

ZIEGLER INVESTMENT BANKING

CHARTER SCHOOL FINANCE Z-NEWS

Page 1 | May 2018

FEATURED ARTICLE

BLACK CLOUDS FOR BIG RETAIL MAY HAVE SILVER LINING FOR SCHOOLS

A growing charter school seeking a facility may look for real estate that formerly housed a large retail operation. As department stores, in particular, appear to be losing favor with American shoppers, it's natural to wonder whether more, affordably priced retail real estate will soon be on the market.

In a recent edition of *Z-News*, we outlined common questions a nonprofit organization needs to answer before purchasing a commercial property to be retrofitted for school operations. One type of commercial property that some schools have been utilizing lately are former retail locations. Whether it's a strip mall or a shuttered big-box store, large retail spaces are typically found in high-traffic areas with easy access and ample parking. Let's see how the worrisome trends for certain retailers may have a silver lining for charter schools in need of affordable real estate.

It is quite possible that more former retail properties will come on the market in the years ahead—if America continues to purchase more goods via the Internet rather than shopping at brick-and-mortar stores. Shopping at home is a highly attractive convenience for busy Americans. Why spend time wandering a huge store or mall when there's two-day free shipping online? To put some of the on-going change in perspective, Census Bureau data shows that brick and mortar department stores had total sales of **\$230 billion in 1999 versus only \$155.5 billion in 2016**.

New data for school leaders to digest comes our way courtesy of JP Morgan Chase and General Growth Properties (GGP), one of the largest owners of shopping malls in the United States.

As we can see from the graph below, we love our retail in America! Among the industrialized world, the United States is the leader with 24 square feet of retail space per capita, compared with 16 square feet for Canadians and only two to five square feet of retail space for European countries. The lofty square footage of retail is a uniquely American tradition and a result of having ample land available for such structures.

	SIX MONTHS PRIOR	CURRENT
5 Yr Treasury	2.03%	2.81%
10 Yr Treasury	2.41%	2.98%
30 Day LIBOR	1.23%	1.89%
Prime Rate	4.25%	4.75%
30-year MMD	2.77%	3.08%

Source: Ziegler Capital Markets
Rates as of April 24, 2018

INTEREST RATE UPDATE

The long anticipated rise in interest rates is here. One glance at the interest rate box above shows the upward movement for many of the well-known indices. For borrowers considering a project, it may be time to move ahead. Market observers are predicting that the Federal Reserve may raise the Fed Funds rate two or three more times in 2018.

ABOUT US

Ziegler is a **national leader** in providing **financing** to **charter organizations nationwide**.

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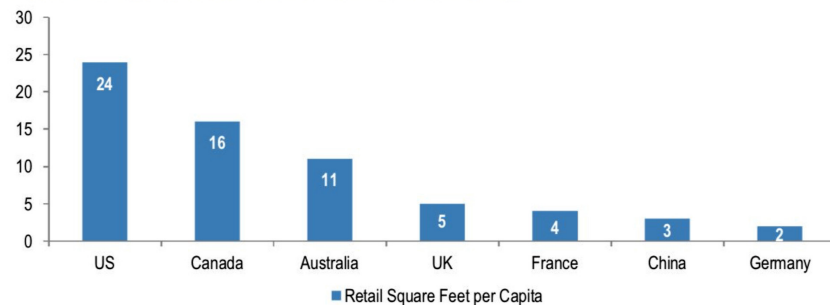
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The Issue: The US is Materially Over-Retailed

Figure 1: Shopping Center Retail SF Per Capita by Country



Source: GGP Investor Presentation, citing ICSC

If Americans grow even more comfortable purchasing goods and services from online retailers, large retail stores will see less traffic, and more stores will close. But there may be a silver lining in that dark cloud. It is plausible to forecast a significant downturn in the price of retail real estate, as more vacated stores become available to be repurposed. That is good news for organizations looking to breathe new life into those sites.

The chart below, prepared by JP Morgan Chase, notes how much real estate could theoretically become available and need to be absorbed if the demand for retail space declines by even a small amount. A reduction in real estate demand of just two square feet per capita would result in 760 million square feet of “surplus” real estate coming on the U.S. market. That amount might take 13 years for the economy to absorb. If U.S. per-capita real estate fell to the 16-square-foot per-capita rate in Canada, it would result in 2.5 billion square feet needing to be repurposed. A larger change in shopping habits could take decades for the real estate market to digest.

Table 1: JP Morgan Sensitivity of Years Consolidation to Reduction in US Shopping Center Retail SF per Capita

% Reduction	US Shopping Center Retail Square Footage (Millions)	US Shopping Center Retail Sq Ft Per Capita	Implied Square Footage Consolidation (Millions)	Implied Years of Consolidation
0%	7,597	24	0	0
10%	6,837	22	760	13
15%	6,457	20	1,139	19
25%	5,697	18	1,899	32
33%	5,064	16	2,532	43
40%	4,558	14	3,039	51
50%	3,798	12	3,798	64

Source: J.P. Morgan Estimates. ¹Holding Population Constant, ²Using 2017 YTD of ~4000 announced store closures/~60M square feet as the baseline

What could this trend mean for your building plans?

That’s a great question! The data above is simply food for thought; it does not constitute a forecast for retail space. It’s possible that U.S. consumers will continue to patronize brick-and-mortar retailers, making this a moot point. Also, the data is based on per-capita numbers which will be affected by future population growth (or lack of it). Nonetheless, the numbers do provide a number of interesting long-range discussion topics for schools:

- Given that the U.S. has the largest per-capita square footage of retail space in the world, any change in shopping habits away from that model would likely depress retail real estate values. For schools seeking a new site or a second campus location, **former retail locations may become even more available and affordable in the years ahead.**

- However, if you currently own or decide to purchase a retail site, **you may not see stable or rising property values in the future.** This is not a problem for many charter schools, as most are not purchasing property for investment purposes, but rather as a permanent home for their operations.
- If your strategy in purchasing a retail site is to lease a portion to commercial retailers, **your lease income could be more at-risk in the years ahead.** Ziegler has worked with certain schools who purchased retail sites with a plan to make related mortgage payments with lease income from commercial tenants. If demand for retail space starts to decline nationally, that could affect your leverage to keep tenants and/or generate stable rents. Remember, the likely reason that retail site became available to your school in the first place was a lack of higher-paying retail tenants to occupy the space.

These concerns may not apply to every situation. The retail location you purchase may be in an area of significantly increasing population, which could result in rising property values. And as building restrictions get tighter in some urban areas, finding space that is built out and zoned for retail may be more difficult, which could also result in higher land and rental values.

In summary, since the 2008 recession, surplus commercial real estate has been an possible way for charter schools to stretch their purchasing dollars and acquire very functional buildings. If your school is exploring the option of purchasing a retail space, we encourage you to read a recent *Z-News* issue entitled “*Six Questions to Ask Before Investing in Commercial Property.*” It explains key considerations for purchasing commercial space. Understanding these considerations—and weighing the impact of retail trends—could help you create a wise, long-term real estate strategy that significantly furthers your mission.

Scott Rolfs is the Managing Director & Group Leader for the K-12 & Charter School Facilities Finance team at Ziegler. Contact us at 800-558-1776 to learn more about facilities finance options Ziegler offers.

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