BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

SPECIAL REPORT RETAIL

FOURTH QUARTER 2020

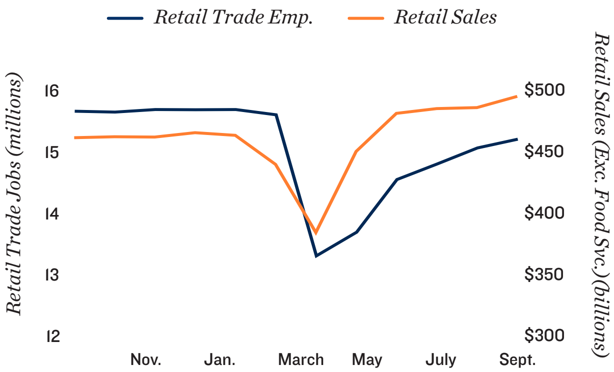
Retail Operating Fundamentals Soften in Third Quarter; Widespread Weakness Avoided as Some Sectors Remain Healthy

Retail market faces new realities and old challenges. Although the health crisis has not yet significantly weakened retail fundamentals, the number of announced store closings and shift forward in online shopping will reshape some of brick-and-mortar retail. The likelihood of more persistent weakness will be isolated to older malls, though a failure to find a solution to the health crisis in the near term could present long-term challenges elsewhere. Malls have long been struggling to maintain occupancy levels, and the health crisis accelerated that trend. The pandemic also increased a preference to online shopping. Nonstore retailers have recorded a 22 percent increase in retail sales since from February to September, and a significant portion of that shift could be retained after the pandemic is over.

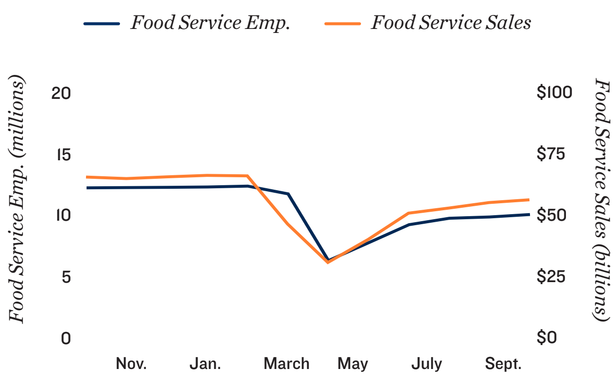
Retail employment gains dependent on reopening and a vaccine. Many retail trade workers have been added back to payrolls since February. Of the 2.4 million workers who lost their jobs in March and April, only 480,000 are still not on payrolls. The cuts represent a 3.1 percent decline in the sector, well below the average decrease across the nation as workers have shuffled to new positions. Nonetheless, recouping additional positions may prove to be challenging until occupancy constraints are lifted. That trend is particularly difficult for restaurants, which are not included in the retail trade sector. Another 2.3 million residents formerly employed at food services and drinking places have not been rehired within the industry, representing nearly 19 percent of positions predating shutdowns.

Investors elevating due diligence to deploy capital. After falling dramatically during the second quarter, retail property sales improved in the third, though volume remains well below the pre-health crisis pace. Before large-scale lockdowns and dispersed working, quarterly transaction volume generally ranged between $15 billion and $20 billion, whereas sales volume was $10 billion in the third quarter. In the spring period, sales volume fell to $7 billion. Single-tenant, net lease assets occupied by a creditworthy tenant are the most sought after by buyers completing the upleg of a 1031 exchange. Other assets generally favored by investors are grocery-anchored neighborhood and community centers, and power centers. As the disparity in reopening strategies begins to become clearer, investment activity will also take on a more geographical focus in the coming months.

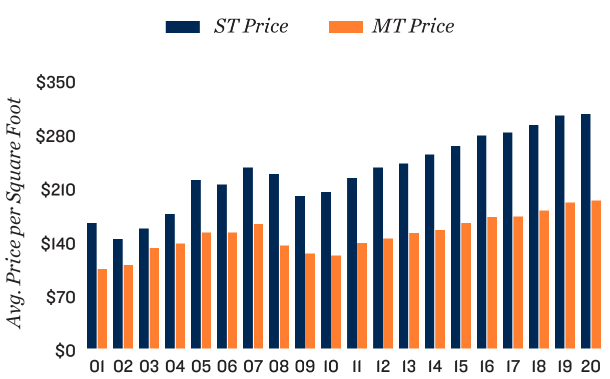
Retail Sales Return Ahead of Jobs



Restaurant Jobs Face Steep Recovery



Year-over-Year Prices Leveling



* Trailing 12-month period through third quarter

Sources: Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics; U.S. Census Bureau

