

June 10, 2020

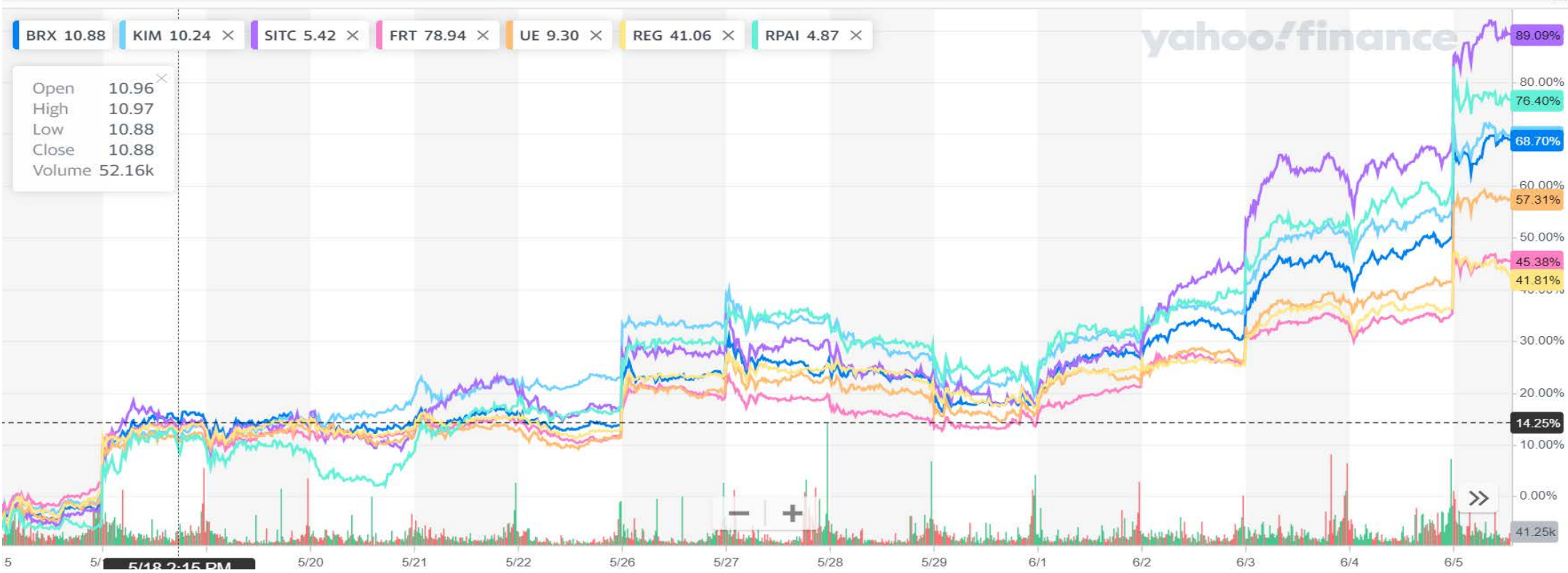


Sharks or Dolphins?



Is it safe to go back in the retail waters?

