STORE Sets A Mission To Help Retailers

STORE Capital allows retailers to get out of the real estate business, and focus on their core business operations.

Randall Shearin

In the net lease sector, most investors want to acquire the properties of credit-rated companies who have a track record of paying rent on-time and according to terms. But there's a swath of retailers and retail-related businesses that are just beyond that credit-rated playing field who are healthy and well performing. Their size, however, limits them from larger banking relationships. Phoenix-based STORE Capital was founded to serve the real estate financing needs of these companies, many of whom grow by building and owning their own real estate. STORE — which derives its name from the Single Tenant Operational Real Estate (STORE) it seeks — takes the real estate off their hands, providing capital in return for the properties. It is a net lease solution for non-traditional net lease players.

"These companies have a choice as to whether they rent or own their real estate, whether they are running supermarkets, quick-service food or automotive parts," says Christopher Volk, president and CEO. "With us as their landlord, we can lower their cost of capital and increase their shareholder performance. In the wake of 2008, we felt the need was more acute than ever."

Founded in 2011 by Volk, Chairman Morton Fleischer and a team that has been together for over a decade, STORE Capital's mission is to provide capital through real estate. During the Great Recession, the Dodd-Frank ruling put more regulations than ever on commercial banks, which made it harder for middle-market companies to finance their real estate assets. The Basel III Accord also makes it more difficult for banks to focus on mid-size companies. STORE Capital has differentiated itself in the net lease sector because it is foremost a provider of real estate finance solutions, and not necessarily a real estate company.

"Our clients are companies that don't have ready access to long-term capital," says Volk. "Continuing our life's work by doing a third platform for companies of this size made a lot of sense in the wake of the Great Recession."

Main Event is a concept that puts bowling, laser tag, billiards, rock climbing,

STORE Capital was quick to get going. The company raised $500 million in four months, on the strength of the principals' track record. That track record has been to outperform historic market returns for its institutional investors.

"We've never lost money for any shareholder that we've raised capital from," says Volk.

Volk and his team have a 25-year-plus history in the net lease sector, growing and operating several different companies. Starting in the mid-1980s, Volk helped Fleischer build Franchise Finance Corporation of America into the leading provider of net lease financing and mortgage financing to the chain restaurant industry. That company grew to also handle convenience stores, interstate truck stops and automotive parts stores. Catherine Long, now CFO of STORE Capital, joined Franchise Finance along the way, and became an integral part of the organization. In 1994, the company went public. Eventually, Franchise Finance grew to about 6,000 assets. In 2001, it was sold to GE Capital, where Mary Fedewa — now STORE's executive vice president of acquisitions — worked. Fleischer, Volk, Long and Fedewa left GE to start Spirit Finance, now Spirit Realty Capital, in 2003. In 2007, Spirit, which is still in operation, was sold. In 2011, the team started STORE Capital.

In 2013, STORE Capital invested in about $837 million worth of net lease properties. That makes the company in the top five of net lease investors, but really the only large player who focuses solely on non-credit rated companies. Volk estimates that the company will acquire $1 billion in assets in 2014. It's a niche in the net lease market that has a

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STORE acquired three Ashley Furniture stores in 2011 to fund a franchisee's operations.

definite need for capital: STORE Capital estimates that 85 percent of companies that have over $300 million in revenue do not have a credit rating.

"We think the marketplace for what we do is huge," says Volk. "The net lease sector is valued at over $2 trillion. Even with all the players in the market today, we can't begin to cover it. We are here to create demand for net lease solutions from companies who can't do that through traditional buyers."

STORE Capital helps companies who traditionally have owned their real estate convert their holdings to net lease. For many, it is a better choice since it gets them out of the real estate business and enables them to focus on their core operations. That said, STORE does not consider itself real estate-centric. It works directly with the companies where it invests, as opposed to just buying real estate. Occasionally, the company also works with developers seeking to buy real estate assets.

"We become a long-term partner for our customers," says Fedewa. "Our market includes any profit centers that are integral to our customers' business."

For STORE, that means defining retail differently than traditional owners of single-tenant retail projects. This has meant doing business with companies like theater chains, fitness centers, service centers, restaurants and family entertainment properties. About 20 percent of STORE's portfolio is considered pure retail. More than 70 percent of the portfolio is service related locations. The balance of the portfolio consists of industrial locations, mainly manufacturing facilities.

