE SALES	$ 2,309,907	$ 2,379,204	$ 2,450,581	$ 2,524,098	$ 2,599,821	$ 2,677,815	$ 2,758,150	$ 2,840,894
WALMART	$ 455,928	$ 593,067	$ 737,342	$ 900,773	$ 1,073,872	$ 1,259,090	$ 1,475,000	$ 1,638,453
ALL OTHER DISC. DEPT. STORES	$ 1,853,979	$ 1,786,138	$ 1,713,239	$ 1,623,325	$ 1,525,949	$ 1,418,726	$ 1,283,150	$ 1,202,441
AVG STORE GLA	81.3	83.1	83.4	83.4	83.4	83.4	83.4	83.4
TOTAL STORE GLA	12,192	11,216	11,342	11,342	11,342	11,342	11,342	11,342
AVG SALES/SF (ALL OTHER DISCT)	$ 152	$ 159	$ 151	$ 143	$ 135	$ 125	$ 113	$ 106
PV SALES/SF (ALL OTHER DISCT)	$ -	$ 159	$ 147	$ 135	$ 123	$ 111	$ 98	$ 89
SALES TO ACHIEVE 4.5% OPER. MARGIN		$ 193	$ 197	$ 201	$ 205	$ 209	$ 213	$ 217
TOTAL SALES		$ 1,786,138	$ 1,713,239	$ 1,623,325	$ 1,525,949	$ 1,418,726	$ 1,283,150	$ 1,202,441
MAX GLA TO MEET BREAKEVEN		9,255	8,703	8,084	7,450	6,791	6,022	5,532
REQUIRED REDUCTION IN GLA		1,962	2,640	3,258	3,892	4,551	5,321	5,810
REQUIRED STORE CLOSINGS		24	32	39	47	55	64	70

CHAPTER 5: POTENTIAL REUSE OF SPACE

A logical starting point for analyzing the potential reuse of the subject space is to examine the characteristics of the shopping centers which are occupied by the subject retailers. The ultimate reuse of this space may depend to a large extent on the tenant mix and other characteristics of the shopping centers they are located in. For example, the effect on a shopping center of the sole anchor tenant closing is likely to be more severe than losing an anchor in a multi-anchored center.

Center Characteristics:

The data summarized below consists of the characteristics of the shopping centers occupied by the combined 100 distressed discount stores in the defined eastern Massachusetts region. The data was obtained from a combination of the Finard & Company Retail database (approximately 85%), the NRB Shopping Center Directory for locations not covered by Finard & Company (approximately 10%), and estimates based on site visits when information from neither source was available (approximately 5%).

As is evident from the charts below, these retailers occupy the full spectrum of shopping centers from neighborhood centers to super-regional malls. Nonetheless, the highest concentration of the subject retailers (61%) are located in what are loosely defined as community centers which typically have gross leaseable area between 100,000 and 300,000 square feet. The second largest concentration of these retailers are in regional malls (17%).

Table 17: SHOPPING CENTER CONCENTRATIONS

	CENTER SIZE	# OF STORES	PERCENT
SuperRegional	500,000+	9	9.0%
Regional	300-500,000	17	17.0%
Community	100-300,000	61	61.0%
Neighborhood	0-100,000	9	9.0%
Unavailable		4	4.0%
Total		100	100.0%

Source: Finard, NRB

It is evident from the chart below that in 20 of the 100 centers studied (20%), the distressed retailers are the sole anchor tenant. This has important implications for potential store closings as the in line tenants of these shopping centers are generally dependent on the drawing power of the anchor tenant for a significant share of their sales volume.

Table 18: ANCHOR CONCENTRATION

# OTHER ANCHORS	# OF STORES	PERCENT
3+	13	13.0%
2.0	22	22.0%
1.0	44	44.0%
None	20	20.0%
Not Reported	1	1.0%
Total	100	100.0%

Source: Finard, NRB, Site Visits

These 20 single anchor shopping centers represent total space of approximately 2.2 million square feet or less than 2% of the total market. The 77 multi-anchored centers represent over 20 million square or roughly 15% of the total market.