Multi-Tenant Retail Awaits Tenant Shuffle Following Health Crisis; Holiday Sales Could Benefit From Reduced Travel

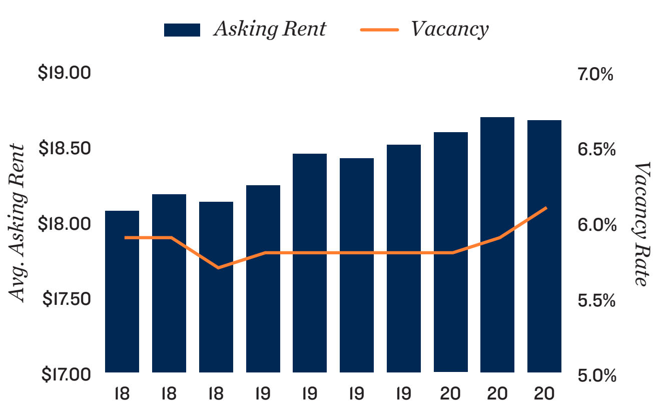
Multi-tenant operations most at risk in post-pandemic world. Vacancy at multi-tenant properties increased 40 basis points in the third quarter to 6.4 percent. The rate was last matched in the first half of 2017, and further erosion is anticipated in the coming months. Malls and neighborhood centers have weighed on the overall rate, with increases of more than 100 basis points since the beginning of the year. The discrepancy between neighborhood centers with grocery stores and those with nonessential anchors, such as apparel stores, has created a divide. Even with a grocery anchor, some in-line retailers have shuttered permanently due to extended closure restrictions. An impact on rents has not emerged nationally.

Future bifurcated for multi-tenant retail. There is little doubt a shakeout in the multi-tenant retail sector will transpire following the health crisis. Online retailing will maintain a significant share of overall sales, and consumer behavior is likely to be transformed permanently until a solution to the health crisis is widely distributed. However, some return to normalcy will occur for a significant number of shoppers. Lifestyle centers are anticipated to rebound, and a greater mix of smaller retailers are expected to migrate to these properties, where foot traffic is stronger, replacing some permanently closed restaurants. Power centers have benefited from the pandemic due to the prevalence of essential businesses, though some of the gains in customer traffic could be surrendered as shoppers are offerred more options when the entire market opens.

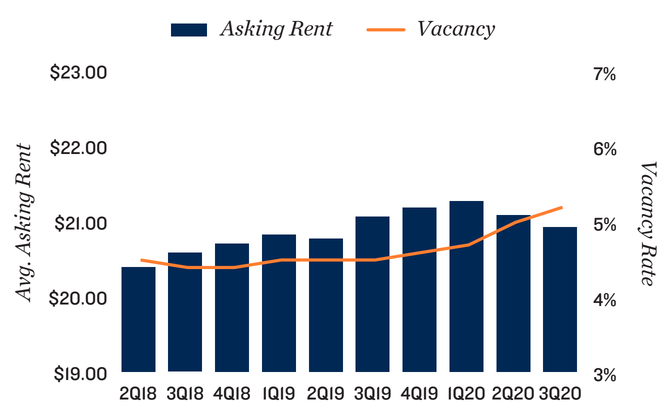
Most single-tenant retailers poised to outperform in short term. Some weakness in the sector has emerged as experience-based retailers struggled, though a sizable share of standalone tenants should be able to weather the crisis. Overall, vacancy in these properties inched up 20 basis points in the third quarter to 5.2 percent while rents softened modestly. Areas of strength in the sector include quick-service restaurants with a drive-thru lane and essential retailers such as drugstores. Big-box retailers that have been allowed to continue to operate through the downturn are also reporting strong sales. As the prospects for a widely distributed vaccine extend into 2021, and another wave of infections occurs across the country, more standalone retailers could be damaged without additional federal stimulus.

Holiday sales outlook has potential for upside. A combination of factors could boost retail sales above 2019 levels despite significantly higher unemployment. Following the election, a deal to inject a new round of stimulus could move forward without political entanglements. The potential for a new round of checks sent to all Americans could provide a boost for retailers. Furthermore, bipartisan support for a resumption of unemployment benefits, potentially retroactive, will move cash into consumers' hands, even those who are still searching for jobs or awaiting the return of former positions. Finally, a lack of travel and entertainment options will encourage shoppers to purchase retail items. If these factors come together, holiday sales could outpace the 4 percent growth recorded last year.

