Appraising Retail Properties in the "Amazon Jungle"

by Franz H. Ross, MAI, and Sergio S. Lo Presti, MAI

Abstract

Changing buying patterns for retail goods and the impact of Amazon and other e-commerce have made retail perhaps the riskiest property type. Predicting which properties will "go dark" necessitates thorough market analysis. For owner-occupied properties, appraisers should ideally analyze the store's financial statements but at a minimum analyze historical revenues. In appraising hotels, nursing homes, convenience stores, and other property types, revenues are the primary measure of captured demand, and going concern appraisals are the accepted practice. The profession should be consistent in using the financial information of the going concern (at the store level) particularly in analyzing freestanding retail properties, and to the extent possible, all retail properties. This will improve the reliability of the highest and best use analysis and the forecast of durability of the current use. In this article, the "durability of the current use" relates to the likelihood of vacancy under the current highest and best use of the real estate, not the brand name occupying the space, with vacancy caused by deficiencies in location, functional aspects, or demand.

Introduction

Blockbuster had revenues of nearly $5 billion in 2000, with sales increasing at a compound growth rate of 13.9% in 1996–2000. With 51 million active movie rental accounts in the United States and Canada, one in six persons had a Blockbuster account. The 5,191 US stores allowed Blockbuster to achieve dominance by putting at least one store in virtually every small market.

Meanwhile, three-year-old Netflix saw promise in its online movie rental and mail delivery service, although streaming would not be available for seven more years. In 2000, Reed Hastings, the Netflix founder, offered to merge Netflix into Blockbuster at a price of $50 million,[1] as Netflix was losing money, with sales then in the $35 million range. Blockbuster CEO John Antioco declined the opportunity of a lifetime. Netflix grew to $11.7 billion in sales by 2017 and had market capitalization of $145 billion by October 2018. Blockbuster sales peaked in 2004 at $6.1 billion, but storm clouds were gathering, as Walmart and other discounters were taking market share by selling movies rather than renting. Blockbuster took a $1.5 billion impairment charge in 2004, and its sales and prospects deteriorated quickly. Netflix introduced streaming video in 2007, and Amazon had become a major competitor. Blockbuster filed for bankruptcy in 2010; in 2012 the last 300 corporate-owned stores were sold to Dish Network for $320 million, or about four cents on the dollar compared to the $8.4 billion Viacom paid for Blockbuster in 1994. Dish's $320 million investment proved to be essentially worthless. As of October 2018, only the Bend, Oregon, franchise remained.

Blockbuster's 10-K reports typically would begin with a market analysis showing total industry revenues and explaining how Blockbuster would continue to dominate the at-home video market. Obviously, the market analyses by Viacom in 1994, by John Antioco in 2000, and by Dish in 2012 were greatly flawed. They failed to recognize changes to the market—that streaming would become available was predictable. Over 5,000 Blockbuster stores closed over the space of a few years, including fee simple and leased fee properties. Of the hundreds of Blockbuster store appraisals done during its 2004–2010 decline, how many got the value right? Probably very few.

The Blockbuster story is not an isolated case. Sears dates to 1886 and was the Amazon of the

1. Mark Graser, "Epic Fail: How Blockbuster Could Have Owned Netflix," *Variety*, November 12, 2013.