April 2, 2020

Views and News #2

AmCap 40 YEARS

Transforming Retail Properties.

The View From The Shopping Center

April 1st became the biggest day on the retail calendar, perhaps ever. With rents due, the path ahead for the industry would become clear – or, as with the times, perhaps more confused. As of today, it's still a murky puddle of uncertainty.

We are working with all of our tenants to come up with an equitable solution to the question of paying rent – when and how much. The easiest tenant to find is the one which you already have, so we have no desire to force a situation where a tenant has to leave. The CARES act did contain a way forward for retail landlords. SBA loans for businesses will cover salary and rent payments tax free for two months. We are working with all of our tenants to help them apply for a loan. Once a tenant has applied we will work with them on their rent. However, if the tenant chooses not to apply for an SBA loan then we will have a different conversation.

National credit tenants are going to see a more unified stance from the industry. Discussions with nationals will unfold over the coming weeks, outcomes will vary by tenant and state. We heard from one national tenant yesterday that they will be paying April rent, despite the fact that all of their stores have been closed since mid-March. However, they indicated that they expect to have a dialogue about some sort of forgiveness over time. The irony of all of this – with the passage of CARES, the least credit worthy tenants will likely be current on rent, while those with the deepest pockets may be the first to look for some abatement from the landlord.

Our grocery-anchors continue to be incredibly busy, whether a King Soopers (Kroger), Publix, Target, etc. The inline performance is quite mixed. More stores were deemed essential businesses than expected (a craft store, for example, is essential) so there's been some slight upside in that regard.

CORONAVIRUS EMERGENCY LOANS
Small Business Guide and Checklist

- A borrower is eligible for loan forgiveness equal to the amount the borrower spent on the following items during the 8-week period beginning on the date of the origination of the loan:
  - Payroll costs (using the same definition of payroll costs used to determine loan eligibility)
  - Interest on the mortgage obligation incurred in the ordinary course of business
  - ***Rent on a leasing agreement***
  - Payments on utilities (electricity, gas, water, transportation, telephone, or internet)

