COVID-19 RECOVERY OUTLOOK

COMMERCIAL REAL ESTATE - RETAIL SECTOR

July 9, 2020

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This report examines the potential impacts of COVID-19 on the retail sector. This report aims to assist County policy makers promote business in the emerging post-COVID-19 business climate consistent with the Council's Economic Development Platform – Business Development Pillar.

KEY TAKEAWAYS

- As of 2019, there were 4,449 retail and food and drinking establishments in Montgomery County (13.6% of total privately-owned establishments, employing 75,243 employees (19.7% of total employees).
- Smaller retailers may have more difficulty negotiating rent concessions due to complex property ownership.
- Retail recovery, and larger national economic recovery, depend on return of consumer confidence and spending. Reduction in high-income consumer spending is linked to decreases in business revenue and low-income worker employment.
- Young, Black, and Asian workers comprise a larger share of the County's retail industry relative to their share of the workforce overall. These workers are likely to be disproportionately impacted by retail closures.

Additional OLO research on COVID-19 recovery is available here: www.montgomerycountymd.gov/olo

WHAT IS RETAIL?

The Montgomery County Planning Department defines the retail sector to include: [1]

Neighborhood Goods & Services
Examples: grocery stores, hardware stores, drugstores, and dry cleaners

Food & Beverage
Examples: restaurants, cafes, and bars

General Apparel, Merchandise, Furnishings & Other
Examples: clothing stores, bookstores, electronic stores

MONTGOMERY COUNTY RETAIL MARKET IS STRONG AND STABLE (2019)

The Planning Department reports that there are 40.6M leasable retail sq. ft. across 2,390 properties Countywide.[2] The most prevalent shopping center type is grocery-anchored neighborhood centers, followed by in-line retail and regional shopping malls. Proximity to transit, downtown centers, and convenient commuting routes are primary factors in determining retail market competitiveness.[3]

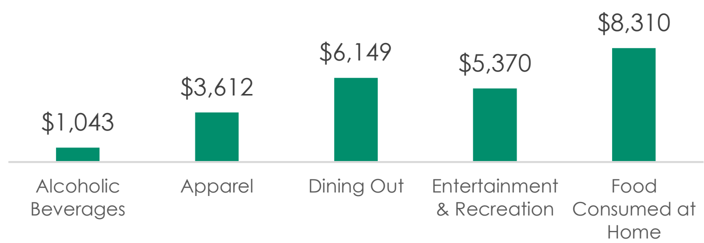
Establishments & Employment (2019). The U.S. Bureau of Labor Statistics reports there are 4,449 Retail and Food and Drinking Places establishments in the County (13.6% of total privately-owned establishments), employing 75,243 employees (19.7% of total employees).[4]

Top Retailers in Montgomery County[5]

By Number of Stores
- 7-Eleven (49 stores)
- Subway (48 stores)
- Starbucks (44 stores)

By Square Footage
- Giant (1,191,452 sq. ft.)
- Macy's (726,952 sq. ft.)
- Safeway (704,799 sq. ft.)

Consumer Expenditures per Household in the County 2019
Averaged $24,484 per Year on Retail, Dining Out and Entertainment (about 20% of total household spending).[6]



COVID-19 RESULTS IN RETAIL SECTOR JOB LOSSES AND NONPAYMENT OF COMMERCIAL RENTS

Retail contributes $2.6 trillion (25%) to annual GDP, supporting 52 million jobs.[7] Due to COVID-19, an estimated 25,000 stores could permanently close, with approximately 50% to 65% of closures occurring in malls. S&P Global reports 30% of retail companies had a credit rating that indicated a 50% chance of defaulting on debts.[8]

Retail Employment (March-May 2020) In May, employment rose sharply in retail and food establishments reflecting re-opening policies. Employment in retail trade rose by 368,000, after a loss of 2.3M in April. Employment in food services and drinking places rose by 1.4M.[9]

National Retail Employment (in the thousands)