Multi-Tenant Vacancy Rising



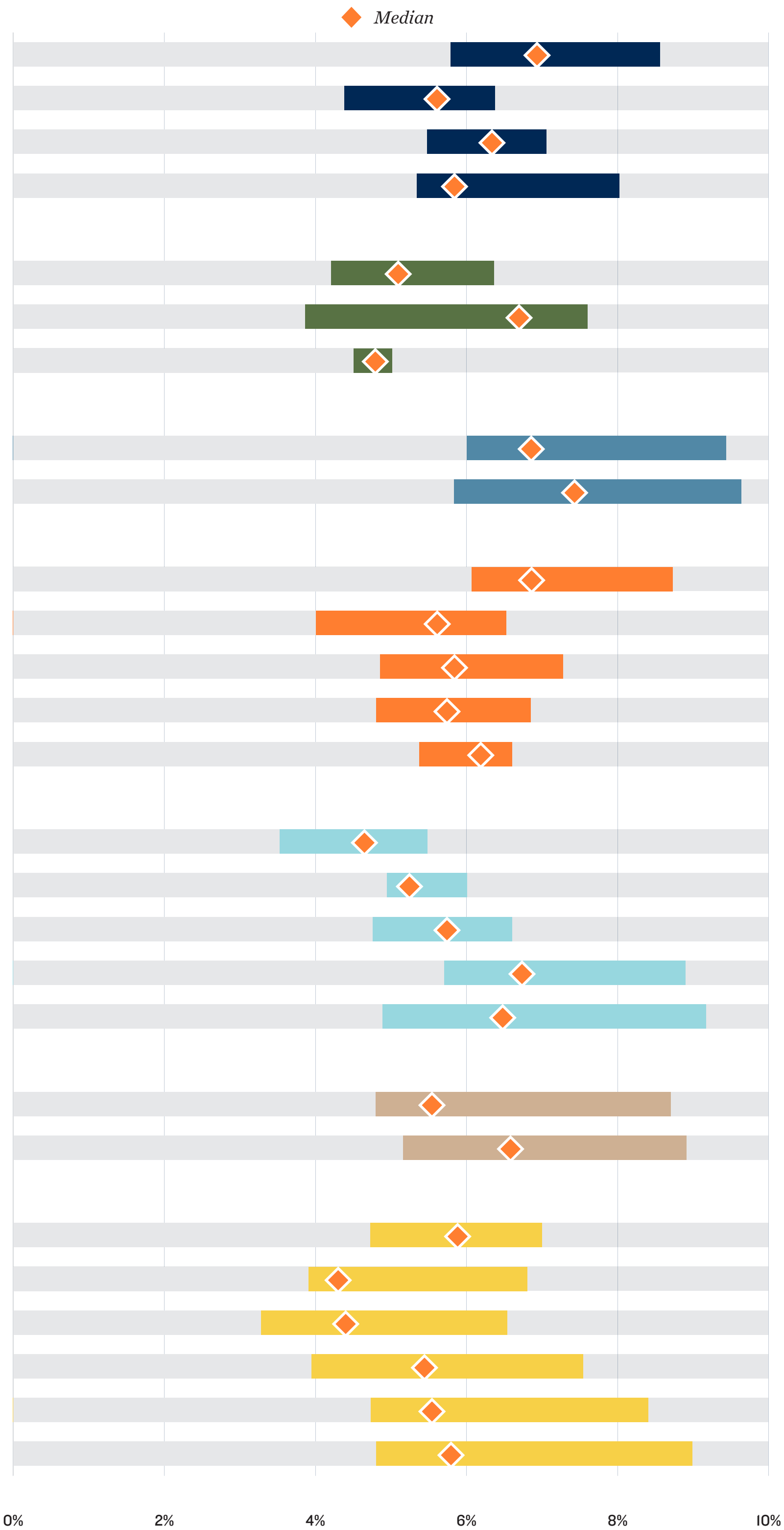
Single-Tenant Vacancy Inches Up



Source: CoStar Group, Inc.

Brand	Locations*
Auto Parts	
Advance Auto Parts	4,276
AutoZone	5,815
Caliber Collision	1,062
O'Reilly Auto Parts	5,477
Convenience Stores	
7-Eleven	8,707
Circle K	6,250
Wawa	815
Dollar Stores	
Dollar General	16,278
Dollar Tree/Family Dollar	15,288
Fast Casual Restaurants	
Applebee's	1,682
Bloomin' Brands	1,214
Chili's	1,238
Darden Restaurants	1,812
Red Lobster	749
Grocery and General Retail	
Aldi	1,987
Safeway	895
Sherwin-Williams	4,415
Verizon Wireless	1,703
Walmart	5,078
Pharmacies	
CVS	8,131
Walgreens	8,916
Quick Service Restaurants	
Burger King	7,566
Chick-fil-A	2,497
McDonald's	15,338
Starbucks	16,752
Wendy's	6,289
Yum! Brands	18,841