US Chamber of Commerce, March 2020

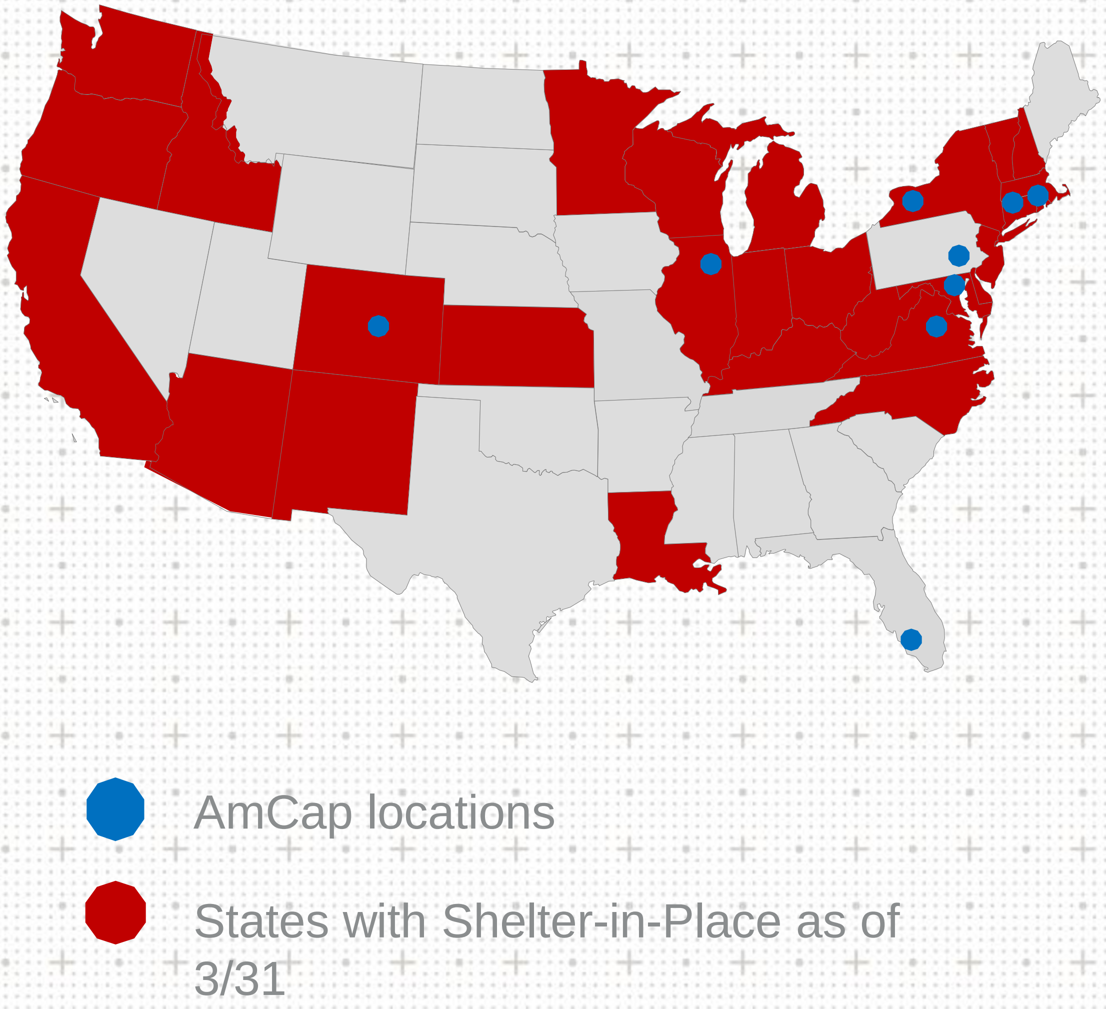
The View…

Most of our centers are located in communities with strong demographics – growth markets, density, etc. This is great for the long term but it's these same markets that have been hit the hardest, or at the very least are located in states where the governors have ordered stay-in-place measures. Traffic as a result has fallen off substantially. Takeout service from restaurants is available, but that isn't replacing their core of business. The home concept is mixed: home improvement is doing ok, but with traffic well off normal, while home furnishings are closed for the duration.

On an operating basis, we are doing everything we can to minimize outlays at our centers and therefore keep CAM charges, etc to a minimum. Garbage pickups have been adjusted (a lot more at the grocers, almost none anywhere else), where we can defer something we are doing so. Construction goes on in some markets, others are shut down. Security is up across the board.

Leasing activity remains relatively good, especially with nationals. Most of the nationals seem committed to their plans. We're moving leases ahead on several fronts with national tenants. Negotiations with inline tenants proceed as well but are much slower – if you're a restaurant planning on opening in six months, you need to sign the lease and get busy getting ready.

Mortgages – no one knows yet what will happen here. We hold much of our portfolio unlevered so not an overwhelming concern across all assets. Where we do have in-place debt there will likely be a conversation with our lender, as will be true with most borrowers and lenders. Even in the GFC the banks were more often willing to work with borrowers than take a property, and we don't think this time will be that different. They don't want to own community shopping centers. The operating requirements are just too high.

