Mattress Firm Is Looking for Lease Flexibility

Earlier this year, ProBank Austin offered an article on leased fee risk for lenders and mentioned Mattress Firm's intention to close roughly 200 stores nationwide. By June 30, 2018, it had closed 149 stores; however it also opened 16 new stores, and acquired 14 franchise stores for a net decrease of 119 stores[1]. Evidently this effort failed to staunch the bleeding. Mattress Firm is now contemplating a bankruptcy filing to force landlords into lease negotiations.

As with the store closures, this will have a ripple effect for owners and their creditors. Mattress Firm has been a landlord's dream tenant: typically, above market lease rates, usually triple net terms or better, low- impact tenancy with no environment issues, and minimal wear and tear. The increased rent translated into an increased leased fee value, often resulting in a higher dollar loan. Those excess dollars became the basis for other investments or cash needs.

The company's lease negotiations via the potential bankruptcy filing will not only result in reduced cash flow and debt service coverage, it may also increase loan to value based on the diminishing cash flow and ultimately value decline. In worst-case scenarios, cash flow may no longer service debt. Or, if negotiations result in vacating the premises, the vacancy could potentially trigger clauses in sister leases within a strip mall or shopping center.

It's time to check the portfolios for Mattress Firm tenancy and analyze the potential impact to clients and loan repayment sources. It won't take long to stress test the cash flow. One scenario is to reduce Mattress Firm lease income to the same or average terms of other tenants using the same lease per square foot and expenses. If it's a standalone building, look at other retail lease rates or vacant spaces available (if the latter, drop it at least 5%). A second scenario takes the newly adjusted Mattress Firm's lease payment 10% below the market while maintaining the same expense pass throughs as other tenants. The third and final scenario looks at the cash flow without Mattress Firm. Utilize local absorption to estimate the window of time before another tenant may be located. Given that most of these have strong locations with visibility and strong traffic counts, the absorption may last less than six months. But, it could potentially be a year or more before a tenant is found. Each location has to be individually assessed. Again, expense terms should match market.

While stress testing, revisit your loan agreement. If there isn't a clause triggering the option to call a loan, an increase in rates, require additional collateral, or a principal reduction due to a significant tenancy change, now is the time to consider the addition of such language. Other retailers are in trouble and bailing from their leases, but the majority of those were within typical market range. Mattress Firm was an outlier.

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[1] http://www.furnituretoday.com/article/555255-matt-firm-turnaround-plan-shows-early-success/

There is no way to protect a portfolio from all scenarios, but understanding the risk and forecasting the potential cash flow issues can help prepare lenders.

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