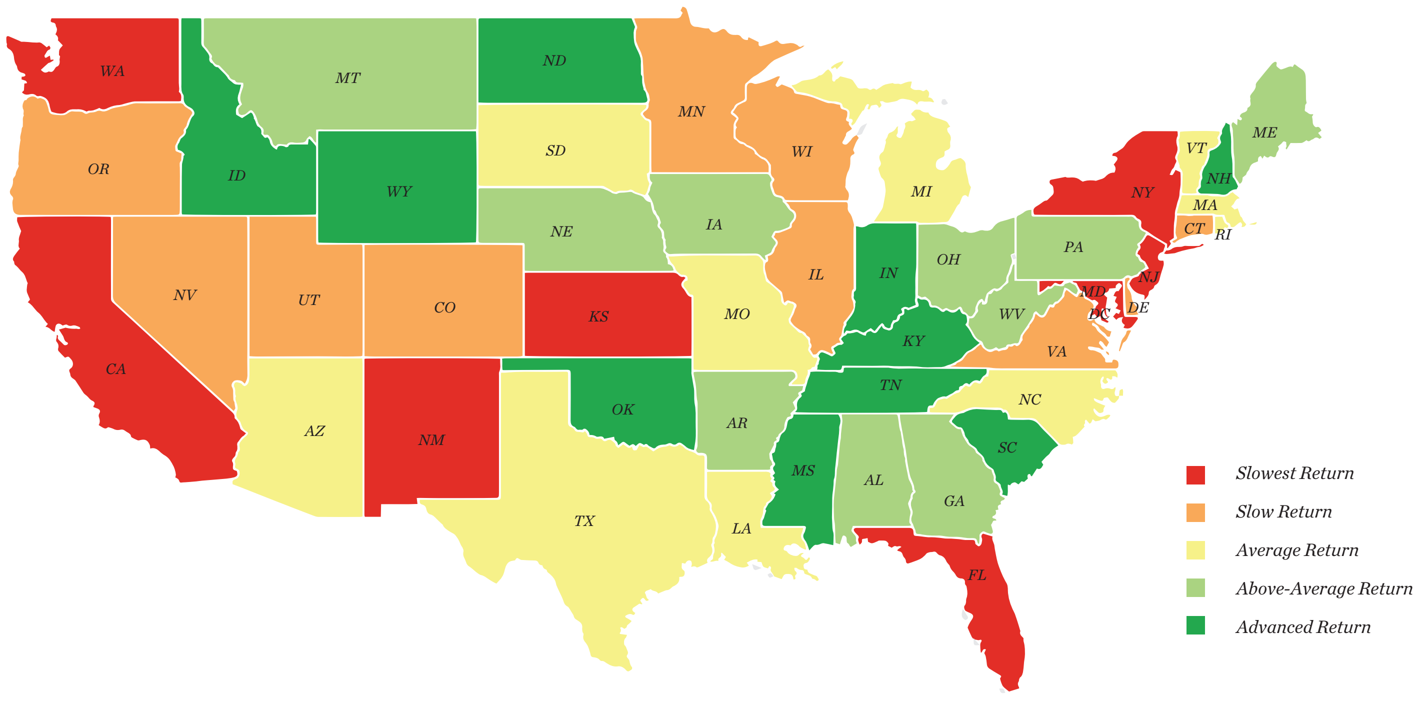
STNL CAP RATE RANGE BY BRAND**



Cap rates shown above are representative of transactions that closed in the trailing 12 months ending in September. Actual yields will vary by locations, tenant, lease terms and other considerations.
Locations sourced from Creditntell for public companies and company websites for private companies.
** U.S. and Canadian locations ** For transactions closed in the trailing 12 months ending in September*
Sources: Marcus & Millichap MNET; CoStar Group, Inc.; Creditntell

Uneven Return of Shoppers to Nonessential Retailers Impacting Recovery

States at Various Stages of Recouping Foot Traffic



Based on year-over-year foot traffic through Oct. 12, 2020

Shoppers returning to nonessential retailers. The flow of traffic to five nonessential retail sectors is contingent on consumer behavior and public policy. Apparel, casual dining, fitness, leisure, shopping centers, and spa and beauty establishments were mostly closed during shelter-in-place orders. Although all sectors showed a year-over-year decline as a whole, many states are significantly closer to returning to visit levels on a year-over-year basis. Shopper preference is the driving factor in some locations. Florida, for example, has some of the most relaxed restrictions, though the state's older population is shying away from nonessential retailers. States with more strict restrictions, such as California and New York, meanwhile, are also lagging as consumers do not have the option to return to nonessential retailers in large numbers. Less densely populated areas tend to be further along, while the Sunbelt as a whole is outperforming.

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Price: $1,500

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Moody's Analytics; Placer.ai; Real Capital Analytics; Standard & Poor's; U.S. Census Bureau