BEYOND THE GLOBAL HEALTH CRISIS

IPA INSTITUTIONAL PROPERTY ADVISORS

Special Report

Retail

THIRD QUARTER 2020

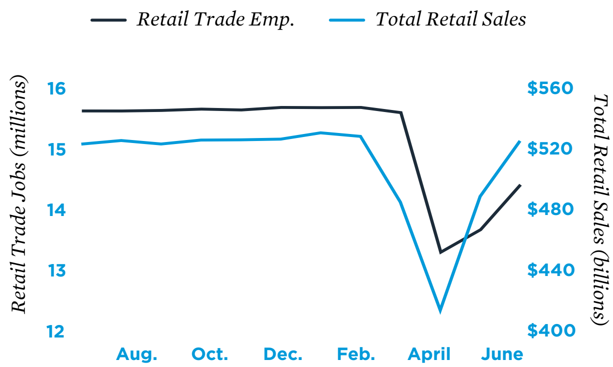
Market Looks Toward Recovery as Consumption Strengthens; Scale of Damage to Retailers Still Evolving

Spending recovers as economy reopens. Stimulus and fewer business restrictions propelled the retail market during the past few months. As the central bank and federal government flooded the economy with liquidity, personal income soared by $1.4 trillion in the second quarter, more than seven times the rise in the first quarter. As a result, retail sales had nearly returned to pre-health crisis levels by midyear. However, several states slowed their reopening process due to a spike in positive COVID-19 tests, which could restrain consumer spending in the final five months of 2020. Meanwhile, less than half of retail trade jobs have been recovered, indicating there may be some potential upside on the employment front.

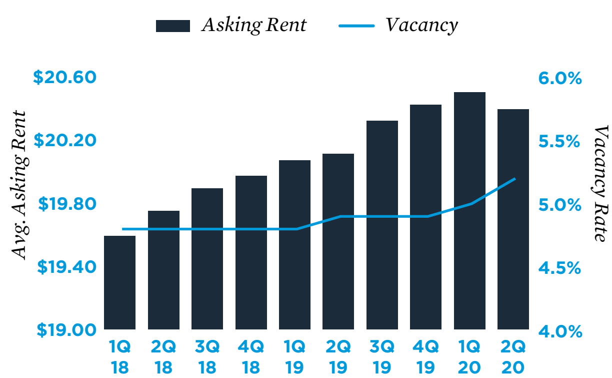
Retail property fundamentals soften. In the second quarter, retail vacancy ticked up 20 basis points to 5.2 percent while asking rents dipped 0.5 percent to $20.39 per square foot. Although still tight by historical standards, the true impact of a partial economic shutdown may not be reflected in vacancy for several quarters. While property owners have been accommodative through the crisis and Paycheck Protection Program (PPP) loans prevented many shuttered tenants from becoming delinquent, the ramifications of this recession will be pronounced in the second half of the year. Unlike during the global financial crisis when many retailers slowly withered over a six-quarter downturn, an abrupt recession will condense business failure timelines. Consequently, some retailers may be spared due to reduced competition.

Investment market fragmented. Single-tenant properties occupied by an essential business will attract buyers, often at prices near or above those paid prior to the recession. Investors are also searching for distressed assets when available. Dispersed working conditions and uncertainty weighed on sales velocity in the early stages of the pandemic. Although limited relief in the sales market was reported in late June and early July as the extended 1031-exchange deadline approached, challenges with closing deals have persisted into the third quarter. Underwriting assets for a post-pandemic economy is hampering decision making for buyers and sellers. Other barriers are abating, such as showing properties or obtaining financing from banks tasked with distributing a significant share of CARES Act funds.

