Crow Holdings Capital

The retail model that remains viable during — and after — the pandemic

Jonathan A. Schein, senior vice president and managing director of global business development for Institutional Real Estate, Inc., recently spoke with **Sam Peck,** managing director for Crow Holdings Capital, about the firm's retail strategy in the current market environment. Following is an excerpt of that conversation.

The COVID-19 pandemic has had a significant impact on retailers and retail owners. How has the pandemic influenced your retail investment strategy?

The pandemic has reinforced our strategy of focusing on well-located, neighborhood shopping centers with food, service and daily-needs tenancy. This tenancy, coupled with our ability to adapt operationally and provide retailers with access to available resources, has aided them in remaining operational. Consumers have never had more alternatives in how they shop, and retailers have never had to be more agile. Crow Holdings Capital's food and service retail portfolio comprises 162 shopping centers with more than 1,500 tenants across 29 states. Over the past five years, we have been the most active acquirer of neighborhood and community shopping centers of less than 50,000 square feet in the United States. The pandemic has highlighted the value of the type of product we own. Open-air, single-story centers offer a variety of ways for retailers to sell their goods and services, whether that be indoors or through curbside, drive-thru, pick-up windows, parking lots, or other outdoor spaces. This has provided flexibility for tenants to continue to conduct their businesses, even amidst government shutdowns and changing restrictions. Food and delivery apps have also bolstered tenant sales. Our QSRs [quick-service restaurants] and restaurants have remained busy, and in some cases, the volumes actually exceed pre-pandemic levels.

We collected 90 percent of rent from April through December. Our food and service retail strategy has proven to be not only durable, but also resilient, as we saw more year-over-year renewals in 2020 than in 2019.

The pandemic has demonstrated the resiliency of unanchored retail located close to hospitals, in affluent neighborhoods, and even near colleges and areas of daytime office employment. Consistent cash flows in good times and in bad, coupled with low capital expenditures, make essential retail with convenient access a stable investment. We will continue to seek to acquire these conveniently located, smaller, unanchored centers surrounded by strong demographics.

A 90 percent collection rate is great. Have you had to do something outside your normal business to retain cash flows?

From the beginning of the pandemic, we decided to dedicate internal resources to monitoring the relief that was coming out of Washington, D.C., states and local municipalities. Given our portfolio of primarily unanchored shopping centers with about one-third local tenants, one-third regional, and one-third national, many of our tenants didn't have commercial banking relationships with the largest and earliest allocators of the paycheck-protection funds, nor were they familiar with the deadlines and the many nuances to the rules. In response, we used our scale and relationships to help point tenants to the top SBA lenders in their states and zip codes, and we continue to dedicate internal resources to this effort. We believe the goodwill we have created with our tenants may place us in a favorable position to retain that tenancy long term. We have remained in weekly, if not daily, contact with our tenants to understand their challenges and help them remain open. For example, we helped some of our restaurants create an online presence. We allowed fitness concepts in warmer climates to set up in the parking lots. So we had outdoor yoga, which we never would have contemplated before! But if that allows the tenant to keep the lights on, then we are going to lean in.

Are you tracking different types of information or data now?

Everybody's report card is based on collections, and we have been tracking that data in detail, obsessively, every night since Monday, March 16, 2020. Long term, we will continue to track collections and bifurcate the data across the different constituencies within our portfolio. How are the locals doing relative to the regionals, relative to the nationals? How are the corporates doing relative to franchises? How are our centers located next to hospitals performing relative to centers in areas of daytime office employment? Our portfolio was purposefully built to be recession-resilient and ecommerce resistant. Collectively, these smaller centers cater to daily needs — sandwich shops, hair and nail salons, coffee shops, and veterinarian offices, to name a few. In good times and bad, these tenants tend to offer low-cost, high-margin goods and services that result in the opportunity for them to withstand varying market cycles.

How has geographic location impacted pandemic performance of your centers?