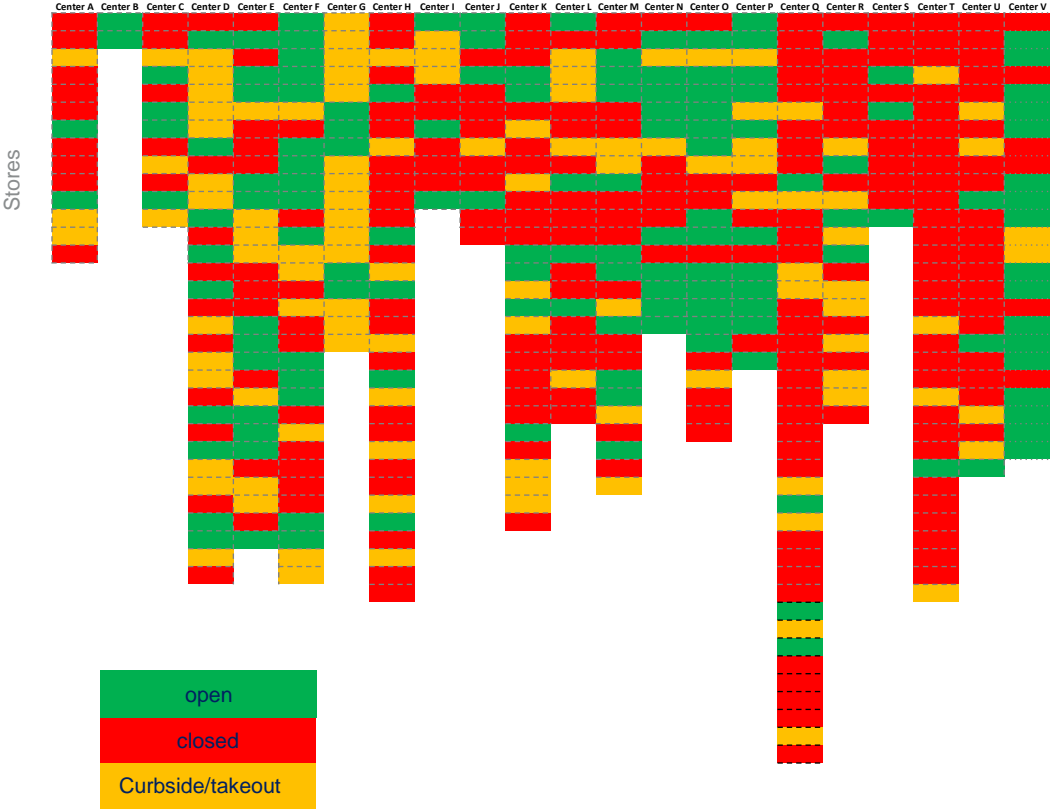
The Market Seems To Think So...



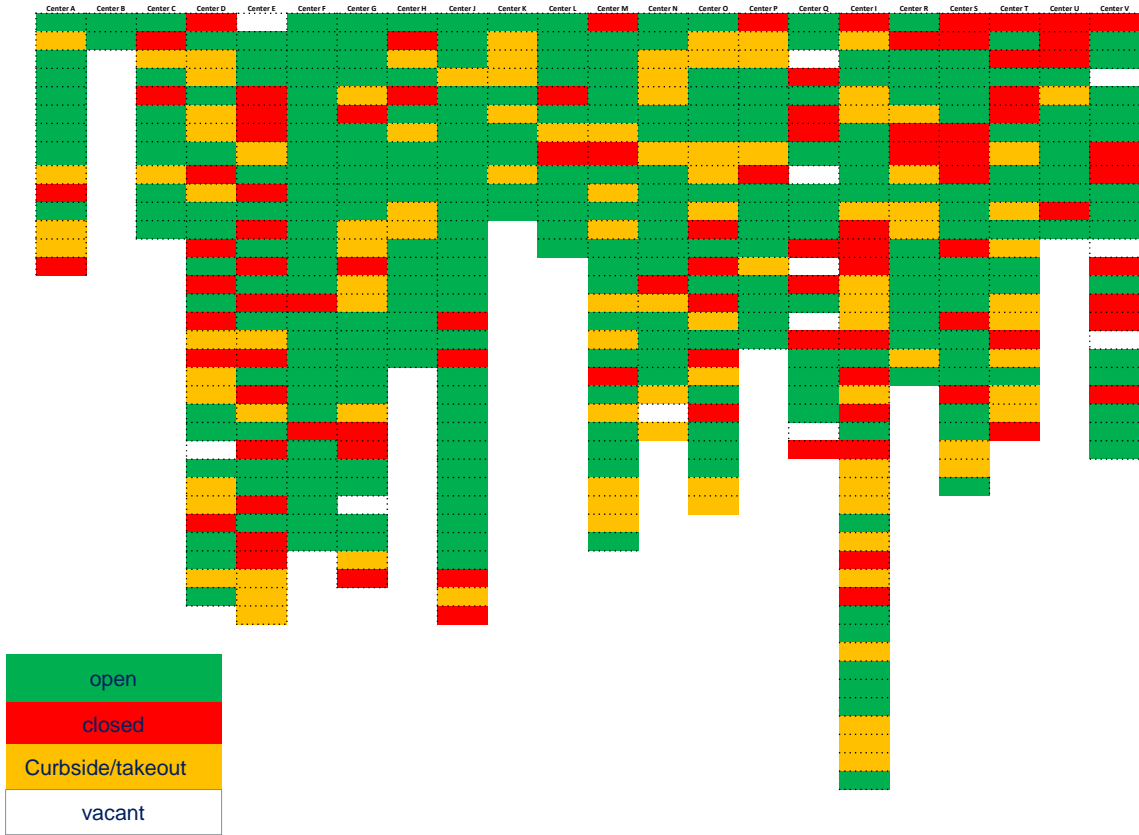
Strip Center REIT Stock Performance Since May 15, 2020
Brixmor, Kimco, Site Centers, Federal, Urban Edge, Regency, Retail Properties of America

