Publication: Real Traffic

Jul 21, 2009 12:09 PM, By Elaine Misonzhnik

Grocers Increasingly Taking Over Vacant Big Boxes (7/21)

Later this year, Seafood City, a California-based supermarket chain specializing in Asian cuisine, will open a new store in Concord, near San Francisco's Bay Area. In its new location, Seafood City will benefit from high visibility on Diamond Boulevard, a trade population of 133,430 within a five-mile radius and average household incomes of $88,184 per year. But the supermarket chain won't be building a new store. Instead, it will take over a 61,833-square-foot former Circuit City box it recently bought from the Red Mountain Retail Group, a Santa Ana, Calif.-based retail developer, in a $10,280 transaction.

Meanwhile, over on the East Coast, Safeway Inc., a Pleasanton, Calif.-based supermarket operator, is looking into opening one of its new lifestyle stores in Towson, a community of 53,401 in suburban Baltimore, with a median household income of $64,313. In June, Bohler Engineering, a civil engineering firm with an office in Towson, reportedly filed for approval from Baltimore County to allow Safeway to move into a space formerly shared by bankrupt house wares retailer Linens ‘n Things and computer seller CompUSA.

These are just a few examples of the growing trend of supermarket chains (along with discounters and some fitness clubs) taking over some of the vacant big boxes that have cropped up on the retail landscape because of mass closures by Circuit City, Linens ‘n Things, CompUSA and other category killers. What the deals getting done have in common is that grocers are picking off the choice locations first--high-traffic sites on busy intersections and in dense, urban markets with higher than average incomes, older than average demographics and higher than average education levels.

Many retailers "went out of business and it had nothing to do with their locations and that left vacancies available in some very desirable areas," adds David J. Livingston, a Waukesha, Wis.-based supermarket consultant.

The trend is benefiting landlords as well. The roster of typical big box tenants continues to thin. Most big box chains are not expanding and there are few new concepts on the horizon as others deal with bankruptcies, closures and liquidations. In this climate, grocery stores have become an attractive option.

For example, last year's liquidations of Circuit City and Linens ‘n Things delivered close to 1,300 empty boxes to the market. Closings by chains including CompUSA and Home Depot left even more stores vacant. From the first quarter of 2008 to the first quarter of 2009, the vacancy rate in the big box sector jumped 280 basis points, to 7.3 percent from 4.5 percent, according to research from Marcus & Millichap Real Estate Investment Services and the CoStar Group. At the same time, the absorption rate moved from negative 230,733 square feet to negative 1,057,687 square feet.

"Before, the landlords would have multiple parties knocking on their door. Now they are lucky to get [one] interested retailer," notes Alvin Williams, principal of Excess Space Retail Services, a Huntington Beach, Calif.-based real estate disposition and lease restructuring firm. And today, that retailer has become a supermarket.

Everything old is new again

There are a number of reasons big boxes can become a great real estate opportunity for grocers. In addition to inheriting strong locations boasting good demographics, taking over existing buildings means grocers don't have to deal with the headaches of getting permits for new construction. For new stores that can take months, especially in the Northeast, where approval processes are notoriously lengthy.

Moreover, given today's market environment, supermarket chains can strike very favorable deal terms with landlords desperate to fill vacancies. According to the Marcus & Millichap and CoStar report, average rents for big box spaces have fallen 4.5 percent from the first quarter of 2008 to the first quarter of 2009, to $11.30 per square foot. Anecdotally, some brokers say rents are even more attractive than that. In Dublin, Calif., an unidentified local grocery operator has been considering buying or leasing a 58,588-square-foot Circuit City, according to Deborah Perry, a broker in the Walnut Creek, Calif. office of Colliers International. That Circuit City space is expected to fetch between $14 per square foot and $16 per square foot—as much as 20 percent below market rate rents at the beginning of 2008.

