Taking Destiny into their Own Hands:

LANDLORDS PURCHASING DISTRESSED RETAILERS

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The last decade has been enormously transformative for the retail industry. The soaring popularity of e-commerce, shifts in consumer behavior and demographics, and declining store foot traffic have pushed many traditional brick-and-mortar retailers to the brink, and some were tipped over into bankruptcy, including household names like Sears and Toys R Us.

The already ailing retail sector was hit particularly hard by the COVID-19 pandemic. Stores were forced to close abruptly to comply with states' shutdown orders, and some debtors that were in the middle of winding down at the time were not able to conduct liquidation sales. Retailers' ability to deal with their leases in an orderly fashion, especially given the extraordinary lockdowns, was also curtailed by the 2005 amendment to the Bankruptcy Code that limits a Chapter 11 debtor's time to decide whether to assume or reject a nonresidential real property lease to 210 days after the filing. The debtor initially has 120 days to assume or reject these leases and can obtain an additional 90 days with court approval. Any further extensions require landlord consent.

It is difficult for retailers with numerous leases to implement a new business plan and decide which leases to assume (and potentially assign and sell to third parties) or reject within 210 days during normal times, let alone during a pandemic. In an extraordinary move, certain Bankruptcy Courts exercised their equitable powers under the Bankruptcy Code to allow debtors to "mothball" their Chapter 11 cases and only pay "critical" expenses for a certain period of time.

Some of these orders, including those issued in the Chapter 11 cases of Modell's, Pier 1, and True Religion, had a direct impact on landlords by allowing Chapter 11 debtors to suspend and defer rent payments. This occurred in spite of the requirement of Bankruptcy Code Section 365(d) that a debtor pay its post-petition rent timely until the lease is assumed or rejected, although courts can extend the time for performance, for cause, up to 60 days following the petition date.

The Consolidated Appropriations Act (CAA), signed into law on December 27, 2020, gave Chapter 11 debtors further leverage–albeit only through December 27, 2022, when these provisions sunset—by extending the debtors' period to decide whether to assume or reject nonresidential real property leases by another 90 days. As a result, Chapter 11 debtors can now have 300 days to decide whether to assume or reject a lease, subject to further extensions with landlord consent. Additionally, the

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CAA allows small business debtors in Subchapter V cases to seek deferrals of current performance under leases for 120 days rather than 60 days.

But the impact on landlords went significantly beyond that. Outside of bankruptcy, landlords were suddenly faced with a wave of rent deferrals, abatements, and the prospect of flagship tenants potentially going out of business. Considering these systemic risks, it is perhaps not surprising that some landlords are stepping in to rescue their tenants—and help themselves.

Over the past couple of years, bankrupt retailers saw large landlords like Simon Property Group and Brookfield Properties form joint ventures to step in as stalking horse buyers of failed retailers. For example, Simon partnered with intellectual property (IP) licensing company Authentic Brands Group to purchase Brooks Brothers and Lucky Brands. The same team joined forces with Brookfield to purchase Forever21, and Simon and Brookfield purchased JC Penney. In many of these cases, the buyers acquired only a subset of the existing store bases—for example, better performing locations and their own properties—with the remaining stores being liquidated **(Figure 1)**.

While these landlords' forays into retail are miniscule relative to their overall business enterprise, this strategy nonetheless has enabled them to take advantage of unique synergies. Partnering with brand management companies like Authentic Brand Group, they could hope to monetize potentially valuable brands and generate return on investments while controlling the loss on the real estate side of the business.

This, however, was not the first time Simon and others invested in distressed retailers. In 2016, a joint venture between Authentic Brands, Simon, GGP, Hilco, and Gordon Brothers—a unique partnership of landlords, a brand licensing company, and liquidators—purchased Aeropostale out of its Chapter 11 case for $243 million. Simon has publicly stated it has made "a ton of money" in the Aeropostale deal.[2] Accordingly, the recent acquisitions were likely more strategic than landlords simply seeking to resolve their own trouble, although that is certainly part of the equation. As for the future of the purchased brands, the buyers will likely focus on brand value, increasing online presence, and cutting unnecessary costs.

Challenging Environment Persists

It is worth noting that landlords like Simon and Brookfield are uniquely positioned to pursue retail deals as buyers. In addition to their deep pockets, they also operate mostly Class A upscale malls, where debtors' stores are more likely to be performing well. This strategy likely would not work for owners of average malls that are generally struggling more.

While Simon and Brookfield are capitalizing on their advantage, the challenge of operating a retail business in the current disruptive environment

Figure 1: Retailers Purchased by Landlords

CASE	FILING DATE	DESCRIPTION	CASE RESULT/BUYERS
Brooks Brothers	07/08/20	New York-based clothing retailer focused on men, women, children, and home furnishings. Brooks Brothers had 424 retail and factory outlet stores[1] worldwide (236 in the U.S.). The company filed for Chapter 11 with debtor-in-possession (DIP) financing of $75 million to be provided by WHP Global, but Authentic Brands Group outbid it with an unprecedented no-fee/no-interest DIP of $80 million.	Going concern sale to SPARC, a joint venture between Simon and Authentic Brands Group for a purchase price of $325 million. SPARC assumed at least 125 leases, or about 53% of domestic locations. No other qualified bids were submitted.
Lucky Brands	07/03/20	Apparel lifestyle brand that designs, markets, sells, distributes, and licenses a collection of contemporary premium fashion apparel under the Lucky Brand name. As of May 2020, the company operated 112 specialty retail stores and 98 outlet stores in North America (total 210).	Going concern sale to SPARC for $192 million ($140 million of cash plus $52 million of "credit bid equivalent"). SPARC assumed more than 150 leases, or about 75% of the stores. No other qualified bids were submitted.
JC Penney	05/15/20	Department store chain operating 846 stores in the U.S. & Puerto Rico. JC Penney filed its Chapter 11 case with a restructuring support agreement (RSA) with certain lenders who also provided the DIP. The RSA provided for a reorganization around a viable operating company and formation of a REIT, while dual-tracking a sale process.	The RSA parties ultimately opted for the sale path. The business was bifurcated into an operating company (OpCo) and the real estate holding company (PropCo) to hold a subset of the owned properties and the distribution centers. OpCo was sold to Simon and Brookfield. PropCo was sold to the DIP/senior lenders through a credit bid. This deal kept intact more than 600 stores, or about 70%. No other qualified bids were submitted.
Forever21	09/29/19	Los Angeles-based fast-fashion retailer, operating and franchising 785 stores worldwide (534 in the U.S.). The company initially did not contemplate a sale but pivoted in November 2019.	Going concern sale to a consortium of landlords led by Simon, Authentic Brands Group, and Brookfield for $81.1 million. Buyer assumed more than 150 leases, or 28% of domestic locations No other qualified bids were submitted.

still exists. Vaccines may help life gradually return to normal, but the long-lasting effects of the pandemic and, more generally, fundamental shifts in consumer behavior will likely prolong the struggles of traditional retailers and ultimately result in permanent industry-wide changes. Whether the landlords' activity in the distressed retail space will continue or was a fleeting opportunistic move remains to be seen.

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[1] Includes stores operated by affiliates, joint ventures, and third-party licensees.
[2] cnbc.com/2019/07/31/simon-property-could-save-retailers-from-going-out-of-business.html

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