Table 19: SQUARE FEET OF MULTI-ANCHOR AND SINGLE ANCHORED CENTERS

	# centers	Tenant Size	Center Size	% of Center	# of oth anch
MULTI ANCHOR CENTERS	77	6,434,276	20,483,341	31.4%	148
AVERAGES		83,562	266,017		1.92
SINGLE ANCHOR CENTERS	20	1,641,000	2,165,550	75.8%	
AVERAGES		86,368	113,976		
TOTAL	96	8,075,276	22,648,891	36.7%	148
AVERAGES		84,117	235,926		1.48

Source: Finard, NRB, Site Visits

Important to note is the fact that of the 77 multi-anchored centers, 33 are anchored by supermarkets, another 20 by a supermarket and at least one other anchor. This suggests both positive and negative implications.

Table 20: MULTIANCHORED CENTERS

	# OF STORES	PERCENT
SUPERMARKET ONLY	33	33.0%
SUPERMARKET & OTHER	20	20.0%
NONSUPERMARKET ANCHOR(S)	24	24.0%
NO OTHER ANCHOR	19	19.0%
Unavailable	4	4.0%
Total	100	100.0%

Source: Finard, NRB, Site Visits

On the positive side, the potential loss of one of the subject retailer should in theory be less dramatic on a shopping center with multiple anchors than on a single anchored center.

In certain local shopping centers, an anchor retailer has been lost and the center appears to remain healthy. For example, several centers which have closed Stuart's stores appear to have remained viable centers even without re-leasing the empty space. For example, a 184,000 square foot shopping center at 700 Boston Road in Billerica has a vacant Stuart's store at one end but appears to have remained a productive center with a J.C. Penney's and Bob's providing the draw for the rest of the center. Similarly, a 132,000 square foot shopping center at 199-215 Plain Street in Lowell has a vacant Stuart's at the far end but appears relatively unaffected with a Stop& Shop, restaurant, health club and CVS providing the critical mass of activity. This suggests that center's with a certain "critical mass" of activity, can survive the loss of a discount anchor. In the above examples, two other anchors provided the critical mass.

Supermarkets are also increasing the size of their prototype stores and in some cases have shown a desire to take a portion of the discounters space if it is contiguous to their own.[34] Net Properties has done this with a property in Westfield, moving a Finast supermarket from its 27,000 square foot box to a 53,000 former Ames site.[35]

On the other hand, the abundance of supermarket anchors already in occupancy of the subject shopping centers eliminates a major potential source of replacement tenants (supermarkets) for over half of the subject shopping centers.

[34]Cindy Taylor, Federal Realty Trust
[35] "Changing Anchors, Changing Centers", Shopping Center Age December 1995

In the 100 center sample, there are also examples of how the loss of a discounter in a multi-anchored center was a fatal blow to the center. For example, the loss of an Ames at the Indian Head Center in Marlborough, the loss of Stuarts at the Taunton Mall and the loss of an Ames at the Quintree Mall in Braintree. In all three cases, the loss of the discounter led to the eventual closing of a second anchor and the crippling of the respective centers. One can surmise that these centers were likely weaker at the outset than the centers mentioned above and, as a result, couldn't withstand the loss of one anchor.

A final observation of the space occupied by the subject retailers are the concentrations in various towns, cities and malls.

Table 21: GEOGRAPHIC CONCENTRATIONS

	SQ. FT.		% OF MKT
Brockton	418,300	Milford	21.8%
Danvers*	400,000	Chelmsford	16.1%
Boston**	282,109	Danvers	13.9%
Fall River	279,436	Methuen	13.9%
Saugus	271,500	Raynham	13.3%
Worcester (Est)	270,000	Acton	12.7%
Milford	261,800	Attleboro	12.7%
Leominster	253,900	Leominster	12.1%
Medford	221,625	Brockton*	10.9%
Chelmsford	191,100	Woburn	10.6%

*includes Bradlees on Peabody line
**includes Dorchester, Roslindale & Brighton
Source: Finard

Brockton and Danvers have the greatest exposure in terms of total space while Milford and Chelmsford have the greatest exposure in terms of the space as a percentage of total retail space. Worthy on note, one Caldor store has already closed in East Brockton bringing total vacancy in that market to approximately 15%. The potential vacancy in that market if all of the subject retailers were to close would result in roughly a doubling of vacancy. Danvers, on the other hand, has a relatively healthy current market vacancy of 5.1%.[36]

Reuse of Space: Historical Perspective

One logical method of predicting the future of the retail space in question is to study past reuse of similar space after the failure and liquidation of various retailers. In several cases, the discount retailers under study have closed several locations in the state most notably Stuart's Department Stores and Ames/Zayre.