And the rents are not the only thing that landlords are willing to negotiate on. "More important with grocers are term options and specific use exclusives in the center," says Williams. "The landlords are much more flexible. That's occurring in most major marketplaces, almost regardless of who you are. If you are a national credit tenant right now, there are all kinds of opportunities out there for you."

However, there are also some challenges in retrofitting former big boxes for grocery use. Most major supermarket chains tend to have stores ranging from 45,000 square feet to 60,000 square feet—larger than some of the spaces on the market. For example, former Circuit City locations are in the 30,000 square foot to 40,000 square foot range and some are as small as 10,000 square feet. So grocers may have to adapt concepts or pass on spaces that don't fit existing prototype sizes. There is also the issue of parking. Supermarkets need a parking ratio of approximately 5 to 1, notes Perry, and big box sites might have been designed to accommodate fewer cars than that.

For both of these reasons, many of the grocery stores that are going into former big box locations are smaller concepts or offshoots of larger discounters that specialize in grocery. For example, Williams' firm has been helping British grocery operator Tesco's Fresh & Easy concept look for vacant boxes. Unlike traditional supermarkets, Fresh & Easy typically prefers 10,000-square-foot stores. (However, it is now considering some locations between 30,000 square feet and 40,000 square feet.)

Other companies considering smaller stores include Culinaria, an offshoot of Schnuck Markets which recently opened in St. Louis, and Urban Fresh, a Jewel-Osco concept which opened in Chicago last year, according to Matthew Casey, president of Matthew P. Casey & Associates, a Clark, N.J.-based supermarket real estate consultant. The first Culinaria totals 30,000 square feet of space while Urban Fresh inhabits 16,000 square feet.

Meanwhile, Developers Diversified Realty, a Beachwood, Ohio-based shopping center REIT, recently signed a lease with Sprouts Farmers Market for a former Circuit City location in Culver City, Calif. The Phoenix-based chain operates stores under 26,000 square feet. Developers Diversified is currently working on another lease and has executed a sales agreement for some of the remaining boxes in its portfolio, according to Paul W. Freddo, senior executive vice president of leasing and development with the firm. "We do have significant interest from supermarkets and specialty grocers in our available space," he notes.

As of year-end 2007, Circuit City stores accounted for 1.2 percent of Developers Diversified's GLA and Linens ‘n Things for 0.5 percent.

In addition, discounters including Wal-Mart and Big Lots have also been looking at big boxes for their smaller, grocery-centered concepts. Last year, for example, Wal-Mart launched Marketside, a convenience-sized grocery store, at four locations in Arizona. Marketside locations measure approximately 15,000 square feet—about the same size as Tesco's Fresh and Easy concept. And this May, Columbus-based Big Lots opened its first Polaris store, which will be built around grocery products at the Polaris Towne Center in Polaris, Ohio. The 35,000-square-foot store is located inside a former Linens ‘n Things building. Altogether, Big Lots plans to open 45 new stores in 2009.

"We continue to get a lot of activity from discount retailers that carry groceries, including Dollar General, Big Lots and 99 Cents Only," says Williams. "Maybe for every five deals they signed last year, they are doing one this year. But the retailers that are out there are looking at this as an opportunity to upgrade their leasing portfolio where they can."

Looking for the prime spot

Landlords still have to keep in mind, however, that urban boxes will be a lot easier to move than suburban ones. Livingston, who recently completed a market study for a grocery chain that is considering moving to a former big box location, says the tenant will be looking for a trade area with income levels above $100,000 per year, average age above 30 years old and education levels above Bachelor's degree. The Dublin site that Deborah Perry is currently marketing would fit these criteria—average household incomes in the five-mile radius are at $125,691 per year and daytime population totals more than 117,000. That's why more than one retailer has expressed interest in the space. But a vacant box in a secondary or tertiary market with less spectacular demographics won't attract a lot of attention.

"There is a lot of very unique, once in a lifetime real estate opportunities [out there] because of what's going on," says Williams. "Having said that, there's certainly not an overwhelming amount of leasing activity."