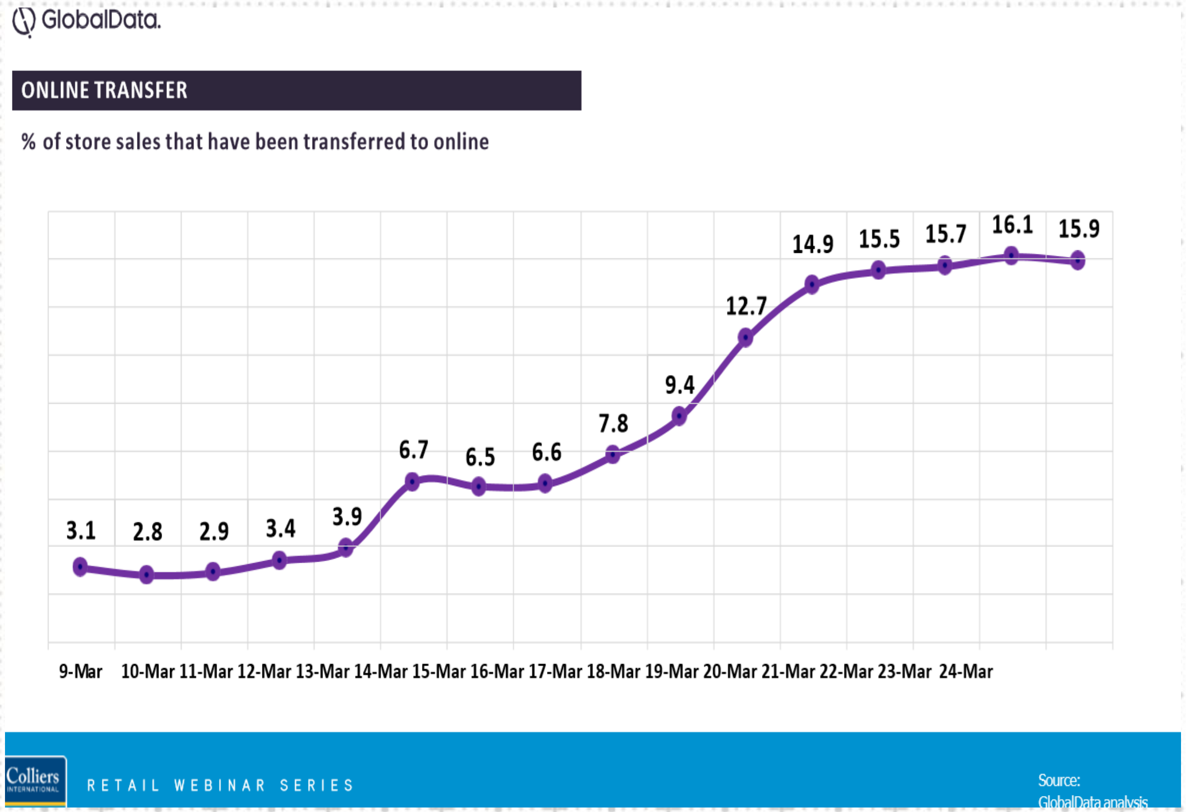


Looking Ahead, A Preliminary View

Nevertheless, there will be some distress. Not every owner will manage through this. Properties may not end up in servicing, but there will be owners who throw in the towel on a well-located center they've owned forever. They simply may not want to handle leasing up vacancy that may develop. We want to be there when that happens.

