Marcus & Millichap
Capital Corporation

Cap Alert

LATEST DEBT MARKET INFORMATION

June 12, 2020

Assessing the Outlook for Retail as the U.S. Reopens

This week Federal Reserve Chairman Jerome Powell said the Fed was committed "to do whatever we can for as long as it takes" to protect the U.S. economy from the fallout of the coronavirus pandemic. Powell said the Fed will not raise interest rates through 2022. It will also continue its current pace of buying at least $80 billion in Treasurys and $40 billion in mortgage securities, net of maturing bonds, each month.

We're encouraged by the Fed's relentless efforts to provide stability, as well as the reopening of activity in cities across the U.S., which should give a boost to ailing retailers. Marcus & Millichap recently released a special report focused on retail and net lease properties, part of its series "Beyond the Global Health Crisis." Here are key highlights.

Essential and Omnichannel Outperformed

Operators are most likely to receive rent payments from necessity-based tenants, which have prospered during shelter-in-place orders. They include supermarkets, drug stores, and big box chains such as Walmart, Target, Costco, Home Depot and Lowes. Businesses with an omnichannel presence also benefitted as households moved more shopping online. Walmart, for example, saw a 74 percent rise in ecommerce sales in its latest quarter. Dollar stores are also thriving; Dollar General alone plans to build 1,000 new stores and remodel 1,500 more.

"If your establishment was deemed essential retail, it felt like holding a winning lottery ticket," said Scott Holmes, Senior Vice President and Director of Marcus & Millichap's Retail Division. "Regulatory decisions were made city to city and state to state, and there wasn't a lot of rhyme or reason to it. Marijuana dispensaries, which weren't even legal until recently, were put into the essential category, but mom and pop restaurants had to shut down."

Restaurant chains offering drive-through, mobile ordering and delivery outperformed. "Starbucks closed some units because of staffing issues, but its stores did 85 to 150 percent of pre-COVID volume," Holmes noted. "Sales of pizza also rose significantly during shutdowns. It's considered a 'safe food' -- cooked at a high temperature and put straight into a box – and it's also a comfort food."

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Indoor Malls Continue to Suffer

In recent years many malls have replaced department stores with movie theaters, restaurants, gyms and other experiential offerings, which are now straining to comply with social distancing and increased sanitation, the report noted. Garden Fresh Restaurants, which owns 97 Souplantation and Sweet Tomatoes restaurants, filed Chapter 7, saying it could not adapt its buffet-style model to new restrictions.

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The workout chain 24 Hour Fitness Worldwide, which has 440 clubs in 14 states, recently reopened some locations, but is struggling financially. S&P Global Ratings lowered its debt rating from 'CCC+' to 'D' on June 5. "Gym operators have put in place unbelievably stringent cleanliness and sanitizing processes," Holmes said. "But they may permanently lose some customers who invested in home equipment during the shutdown."

There are roughly 600 large enclosed malls around the country, and many in secondary and tertiary markets. "Some of those may get turned into Amazon distribution centers because they occupy the only big piece of land at the intersection of two major highways," Holmes said.

Single-Tenant Net Lease Assets Shine

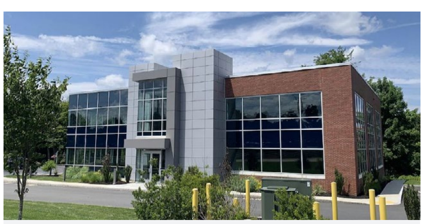
Single-tenant net lease assets continued to perform quite well in categories that remained open, and even those affected by shutdowns are holding their own due to strong balance sheets, the report noted. Lenders and investors are showing renewed interest in single-tenant net lease properties, which are typically in well-trafficked locations, and are highly flexible if a store goes out of business. Supermarkets, drug stores and drive through restaurants are all potential tenants.

Marcus & Millichap, which closed 2,000 single-tenant net lease deals in 2019, is seeing a surge in investor demand for triple net lease assets for investors involved in 1031 exchanges, since the Internal Revenue Service pushed the deadline for these deals to July 15.

On the lending side, banks and credit unions continue to finance retail deals on lease-in-place properties anchored by strong tenants, including supermarkets, drug stores, quick-service restaurants, bank branches and medical offices, such as dialysis clinics. We are seeing terms of 5, 7 and 10 years, LTVs averaging 65 percent, and coupon rates ranging from 325 to 450. Life companies are also in the market, but their credit box is much narrower. Indoor malls and mixed-use retail occupied by department stores, which are facing deficiencies in collections, are much more challenged. On the CMBS side, retail delinquencies rose 647 basis points to 10.14 percent, the biggest jump since 2009, according to Trepp.

Over the past 15 months, MMCC has helped clients close more than 940 loans on retail properties with more than 175 different lenders. With interest rates at historic lows, our ability to clear the market can help owners and investors position their portfolios appropriately in a volatile environment.

RECENT TRANSACTIONS



NET LEASE

Marlborough, MA

- $5,785,000
- 4.03% Fixed
- 5-yr term/30-yr amort.
- Recourse, 65% LTV, no prepayment penalty
- Locked rate at application, no reserves, including no cash management

RETAIL

Prosper, TX

- $3,488,688
- 4.00% Fixed
- 1 yr I.O.
- 5-yr term/25-yr amort.
- 2nd lien financing behind an existing 1st lien secured by grocery anchored shopping center

NET LEASE

Bridgeton, MO

- $2,191,500
- 3.64% Fixed for 10 yrs on a 7 year lease
- 10-yr term/15-yr amort.
- Recourse

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