

Special Report

Sears Bankruptcy

Redevelopment Opportunities Abound as Transformation Of Sector Spurs Bankruptcy of Historic Powerhouse

Modern retail climate drives adaptive strategies. Like several other high-profile retailers in recent years, Sears Holding Corp. failed to evolve with the changing retail landscape and took on an unsustainable level of debt. Consequently, it filed for Chapter 11 bankruptcy, announcing the closure of 142 locations in the process. The company's minimal re-investment into existing operations contributed to its downfall as it was unable to provide an experiential space, a characteristic that has proved to be essential for modern consumers. Additionally, its limited online infrastructure allowed companies such as Amazon and Walmart to steal market share, further diminishing Sears' relevance as e-commerce became a larger part of the consumer shopping experience. Though the company is attempting to develop a restructuring plan in which it keeps some locations open, a full liquidation is certainly possible, which would significantly impact markets with large Sears footprints.

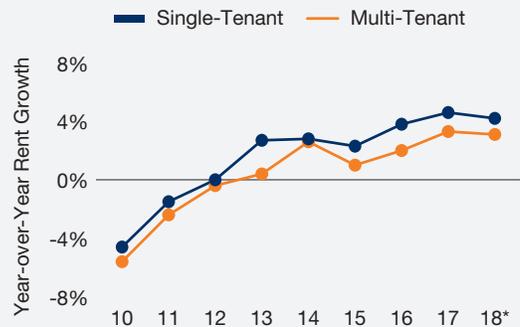
Ability to move rents to market a silver lining for investors. Although large chunks of retail space will be left behind from the bankruptcy, owners are optimistic they can attract higher-quality tenants and lift rents to meet market conditions. Many retail centers have been negatively impacted by Sears' and Kmart's decades-old lease rates, inhibiting property performance. The company's once-prestigious name paved the way for extended lease terms, which in some cases include low- to mid-single digit rents. Depending on several factors such as lease length and location, adjusting rents to market may drastically increase NOI growth for some landlords. While attracting a new retailer to fill an entire space may be difficult, dividing the box into multiple units for several retailers could be more achievable. Nevertheless, a shuttered Sears or Kmart location provides owners with new opportunities to revitalize their properties.

Low-vacancy areas would welcome more space. The slew of available space that could potentially come online may benefit some markets, similar to the Toys R Us liquidation. Empty storefronts would provide relief for parts of the Bay Area as well as Boston and New York due to these markets' tight retail conditions. Empty boxes may provide retailers with the tools needed for expansion, particularly in San Francisco where retail completions are extremely limited this year. Baltimore's large Sears footprint of more than 1.3 million square feet may be a boon for the market as vacancy sits below 4.0 percent and retail deliveries remain around the 500,000 square-foot mark on an annual basis. To the contrary, metros like Chicago and Riverside-San Bernardino would be negatively affected by a bevy of available space as their vacancy rates are expected to be at 6.2 and 8.7 percent by year end, respectively.