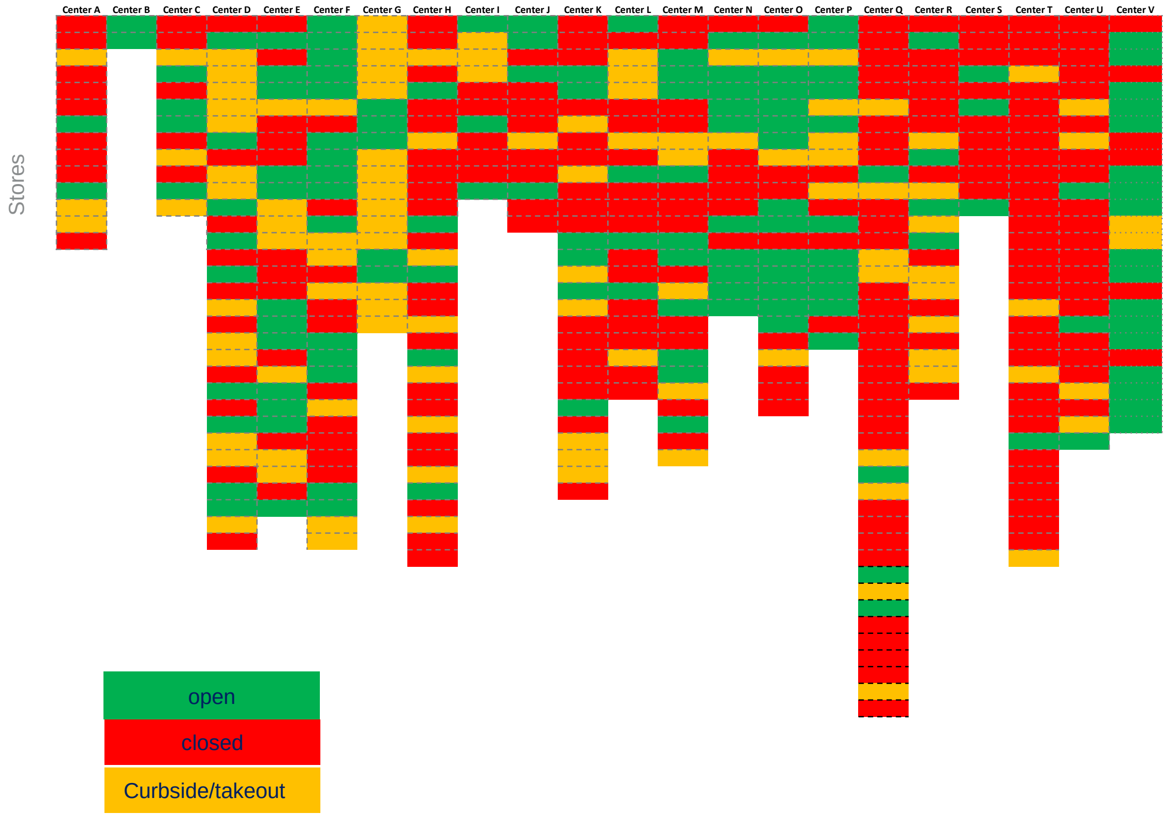
Consumer behavior will change longer term. More people will be comfortable ordering groceries online, so there will be some enduring shift to how the purchase is made. BUT, most of those sales will reside with the local store. The remote delivery concept is not profitable. The caveat to that trend is that people will look at a trip to the store as a social event after being cooped up for weeks. Grocery shopping has always been a mix of need vs. social.

As the neighboring chart shows, for specialty retailers (i.e. the inline tenants) while there has been a spike in online sales the penetration of these sales has stabilized at around 15% of total sales over the past week. We think this is testimony that for a lot of retail, people really do want to see and feel the merchandise.



It's Not The Ghanaian Flag

AmCap's Shopping Center Heatmap as of March 25



We will work to fill in-line vacancy with essential retail. As illustrated to the left, we have some centers where over 60% of our tenants are open and operating, a couple of others rather dark beside the grocer. While we had been making a conscious shift to more necessity types of tenants, I think you'll see more focus in that regard.

We have not seen anything that makes us think the asset type is any less viable than it was. If anything, we think the grocery-anchored concept is proving itself for what is: the center of a community, indispensable in many ways and not going to be disintermediated by a remote fulfillment center. However, we have always thought that this is a winner-take all business. Strong centers with strong grocery anchors will do well, others will fail. That will be true as we emerge from this.

There will be changes to the grocery concept. Regardless, there will be a premium on well-located, infill locations: close to the customer whether for pick up or delivery, easy to access, and supported by other necessity-based tenants.

Pulling It Forward

This will end someday. Our restaurants, salons, gyms, and dentist offices will reopen. Sales will recover, perhaps as illustrated to the right. We have no idea what the impact to NOI will be, whether near or medium term. We are confident, however, that business and tenants will return. Looking at new investments, consider this: the 6-cap center with $1 million of NOI a month ago may now be looking at $700k of NOI, or a value diminishment of $5mm from pre-virus days. Some owners may have been sellers before, and now, with an uncertain future, still want out. We will structure an earn-out with this seller; we will pay a market cap rate for current NOI, and then, as tenants reopen over the following months offer a slightly higher cap rate for the recovered NOI. Perhaps that may entice some anxious owners off the sidelines. We'll have that conversation. We believe in the concept.

Original estimate pre-COVID

Revised estimate

AmCap

Contact Us

We are happy to share our thoughts and perspectives in more detail.

Stephen Chase

Managing Director

schase@amcap.com

203-327-2001