Hope lingers, but retail real estate is in for a long journey back to profitability

BY MATT BAKER

With stay-in-place orders keeping customers at home, the retail sector is set to face pressure unlike other asset classes. And as the NOIs at retail properties contract, that financial stress will radiate up the real estate infrastructure, from retailers shuttering their stores, to landlords unable to collect rents to lenders themselves.

How much pain retailers feel is directly tied to how long our pandemic countermeasures are kept in place. As of this writing, for example, Dallas County's "Safer-at-Home" order is in effect until April 30, which rescinded and earlier extension by the commissioner's court approving the county's disaster declaration until May 20.

"If we open the doors May 1, I think we will just fine. If we open the doors on June 1, there's going to be collateral damage," said Jennifer Pierson, managing partner at Dallas-based STRIVE. "If we go into August, I don't think the word 'severe' would be an understatement."

Before the pandemic, retail was already suffering as e-commerce took its toll and consumers opted to shop from home. The one shining segment of the sector was experiential retail, a tag applied to everything from fitness centers to DIY pottery shops, but which is largely comprised of restaurants and bars.

With shelter in place orders now keeping consumers away from these establishments too, many are in dire straits. The $2.2 trillion Coronavirus Aid, Relief and Economic Security (CARES) Act, passed by Congress and signed into law by President Donald Trump on March 27, seeks in part to address this issue. As written, however, the CARES Act may not have enough protections in place for small, independent restaurants and bars or their employees.

"While we initially thought that that was a fitting safety net, I think the net's got pretty big holes," Pierson said. "There are all these little gotchas that you don't think about until you're diving into the details."

One portion of the CARES Act, the Paycheck Protection Program (PPP), is intended to assist workers like waiters and waitresses. The funds go to the business, who must use 75 percent of the financing to compensate employees at their standard wage over an eight-week period if the loan is to be forgiven—a tall order for a business that still has to pay rent, utilities and other costs with little or no income coming in.

According to Pierson, the forgivability of the PPP loan is unclear and it may even incentivize some businesses to lay off employees and attempt to re-hire them later. She also expressed concern for the high population of Hispanic business owners in the Dallas-Ft. Worth metro and elsewhere in Texas who may be daunted by the application process.

"There are a lot of landlords who specifically target shopping centers that have a high population of Hispanic tenants," said Pierson. "Speaking in broad

strokes, the demographics are such that they are very honest, hardworking people that want to pay their rent and support their family. There are a lot of investors who have made a model of seeking shopping centers that are leased to Hispanic business owners."

This minority group already faces higher scrutiny when seeking out traditional lending and they might be further intimidated by the process of applying for PPP protection. According to Pierson, some shopping center owners are reaching out to Hispanic tenants to help them get online and are even reading the language of the act to them in some cases if the tenant doesn't speak English.

It's probably too early to tell if owners of shopping centers or retail-heavy mixed-use properties are inspecting the marketplace for a possible disposition. Until landlords approach a position where they cannot cover their debt service, most are unlikely to consider a sale right now.

"We're hearing almost across the board that the bank lenders who have these properties on book are working with the landlords and the landlords are passing that savings through to the tenants," Pierson said. "It's really a tale of what kind of lender you have."

If a borrower has a loan that has been securitized, they are going to have a tougher time getting principal and interest relief from that lender, and therefore those tenants are going to suffer for it. CMBS lenders and REITs, which don't have a backdrop of federal aid, are largely holding firm in expecting tenants to pay their rent.

Banks—which account for the majority of financing on retail assets—have contracted considerably with few, if any, putting money out for retail products. Because of that, there would be a pretty extreme widening of cap rates for a property that has suffered severe damages.

It's a scary time right now—both because of the health risks from COVID-19 and the financial worries for those heavily leveraged by retail real estate. But a combination of cabin fever and flattening curves means that, hopefully, we will be out of our homes soon and the retail industry can start to heal. ■