The following chart depicts several locations that have been closed by Stuart's, Ames/Zayre and some of the other discounters, their current status and reuse.

[36] Finard Data

TABLE 22: STUART'S DEPARTMENT STORES LOCATIONS

LOCATIONS:	SQ. FT.
Billerica, 700 Boston Rd (Rte 3A)	33,140*
Brockton, 220 E. Ashland St.	46,312
Chelsea, 170 Everett Ave	84,000
Haverhill, 2 Water St	56,800
Lawrence, Essex St (Plaza 114)	50,133
Lawrence, Winthrop St	42,700
Lowell, 1200 Bridge St	51,657
Lowell, 199-215 Plain St	57,000
N. Bedford, Kings Hwy & Rte 140	55,800
Taunton Mall, 1 Washington St	80,000
Tewksbury, 1900 Main St	39,690
Worcester, 893 Grafton St	82,723
TOTALS	679,955
Average	56,663

*remaining space/partially leased

	# Stores	Percent
FULLY RE-LEASED	3	25.0%
PARTIALLY RE-LEASED	1	8.3%
VACANT	8	66.7%
Total	12	100.0%

Source: 1993 Boston Business Directory

The above chart lists 12 former Stuart's locations. Although no specific data was obtained, it is estimated that most of these locations were closed approximately one year ago. Three of the twelve locations have been fully re-leased. 1200 Bridge Street in Lowell, a center with a supermarket anchor, was almost immediately leased to Ames. One of the larger stores at 893 Grafton Street in Worcester was re-leased to a Building 19. A third location in Brockton was released to a flea market. This indicates that some demand for space exists from other discount stores. Also worthy on note, all three location that were leased have supermarket anchors. Eight locations remain vacant with another partially leased. However, the ability to generalize to the current retailers from the status of the Stuart's locations is difficult due to the generally smaller size of the Stuart's units and their locations in some poor performing malls (Mystic and Taunton Malls) and otherwise in economically depressed areas (Brockton, Lawrence, and Lowell).

The chances of a category killer or other growth retailer wanting a Stuart's location appears unlikely due to its tough locations and the age and configuration of the units.

Table 23: AMES & ZAYRE CLOSED STORES

LOCATIONS:	SQ. FT.
Braintree, Liberty & Grove St	70,403
Braintree, Quintree Mall	82,691
Cambridge, 160 Alewife Brook Pkwy	N/A
Fairhaven, 261 Washington St	70,000
Haverhill, 2 Water St	56,800
Marlboro, Farm Road & Rte 30	59,777
Roslindale, 630 Amer. Legion Hwy	N/A
Roxbury, Warren St & MLK Hwy	40,000

	# Stores	Percent
FULLY RE-LEASED	3	37.5%
PARTIALLY RE-LEASED	1	12.5%
VACANT	4	50.0%
Total	8	100.0%

Source: 1993 Boston Business Directory

This table summarizes a sample of the Ames and Zayre stores on which some data was available. The time elapsed since the stores closed in not known. Three of the eight store have been fully leased. At Tedeschi Plaza in Braintree, the store was replaced by a TJMaxx and Home Goods. At the Alewife Shopping Center in Cambridge both a former Bradlees and Ames have been successfully replaced. At the Berdon Plaza in Fairhaven, the Ames unit was replaced by a Shaw's supermarket which moved from across the street in order to upgrade and expand its store.

In two cases, the closing of the Ames store has resulted in the closing of a second anchor tenant and severely effected occupancy at the center. For example, at the Indian Head Plaza in Marlborough, the closing of the Ames was followed by the closing of a Stop & Shop. Only one tenant remains in the center which is approximately 25% occupied. The second center is the Quintree Mall in Braintree. At this center, both an Ames and Stop & Shop were closed. The center is approximately 20% occupied. Four of six in-line units remain leased despite what appears to be very little activity at the center. Worthy on note, the center has very poor visibility but is otherwise located in a high traffic count area on Route 53 near the Braintree/Quincy line.