The regions that shut down later and reopened earlier have outperformed. For years, we've been seeing population migration to the southeast and southwest U.S. and have strategically focused on these areas. These migration trends accelerated during the pandemic as the southeastern and western markets, where about 60 percent of our food and service retail investments are located, were able to offer more alternatives for both tenants and consumers to adapt to pandemic-imposed operating protocols.

How do you think the definition of credit tenant could change, moving forward?

Historically, a "credit tenant" was one you could count on to pay rent in good times and bad — generally large corporations and/or publicly traded companies. The pandemic proved that even the local and franchise tenants, traditionally the "non-credit tenants," were tremendously resilient. They communicated with us often with transparency and a commitment to live by the obligations of their leases.

As we think about what makes a credit versus non-credit tenant, the focus is on operating history, payment history and unit-level sales. If you have sales and a strong payment history, there is no reason why a local sandwich shop shouldn't be regarded with similar creditworthiness as a national, publicly traded company. The pandemic has shown that our local tenants were agile and quickly adapted to honor their leases to support their livelihoods.

Do you think focusing on retail centers with a smaller suite size gives your portfolio an edge in today's changing environment?

We consider a small suite size anything below 5,000 square feet, which is where you see 60 percent of all new retail leasing. Our average suite size within the owned portfolio is less than half that, at 2,400 square feet, with efficient layouts and accommodating space that appeals to a deep pool of tenancy. We believe these accessible building footprints are uniquely positioned to take advantage of tenants wanting to move out of malls and need less space. We also see more demand from medical users moving out of medical office buildings that require elevator transportation.

How does the scale of your food and service platform inform your ability to make decisions on the future of retail?

Our platform's scale has helped us manage through this unprecedented disruption. We have been on the defense for the past 12 months, and our scale has allowed us to negotiate with our larger tenant relationships in bulk. As we move into 2021 and experience a welcome shift toward being on the offense, we are now conducting portfolio reviews with many of our larger tenant relationships. Although their store openings have been delayed a year, they are still opening the same number of stores. We are in a position, given our scale, to offer them space, where a year ago, space may not have been available. We are excited about being able to use our existing scale to potentially execute multiple leases with some of the stronger national brands. From an investment perspective, we expect the portfolio data we have aggregated this year to inform how we underwrite new investments. We can identify which brands paid on time and make better conclusions about collections by market. Furthermore, much of this sector trades off-market through the 1031-exchange platform; therefore, this data is largely untracked by most research companies.

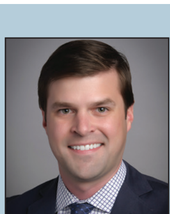
Are there any particular tenants that excelled?

Locations with a drive-thru performed better than locations without a drive-thru by anywhere from 30 percent in April to 10 percent in October. One of our national coffee tenants is doing 98 percent of their sales through the drive-thru and 2 percent of their sales through the in-store café.

Where within the retail sector do you foresee a lot of growth?

2019 was the first year in which you saw more dollars spent in restaurants than in grocery stores. 2020 flipped that on its head, but I think this trend speaks to the demographic construct of our country today. Grocery has performed tremendously well as people stay at home and stock up. This year for grocery stores has been 12 months of operations like the day before Thanksgiving! From an investment perspective, one might predict it will continue to be the strongest subsector, but we would argue against that. Grocery stores have always been a low-margin business and have been investing heavily in expensive technology, including click-and-pick and home delivery. When you layer those costs onto an already low-margin business, what does profitability look like in a restabilized environment where half of every dollar is going to a restaurant again? We believe unanchored, multitenant food and service retail is the safest investment. We have the space that meets the market and provides retailers the flexibility to sell their goods and services. As owners, this gives us the ability to lease to a huge pool of prospective tenants and see annual growth along the way. This past year has been much more challenging for retail than an average recession, but our strong rent collections and stable occupancy speak to the long-term viability of the food and service retail asset class.

CONTRIBUTOR



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CORPORATE OVERVIEW

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