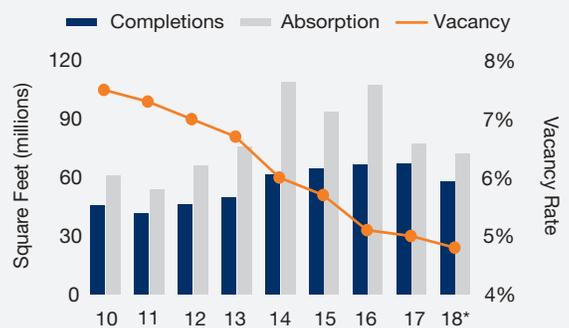
E-Commerce Sales Remain On Upward Trend



Rent Growth by Property Type



Retail Supply and Demand



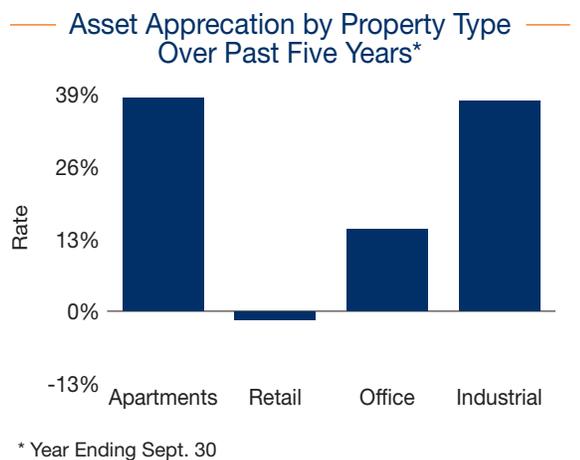
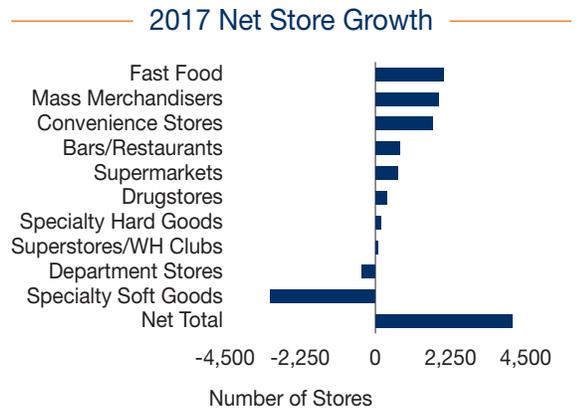
* Forecast
 Core retail sales exclude auto and gasoline sales.
 Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; U.S. Census

Array of Retailers to Capitalize on Wave of Space

With a number of locations set to shutter and possibly more coming in the near future, retailers will look to take advantage of the forthcoming influx of available space. Empty stores with relatively quality locations should attract a variety of prospective tenants; however, this will be dependent on whether the landlord decides to divide the space into several parts or keep it intact. Retailers in expansion mode operating in larger spaces such as At Home, Life Time Fitness and Target could backfill some Kmart locations. Off-price chains like Ross and TJ Maxx may lease out space if the boxes are subdivided. Regional malls with vacant Sears stores will attract a different set of retail tenants. With malls now focusing more on services than goods, gyms may be viable tenants for these locations as well. In addition, experience-oriented establishments including movie theaters and trampoline parks could also fill the void left by Sears.

Repurposing Possibilities May Boost Investor Interest

Considering the evolving nature of the retail sector, some investors may choose to repurpose the now-defunct stores to housing or office space. Though high costs could be associated with a project of this magnitude, such a transformation may prove more stable to some investors in the long term; however, each market is unique. Another option could be to convert the empty boxes into last-mile distribution centers or warehouses. This likely applies more toward Kmart stores as they are generally strip-center anchors or stand-alone buildings, making the transition more feasible. Transforming the boxes into industrial space may be the most viable option for some investors as some Kmart stores are in lower-quality locations, making it difficult to attract new retailers. E-commerce continues to play a vital role in strengthening the nation's industrial sector, supporting exceptional asset appreciation of these properties over the past several years. Additionally, investors may consider replacing the vacant storefronts with self-storage units to help diversify their portfolios.



Markets with the Largest Footprints*

Metro	Sears Store Count**	Kmart Store Count**	Estimated Total Square Footage
New York City	23	25	5,960,000
Los Angeles	18	7	3,460,600
Philadelphia	9	11	2,448,800
Washington, D.C.	11	7	2,375,600
Chicago	9	8	2,161,400
Riverside-San Bernardino	9	8	2,161,400
Miami-Dade	9	6	1,969,800
Boston	7	5	1,564,000
San Francisco-Oakland	6	5	1,409,000
Dallas/Fort Worth	9	0	1,395,000
U.S. Total	370	316	87,622,800

* Locations open in the U.S. as of Oct. 23, 2018. This excludes Sears Appliances & Hardware, Sears Auto Center, Sears Hardware, Sears Hometown and Sears Outlet locations.

** Sears average store size: 155,000 square feet; Kmart average store size: 95,800 square feet

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Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; CreditNtelli; Financial Times; IHL Group; Real Capital Analytics; U.S. Census Bureau