Two former Zayre stores, one in Roslindale and one in Dorchester have been vacant for three years. Both centers in which they were located are over thirty years old, and appear to be marginal locations.

There are also sporadic examples of store closings by the subject retailers. For example, Caldor closed one store in 1994 when Federal Realty Trust bought out its below market lease on a center in Norwell. The unit was then retenanted with a TJMaxx and Home

Goods. Caldor also canceled plans last Fall to open a new store in New Bedford which was a former Ashmont Discount location. This store has since remained vacant..

Caldor recently won bankruptcy court approval to reject two leases on stores in Eastern Massachusetts. One is a free standing store in East Brockton. The fact the store is located across the street from a Bradlees and is located behind another shopping center would appear to make this store difficult to lease. The second was a 89,000 square foot store in the Village Mall in Canton. This is a 300,000 shopping center with a Marshalls and Shaw's supermarket.

Since the store closed only one month ago, it is too early to analyze the effect of this closing on this center.[37] It will be an interesting example of the effect of a lost anchor and potential reuse of the space. The center has two smaller anchors, and roughly fifteen in-line tenants. The leasing agent expects lease renewals of the in-line tenants to be difficult unless a new anchor can be secured.[38]

There are also a few examples of the reuse of Kmart stores. One is the Woburn Mall, where the unit was leased to Lechmere. Another is in North Dartmouth where the store was converted to a Builder's Square which is now vacant. A Natick store was leased by Burlington Coat Factory and a store at the Tri-Borough Plaza in N. Attleboro was leased

[37] Charles Chisholm, Leasing Agent, The Flatley Company
[38] Charles Chisholm, Leasing Agent, The Flatley Company

to Shaw's. One recently closed store in Rockland remains vacant. The owner has considered changing the use of the center to a non-retail use.[39]

Jamesway, another failed discount retailer which did not operate in New England, is a relevant and recent example of a the failure of a discount department store chain operating in largely rural areas and therefore is potentially applicable to Rich's and Ames locations. The company operated 90 stores that averaged approximately 80,000 square feet that were auctioned of this year by bankruptcy court. According to the auctioneer, Ames purchased 11 leases, -approximately 65 leases were rejected and landlords bought back approximately 7 leases.[40]

One property in New Jersey was subsequently leased to Walmart by the owner Mark Center Trust. Mark Center reported that this unusual practice by Walmart was due to the superior location of the property and the fact that the property configuration allowed for an expansion of the unit to the desired prototype size.

As a final note, the Finard & Company survey which was completed approximately six months ago, identified 13 empty units as former discount stores. At this writing, none of these units has been leased.

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[39] John McWeeney, Tedeschi Realty
[40] Keen Realty Consultants

Growing Retailers: Do they Want This Space?

The dominant category killers operating in New England today, such as Home Depot, Walmart, and Circuit City have real estate strategies which almost exclusively involve the construction of free-standing prototype "big boxes".[41] The result has been that approximately 80% of new retail construction in 1994 nationally was big boxes.[42] When these retailers lease a store in a shopping center, they appear to show a strong preference for power centers over community strip centers.[43]

Home Depot has actually purchased and razed industrial properties in Waltham and Framingham for sites to construct new stores. Their reported needs for very high ceilings, substantially higher than average discounter space, makes their use of this space prohibitively expensive.[44]

Warehouse/wholesale clubs such as Sam's (Walmart), BJ's (Waban) and Price Costco are also growth retailers in the region, but, similar to the category killers, appear to desire free-standing locations, high ceilings and their own box.

Best Buy is expected to make its entry into New England in the near future. While Best Buy is typically aggressive in its expansion strategies, the current lack of capital being

[41] Tarez Burns, Burns Associates
[42] Forbes, May 1996
[43] Douglas Tigert, Babson College
[44] Douglas Tigert, Babson College

committed to the consumer electronic industry, the companies low stock price and significant margin erosion over the past two years could slow this firm substantially.[45]

Potential Strategies of Walmart and Target and Implications:

Most category dominant retailers have the strategic goal of achieving market dominance in relatively small markets such as the Boston area in order to maximize return on investment and to justify expansion into a new market.[46] Among the elements required in achieving market dominance in a new market, are rapid growth and aggressive pricing. The ability to achieve market dominance within the planned time frame is crucial. Failure to meet the time frame objective typically results in large losses and potential financial disaster to an aggressively expanding retailer.[47]

Both Walmart and Target are likely to follow a dominance strategy in New England.[48] The implications of this strategy hold the key to the future of the regional discount department store chains and the space they occupy.