Moving In The Right Direction

AmCap's Shopping Center Heatmap, March 25

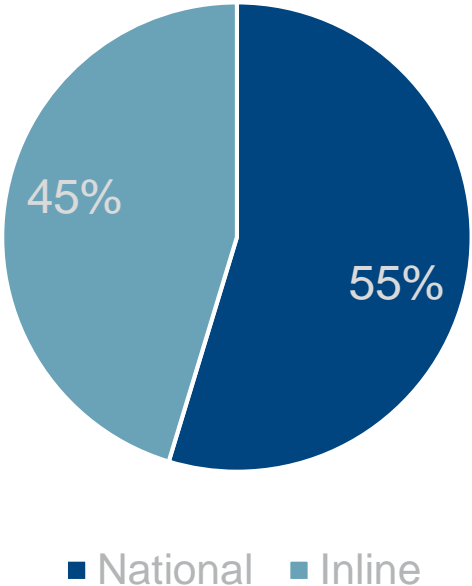


AmCap's Shopping Center Heatmap, June 10

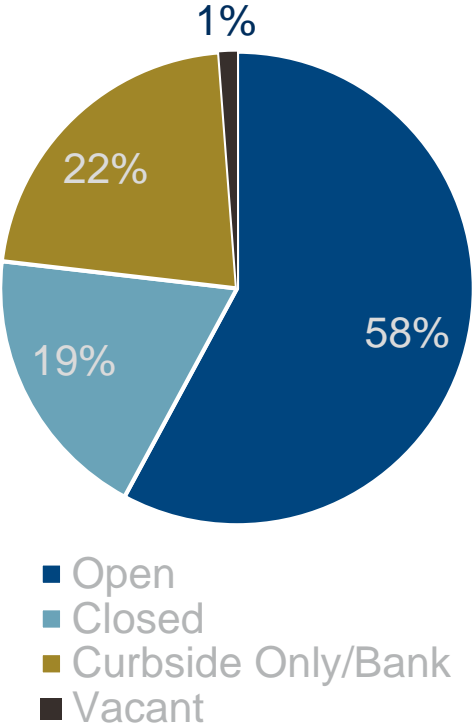


AmCap Tenant Base Snapshot, As of 6/1/20¹

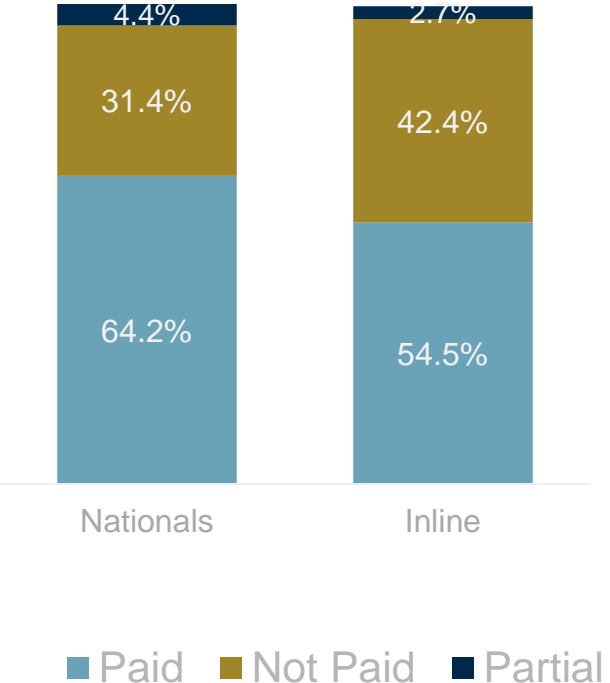
National vs Inline



Open vs Closed



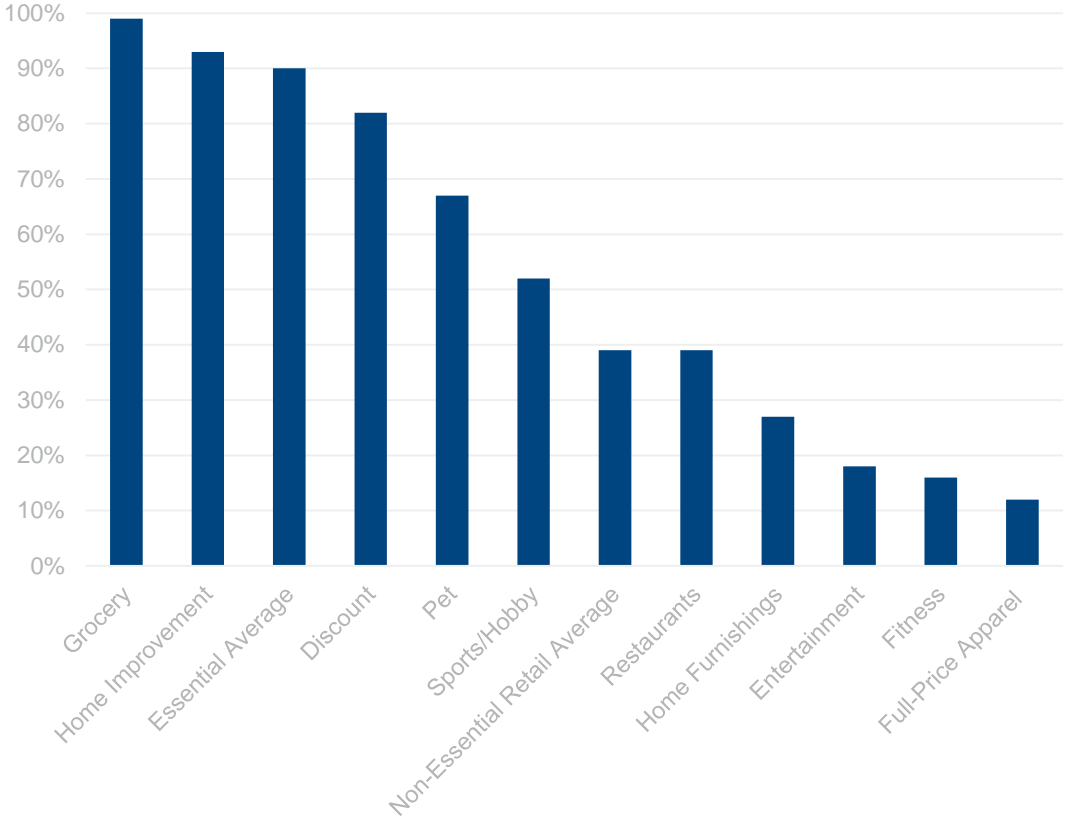
Paid/Not Paid For May



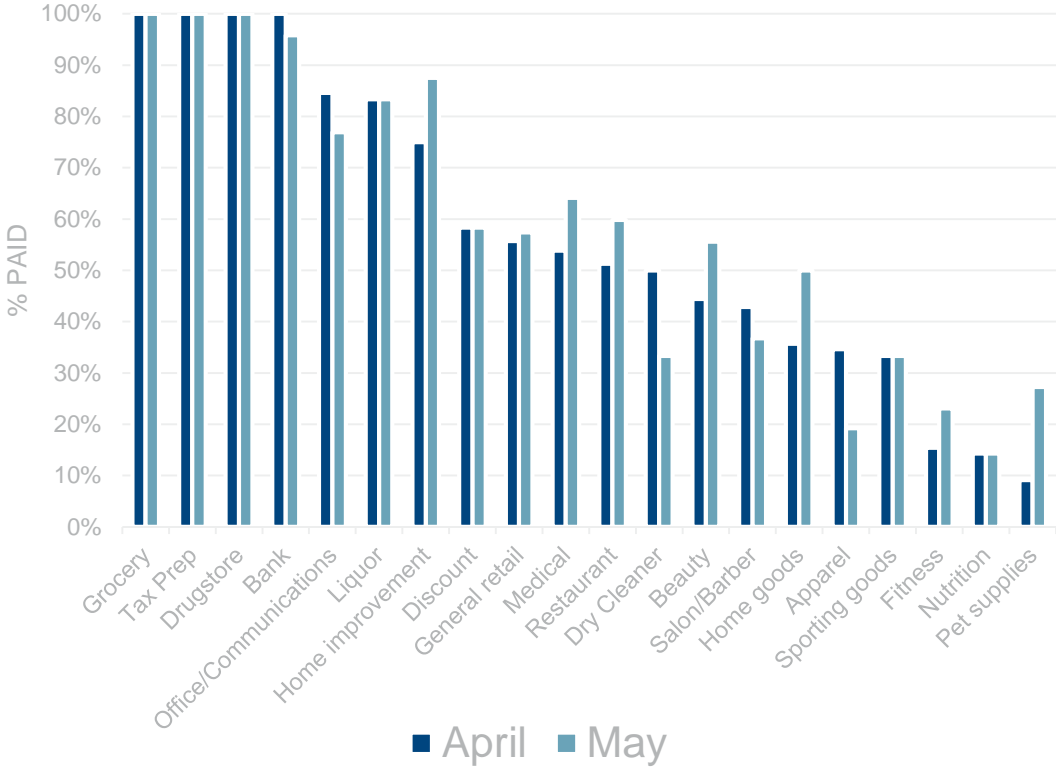
1 Defined by store count

Who paid their rent?

INDUSTRY APRIL COLLECTIONS PER GREEN STREET



% PAID BY TYPE, AMCAP TENANTS¹



Green Street Advisors, Strip Center Sector Update, June 1, 2020