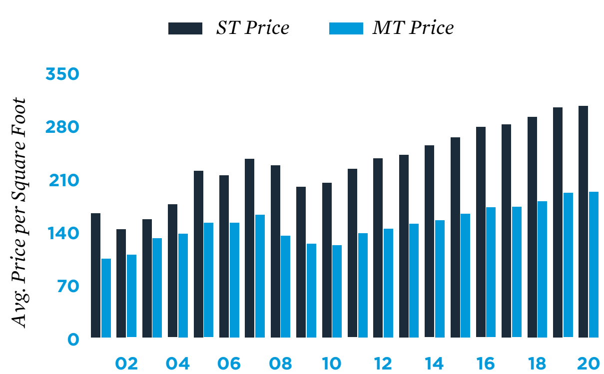
Retail Sales Return Ahead of Jobs



Fundamentals Weaken in 2Q



More Price Discovery Expected in Second Half



* Trailing 12-month period through second quarter
Sources: Bureau of Economic Development; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

Power and Grocery-Anchored Shopping Centers Attract Traffic; Some Tenants Migrating From Malls to Lifestyle Centers

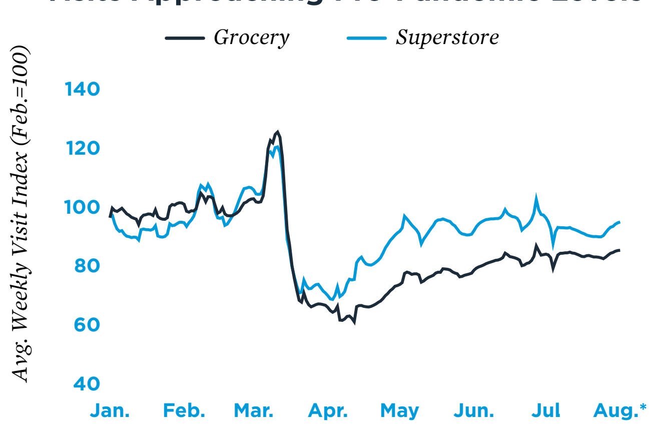
Multi-tenant properties prepare for closures. In the second quarter, vacancy at multi-tenant assets ticked up 20 basis points to 6.1 percent as thousands of store closures were announced. Many of the prominent concepts were among typical mall tenants, though this trend was already gathering momentum prior to the pandemic as shoppers gravitated toward experience-based retailing. The harm done to small retailers that have been closed for an extended period should come to light in the second half of this year. A sizable percentage of these stores are expected to permanently shutter due to the health crisis. Stores located in centers with a traffic-generating anchor or those in areas that reopened faster are better positioned to weather the health crisis.

Neighborhood centers poised to benefit from tenant shuffle. Anchored centers with grocers will be able to refill available space as local economies move closer to being fully opened. Smaller concepts with expiring leases that occupied space in strip centers, particularly mid-block properties, should begin migrating to more trafficked centers in the coming weeks. Approximately 43 percent of the space that has been returned to the market thus far in 2020 lies in neighborhood centers, by far the largest amount among the product types. Another motivating factor for retailers to transition to neighborhood centers is suburbanization. Some shops will follow their target demographic into the suburbs, while others may transition to new markets across the Sunbelt that are receiving former residents of the Northeast and West Coast.

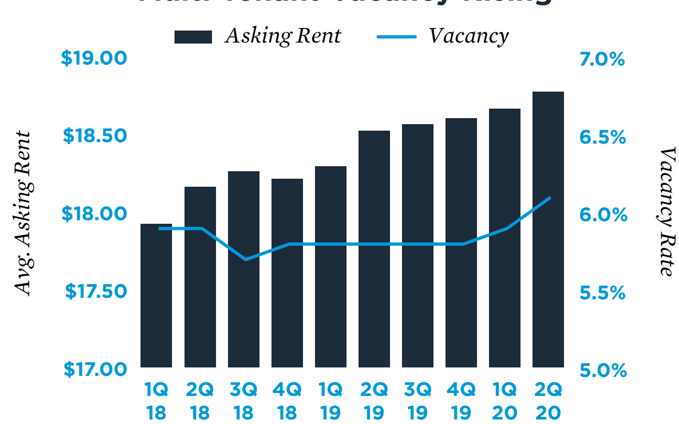
Power centers outperform. The prevalence of essential retailers in these shopping centers has kept operations among the strongest in the market. Only 6 percent of year-to-date negative net absorption has occurred in the sector. Many of the essential retailers that occupy power centers are reporting an increase in earnings due to the pandemic despite a decline in foot traffic. Costco, for instance, had a 9 percent decrease in the average daily visitors in July relative to February. At the same time, sales increased by $800 million, or 6 percent, indicating cart sizes have grown significantly. The ability to remain open while smaller retailers shuttered, and the attractiveness of a one-stop trip will remain a competitive advantage through the health crisis. Some of the market share achieved by superstores is anticipated to be retained beyond the pandemic.