[45] Ron Pastore, AEW
[46] John McWeeney, Tedeschi Realty
[47] John McWeeney, Tedeschi Realty
[48] John McWeeney, Tedeschi Realty

Walmart:

Several people interviewed believe that achieving market dominance in your own box in the Boston region is nearly impossible due to New England's unique real estate environment (Lack of sites, high land costs, political atmosphere). As evidence, they point to Walmart's apparent inability to secure sites in or near the Route 128 beltway at prices which fit its rent/sales ratio targets. This inability has apparently resulted in the selection of a majority of rural locations further out in the Route 495 beltway. As stated previously, It is also believed by that Walmart is experiencing store sales productivity significantly below their national averages. These factors are believed to have resulted in a slow down of Walmart's expansion plans into Massachusetts.

The regional discount chains do possess the "close in" locations that are attractive to Walmart. Therefore, an argument can be made that the acquisition of one of the regionals would be a logical way for Walmart to speed its penetration of the Boston market.

However, there are several real estate and business reasons that make this unlikely. First, the vast majority of all new Walmart stores are new construction of Walmart's "prototype" store. The protoype discount store is typically free standing and averages 110-120,000 square feet. Recently, Walmart has selected sites based also on the ability to expand these stores an additional 60,000 square feet to accommodate the addition of a 60,000 square foot grocery store (together the stores are called "supercenters"). With the recent decline in the growth rate of their discount store operations, the company is reported to consider supercenters as a key to future growth in the United States.[49] Another reason, is that Walmart only occasionally will lease space in a shopping center. The company prefers to own free standing locations. In eastern Massachusetts, Walmart's only leased location in a shopping center is in Fairhaven. (McWeeney).

It appears, therefore, that the combination of the need for bigger and expandable stores, the desire to own rather than lease and their recent slow down in expansion in New England reduce the chance of Walmart acquiring on the regional discounters, at least in the immediate future.

Target:

Target on the other hand, is considered by more people in the industry to be likely to make an acquisition of a regional chain.[50] They are less invested in the supercenter concept with plans to open only two new supercenters this year. Target's also has a greater focus on apparel and, as a result, desires more of a presence in malls. Target has been reported to be looking at several Bradlees and Caldor locations over the past year but has yet to acquire any stores (Burns). Most industry observes don't expect Target to open their first store in the region until late 1997 or 1998.

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[49] Goldman Sachs: U. S.Research
[50] John McWeeney, VP Development, Tedeschi Realty

One of the more likely acquisitions for Target would be the acquisition of the four Ann & Hope stores in eastern Massachusetts. These stores appear more than large enough to accommodate the space needs of Target. The location of the stores in regional malls (except for North Dartmouth) may also be a positive aspect as Target's product mix is heavily weighted on apparel.

An alternative for Walmart and Target in their pursuit of regional discounters-is to wait for a regional discounter to fail and bid for the leases on the strong stores. In relation to an acquisition strategy this would result in the cost savings of not having to close the acquire franchise's weaker stores. However, two disadvantages are also evident. The first is the time lost in waiting for the regionals to emerge from bankruptcy and ultimately file again. The second is the fact that bidding on the leases may become quite intense between Walmart, Target, and the landlords especially where the subject lease has a significant term left and is a below market rent (McWeeney). In this situation, the landlord also has a big incentive to gain control of the lease, so that a market rent can be negotiated. Apparently, several Bradlees leases are below market as a result of the ownership of many of their shopping centers by Stop & Shop which owned Bradlees in the late 80's.[51]

[51] McWeeney

CHAPTER 6: CONCLUSIONS:

Two of the most frequently heard descriptions of the retail industry today are "over-stored" and "consolidation". The most common explanations for these phenomenon are that during the past decade, a more time-pressed, savings conscious, value-oriented, and multi-ethnic America has demanded superior value and convenience from retailers resulting in tremendous pressure on profit margins and record retail failures. Retailers lacking access to capital, buying savvy, efficient distribution and inventory systems and pricing leverage with suppliers are unable to compete with the Walmarts, Home Depots and other "category killers" of the world which possess these advantages.