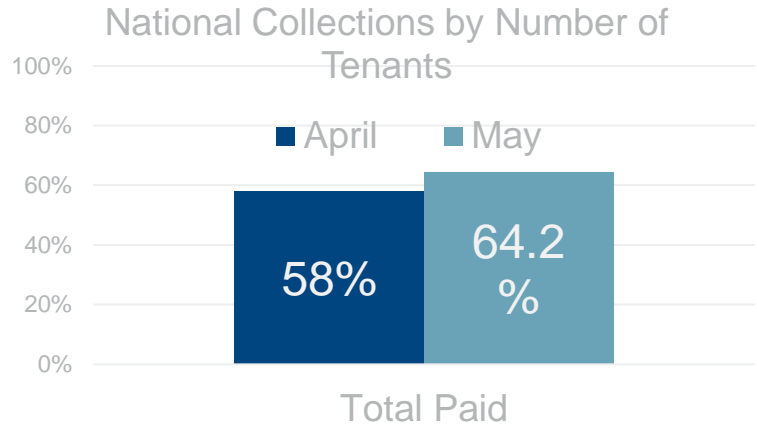
¹ BY STORE COUNT

The Paradox of Size

Shopping centers rely upon a mix of large national tenants and a sprinkling of smaller local store concepts. Historically, the national tenants have credit, mostly good, while the smaller ones may have less, but are personally invested in their business.

Over the years, shopping centers have evolved to include fewer local concepts and more national vendors. Think how a shopping center looks the same in Athens, Georgia or Athens, Ohio.

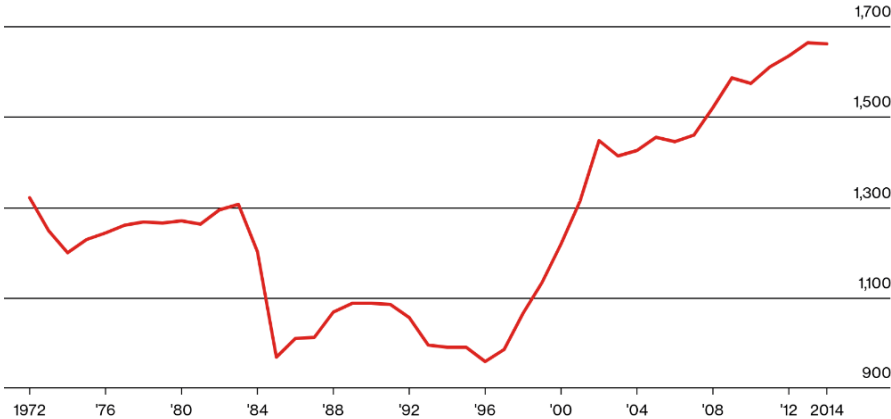
Covid will have a lasting impact on tenant mix. The weak will fold, whether a Pier One or the local pizza guy who's pizza was just not that good. At this time, over 2 million businesses are at risk of going out of business immediately¹. By number, there will be a lot more small stores going under than big ones; healthy, big retailers will get larger, and the landscape will continue to shift to national concepts from local. This is true throughout American business, as reflected in the accompanying chart. Small businesses continue to disappear, and with that, power and economics continues to accrue to the larger players.