Lifestyle centers may benefit from challenges at malls. Year to date, approximately 25 percent of newly vacant space has occurred at malls as several prominent concepts announced closures. GNC, Gap and Victoria's Secret are among the retailers that will dramatically shrink their footprints due to the health crisis. However, many regional malls were already struggling to compete against more popular lifestyle centers and super regional malls. As the market resizes, many malls will not reopen even after getting a green light from local authorities. Lifestyle centers, meanwhile, will attract tenants from dead malls rather quickly as cotenancy clauses are triggered. Vacancy at lifestyle centers may begin recovering prior to the holiday shopping season, particularly if a medical solution is widely available by the end of the year.

Visits Approaching Pre-Pandemic Levels



Multi-Tenant Vacancy Rising



* Through Aug. 7
Sources: CoStar Group, Inc.; Placer.ai

Most Metros Face Softening in Retail Fundamentals in Second Quarter

Market	Vacancy	Quarterly Change	Average Asking Rent	Quarterly Change
Atlanta	5.8%	30	$15.28	0.1%
Austin	4.7%	40	$22.11	1.0%
Baltimore	5.6%	40	$20.77	2.5%
Boston	3.5%	20	$20.58	-3.7%
Charlotte	4.8%	40	$17.25	-0.2%
Chicago	6.8%	30	$17.08	-0.2%
Cincinnati	4.5%	-	$12.12	0.0%
Cleveland	5.2%	30	$11.83	2.4%
Columbus	3.7%	20	$13.52	2.8%
Dallas/Fort Worth	6.2%	50	$17.13	-0.6%
Denver	5.3%	30	$17.74	-3.1%
Detroit	5.9%	30	$14.97	2.0%
Fort Lauderdale	4.9%	30	$23.61	-1.7%
Houston	6.5%	50	$18.18	1.8%
Indianapolis	5.3%	(10)	$13.50	1.4%
Jacksonville	5.0%	(20)	$15.46	0.0%
Kansas City	5.9%	10	$13.26	0.9%
Las Vegas	7.3%	(10)	$19.79	-0.7%
Los Angeles	5.3%	10	$32.14	0.2%
Miami	4.2%	10	$33.63	-2.6%
Milwaukee	4.7%	-	$12.63	-3.2%
Minneapolis-St. Paul	4.0%	40	$15.69	-0.3%
Nashville	3.5%	-	$20.47	0.6%
New York City	3.7%	-	$63.57	-5.3%
Northern New Jersey	4.4%	20	$23.98	-1.0%
Oakland	4.3%	10	$29.63	-0.6%
Orange County	4.4%	20	$29.27	1.1%
Orlando	5.0%	10	$20.73	5.4%
Philadelphia	5.2%	(10)	$18.06	0.6%
Phoenix	7.9%	10	$15.84	-2.6%
Portland	4.1%	30	$19.31	-0.2%
Riverside-San Bernardino	9.0%	40	$18.54	-6.6%
Sacramento	6.7%	20	$17.98	0.8%
Salt Lake City	5.5%	30	$16.28	-1.5%
San Antonio	5.3%	20	$17.08	1.7%
San Diego	4.7%	20	$24.54	-0.6%
San Francisco	3.7%	20	$42.19	-1.6%
San Jose	3.9%	(10)	$35.12	-1.0%
Seattle-Tacoma	2.9%	10	$21.50	0.6%
St. Louis	4.7%	20	$13.79	1.8%
Tampa-St. Petersburg	5.0%	-	$17.10	1.3%
Washington, D.C.	4.9%	10	$25.97	-1.1%
West Palm Beach	5.1%	40	$24.48	2.0%
United States	**5.2%**	**20**	**$20.39**	**-0.5%**

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Sources: IPA Research Services; Bureau of Labor Statistics; Bureau of Economic Analysis; CoStar Group, Inc.; Placer.ai; Real Capital Analytics; U.S. Census