In the past, retail failures and store closings in the Boston area were looked at by retailers and landlords alike as more of an opportunity than a problem, due to the area's historic characteristic of being "under-stored". Retailers that were frustrated with the lack of available space saw store closings as an opportunity to open new stores.[52] Landlords locked into long term leases which underperformed inflation saw the W.T. Grant failure in the 70's as a godsend.[53]

The next cycle of failures and store closings is likely to have different implications for landlords due to the evolution and consolidation of the industry. For example, three of

[52] Philip Rosenberg, Treasurer, J. Baker
[53] Robert McAlear, Vice Chairman, United States Trust

today's growth retailers in the region, Home Depot, Walmart, and Circuit City operate almost exclusively out of their own free-standing "boxes".

The regional discount department store industry is consolidating rapidly and these troubled discounters occupy approximately 8.2 million square feet of space in shopping centers with a total of roughly 23 million square feet representing approximately 15% of all the retail space in eastern Massachusetts. The potential for millions of square feet of empty anchor store space is increasingly likely as Walmart continues to build market share in the region. This analysis estimates conservatively that a minimum of 3 million square feet of retail space in the state currently occupied by discount department stores other than Walmart is "excess selling space".

The evolution of the supercenter, which will likely dominate growth going forward, dictates the immediate need for 120,000 square foot stores with 60,000 square foot expansion. The percentage of existing centers with distressed discount anchors and this expansion ability is very limited.[54] The likeliest potential reuse of existing space by a single user appears to be Target Discount Department Stores (Dayton Hudson) expected to enter the region in 1998. Supermarkets occupying these centers that desire to increase their store size are also potential reusers.

To the extent that supermarket anchors already in occupancy of the subject shopping centers do not need additional space and have "exclusive" lease clauses, this eliminates a

[54] Douglas Tigert, Babson College

major potential source of replacement tenants for over half of the subject shopping centers. This also creates contractual and tenant mix conflicts in the event that empty discounter space is desired by a tenant for a supercenter.

To date, in only a very few cases has the loss of a discount anchor appeared to cause the closing of the other anchor(s). Of the 20 closed stores researched, in only four locations did the closing of an anchor store appear to trigger the closing of a second anchor and severely impact the occupancy of the centers.

In 20% of the centers studied, the subject discounters are the sole anchors tenants; This implies that future stores closings will have a significantly different effect on local centers than past failures as the loss of an anchor in a single anchored center should in theory have a greater impact on in-line tenants than the loss of an anchor in a multi-anchored center;

The hardest hit discounters and shopping centers are likely to be first in rural locations where Walmart is building a dominating presence and where the likelihood of finding major replacement tenants is the least, such as western Massachusetts, Worcester County, and other locations outside 495. These older and smaller units in outpost locations will most likely be divided into multi tenant space, torn down or be converted to non-retail uses. The better locations within routes 495 and 128 are more likely to be in demand due to the lack of alternative sites and high cost of development.

A mitigant to these concerns is the perception that eastern Massachusetts is "under stored" implying the consolidation in retail should have less of an impact in this region as elsewhere in the country. The biggest, most modern stores in close in suburbs should be in demand by Target and possibly Walmart. Many stores which were built twenty or thirty years ago are believed to have below market, long-term leases and/or attractive option periods which could make them attractive to bidders in an auction situation.

The dynamic of winners and losers has several implications for retail property markets. The first implication is that retailers will have a greater incentive to close weak stores in weak locations. This may lead to what most analysts foresee as a bifurcation of shopping centers with the strong getting stronger and the weak getting weaker[55].

The flat sales environment and continuing downward pressure on margins should limit the amount of rent retailers are willing to pay to landlords.[56] The trend toward fewer and larger retailers with higher credit ratings should result in more negotiating leverage on the side of tenants to dictate rent levels and project returns.[57] Finally, the shortened lifecycle of retailers and retail formats is likely to increase the risks of tenant turnover and quicken the obsolescence of retail formats.

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[55] Merrill Lynch, Shopping Center REITs, March 1996
[56] AEW: "Retail Industry Trends"
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LIST OF TABLES

LIST OF FIGURES

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