¹ America's Recovery Fund Coalition, June 2020

Top Dogs Getting Bigger

A measure of the size of U.S. firms relative to their overall industry



Source: Grullon, Larkin & Michaely 2018
 Note: Herfindahl-Hirschman Index, aggregate level for U.S. publicly traded firms in CRSP and Compustat

As we saw during Covidtime, the larger players don't always play nice. Many of them chose not to pay rent, or chose to argue for greatly revised terms, even some who were open for business. What the industry ended up with looks similar to AmCap's experience, as seen to the left.

This was clearly a case of "we are big so we can get what we want." As the landscape evolves coming out of the downturn, landlords will continue to face the conundrum of whether to rent to a smaller, conceivably riskier local operator, or to the safer but more powerful national tenant. Will future behavior be more like what we saw during Covidtime, when those tenants feel at liberty to exercise their might?

This reinforces the need for a focus on the fundamentals: strong location, strong market, strong grocer as your anchor, strong operator. Those shopping centers will be sought out by nationals and locals alike. Weaker locations will struggle to fill vacancy, and those landlords will have little bargaining power.

The Center of the Future: Essential *plus* E-commerce Proof



“Consumer behavior is changing, and COVID-19 is forcing retail companies to innovate not just for today but for the customers of tomorrow, as well.”
Rachel Elias Wein, “Four Predictions for Post-Pandemic Retail Success,” April 3, 2020.

The Pipeline: Something Needs To Give

Seller expectations have not reset

Debt/Cap spreads have moved some for value-add, but not much

Debt/Cap Spread Core	Low	High
Pre-COVID	2.7 bps	2.6 bps
Current Estimate	2.5 bps	2.5 bps

Debt/Cap Spread Value Add	Low	High
Pre-COVID	2.6 bps	2.8 bps
Current Estimate	2.7 bps	3.0 bps

Based on AmCap estimates comparing low cost debt to low cap rate, higher cost debt to higher cap rate.

Distressed opportunities will slowly emerge. There will be forbearance for zombies, whether companies or landlords, similar to what was seen in Japan and Europe over prior decades. Expect patient lenders through 2020. Forbearance plays a role, but its not the only story. Tired landlords seeking liquidity may be the precursor to any wave of distressed.

Investors need to be creative *and* selective. They cannot just be capital providers - everyone has capital. Provide a solution. The deals are there, they just need to be pried loose, like candy from the hand of a child.

The Answers

Here's how we think the near future just might look:

- 1) We'll be ready for COVID-19, v2.0, and no one will care as much. America has a strange capacity for inuring itself to tragedy.
- 2) At-home grocery delivery fades away along with COVID-19 - hopefully by September.
- 3) Meal delivery gets more expensive, enjoying a fading value proposition as diners venture forth into the world.
- 4) Click-and-collect blossoms across retail. Cruise the parking lot, fill your trunk with groceries, pick up some wine and a pillow to replace the one the dog ate, all without leaving your car.
- 5) You will have a candlelit dinner at a white-clothed table, in that same parking lot.
- 6) Gyms will be open and busy as everyone continues to fulfill New Year's resolutions, but with clean hands and reservations. No showers before returning to the home office.
- 7) There will be casualties in retail – but seriously, it will be like cleaning the basement the first week of Covidtime. Out with the old and in with the new. New concepts and new uses will thrive, and the media will talk about new things instead of re-hashing Retail Armageddon stories.
- 8) Last-mile fulfillment takes up residence at your local power center and/or shopping center. Watch that empty junior anchor or movie theater transform.
- 9) Running to get a Jersey Mike's #7 (Mike's Way) for lunch at your local shopping center will be a happy (and needed) respite from your new home office.
- 10) The shopping center is not going away. You've probably been to one already!



Harris Teeter

Food Market And Pharmacy

Contact Us

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

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