"These are companies who have prospered through the recession and they do not have access to capital for growth," says Fedewa. "In this environment, banks are not getting less regulated. We are filling a real need for these types of companies, as evidenced by the $2 billion worth of capital we have placed with them."

One of STORE's recent transactions was a $79 million sale-leaseback investment for a portfolio of Applebee's restaurants owned by a franchisee. STORE Capital's largest transaction to-date was the investment of $105 million in 50 O'Charley's restaurants that were corporately owned. However, even smaller deals make the cut: STORE acquired three Ashley Furniture stores in 2011 to fund a franchisee. Clients have used the proceeds from their sale-leasebacks in various ways. Some use it to expand, others have used the capital to acquire competitors, and others have used it to buy out shareholders. The capital that STORE provides isn't like bank debt; it comes with fewer strings than bank debt. When STORE acquired the real estate assets of the largest franchisee of Popeye's Chicken, it saved the company over $6 million in tax leakage by using its Hybrid Lease product. STORE has a relatively small minimum deal size of $1 million — the company's average deal size is around $12 million — and offers its clients net leases of 15 to 20 years.

"We are here to service the end user of the real estate," says Volk. "The buying we do is a by-product of the number of customers that we can serve. We are going to every customer and saying, 'how can we serve you?'"

As a result of that, the solutions that STORE Capital has are tailor-made to each company. Some may have tax issues that need to be resolved. Others may have structural issues in their capital needs that need to be addressed.

"If we are your landlord, we are replacing traditional bank debt that you would have in a mortgage, but we are also replacing the equity that you would have to place into the real estate," says Volk. "That helps to lower the cost of capital for the retailer."

STORE Capital also makes available to its clients capital for opportunities that may come along with a certain property. For example, if the retailer wants to expand a certain location, it can work with STORE to find a solution. Since STORE Capital owns the location and does not have debt restrictions that limit flexibility, the company can work with the retailer to expand the store. With traditional landlords, the company may have had to forego the opportunity since it might mean the owner would have to restructure traditional bank debt on the property or restructure the lease. Similarly, if a property is not performing well, STORE works with a retailer to develop a solution, even if that means shuttering the location.

"We try to structure our investments so that they have the ability to add more money, if that's called for," says Volk. "We want our clients to be able to capture opportunity value and contain opportunity costs. Our view has always been that financing should create opportunities, not limit them."

In 2013, 15 percent of STORE Capital's investment activity was repeat business and a significant percentage of new business came through referrals from existing clients.

STORE requires retailers to submit unit level financial information so it knows how well each property performs.

"If someone is buying a portfolio of stores, they may not know the data behind every location," says Long. "We get that data. Part of our lease requires the tenant to provide that information so we can

STORE recently made a $79 million sale-leaseback investment for a portfolio of Applebee's restaurants owned by a franchisee.

see which stores are making more money. When we are doing our due diligence with a client, we don't just look at the stores that we are going to buy. We look at all their stores so we know whether the stores we have are 40 percent of their profits or 20 percent."

The property level information helps STORE Capital understand its clients, and the assets that it owns. It wants to create a value for its tenants.

"When you are a landlord, your focus on corporate credit is a little different," says Volk. "You don't have any covenants. We focus on how each property performs. If a restaurant location is performing at $1.5 million in annual sales, that volume transcends credit. When you are investing in profit-producing real estate, you have to focus on the performance of the asset. The store is what pays your rent; corporate credit is there as a back-stop."

The asset managers who invest in STORE Capital have followed the performance of the platforms created by its principals. While STORE Capital has pension fund investors, it has aligned itself with Oaktree Capital Management. Oaktree manages over $80 billion for various pension and endowment clients. Oaktree's clients include 100 of the top 300 global pension plans and 75 of the top 100 U.S.-based pension plans.

STORE Capital feels that it is filling a need for retailers, franchisees and service-based companies. Supply constraint in the net lease market doesn't have as much effect on STORE Capital because it is addressing a large marketplace, where the supply totals more than $2 trillion. The company attempts to buy real estate at values close to the creation value and apply a market cap rate to the property. That way, STORE Capital is providing its clients competitive financing while it doesn't pay a market premium for the real estate.

"We are focused on helping people who need us," says Long. "We joke that a lot of people don't understand what we do. We like to say that we are the wind beneath the wings of these companies. When they are at a cross roads, maybe trying to buy another company or take that next step to grow their business, we can help them do that. Yet, we are behind the scenes. We allow companies to lift themselves and do something amazing." **SCB**