	March	April	May	Change from Apr. 2020-May 2020	Change from May 2019-May 2020
Retail Trade	15,587	13,301	13,669	368	-1,950
Food Services & Drinking Places	11,670	6,251	7,622	1,371	-4,403

Source: U.S. Bureau of Labor Statistics

Retail Rent Concessions and Nonpayment (Trends from March 2020 – June 2020)

Landlords rely on rent payments to pay property taxes, operating expenses, and debt service (mortgages). Commercial properties are typically owned by a group of investors (e.g., life insurers, real estate investment trusts (REITs) and investors in commercial mortgage-backed securities (CMBS)), with dozens of loans grouped together.[10]

Over half of commercial rents were unpaid (58.6%) and 10% of loans for retail properties were 30 days past due in May.[11] National retailers either stopped paying rent or negotiated rent concessions during COVID-related closures. Ross Stores and TJ Maxx stopped paying rent, along with Bed, Bath, and Beyond; Famous Footwear; H&M; AMC and Regal Theaters; and gyms, like 24-Hour Fitness. Starbucks paid May rent but requested rent concessions starting June 1st and continuing for 12 months.[12]

As a result, landlords may issue rent defaults in order to preserve legal rights. In June, Simon Property Group, the largest mall property owner in the U.S., sued Gap (owner of Old Navy and Banana Republic) for $66M in unpaid rent for April, May, and June.[13]

Commercial Real Estate Impacts

- Store closures, including mall anchors, may invoke co-tenancy clauses in retail leases, allowing tenants to request rent reduction or abatement or lease termination– potentially affecting retail vacancies .[14]
- REIT sectors – retail, lodging, and residential – have a higher probability of suffering losses compared to other sectors that may be more recession resilient (such as data centers or grocery-anchored retail). Further, delayed rent collections may impact REIT redevelopment projects necessary to attract new retail tenants. [15]
- Most properties are owned by groups of investors, who collect rent through special servicers. Special servicers make money through extra fees and penalties, giving them little incentive to negotiate rent deferments. This has a greater impact on small business owners, who may not know who they need to contact regarding such negotiations.[16] For OLO's COVID Recovery Outlook Small Business Report, see https://www.montgomerycountymd.gov/OLO/Resources/Files/2020%20Reports/COVID-19Recovery-SmallBusinesses.pdf

Other Jurisdiction Actions to Assist Rent Negotiations

- The DC Council passed emergency legislation in May requiring commercial retail landlords to agree to rent payment plans; the California legislature is considering a bill that would force landlords to negotiate with retail (and office) tenants whose revenues were impacted by COVID or be released from the lease without penalty.[17]
- The Federal Government revised the Paycheck Protection Program to increase the loan amount that could go towards rent, interest on mortgages, and utilities from 25% to 40% (60% of the loan must fund payroll expenses).[18]
- The Federal Reserve purchased $9B in CMBS and stated that banks would not be penalized for offering concessions.[19]

INCREASES IN NATIONAL CONSUMER SPENDING IN MAY DROVE RETAIL SECTOR GAINS

The U.S. Census reports monthly retail sales trends, including for food and drinking establishments.[20] Census publishes total sales and percent change for the reporting month as well as year-to-year change. From April to May 2020, U.S. retail sales increased 17.7% to $485.5B, following a three-month period of decline due to COVID-19 restrictions. The largest month-to-month gains were experienced by clothing and furniture stores.[21] Despite gains, sales are down compared to May 2019 for Retail Trade sales (-1.4%) and Food Services and Drinking Places (-39.4%).[22] In comparison, consumers took about six weeks after the 9-11 terror attacks and about six months after the 2008 market crash to resume spending. Comparatively, after 9-11 and the 2008 recession, consumers tended to trade-down in the restaurant sector, seeking more affordable restaurants. During the current pandemic, there has been was no opportunity to trade-down, so spending transferred to grocery stores.[23]

HIGH-INCOME EARNERS CUT SPENDING, BUSINESS REVENUES FELL, AND LOW-WAGE JOBS WERE LOST

Opportunity Insights, based at Harvard University, utilized consumer spending to evaluate economic recovery post-COVID-19 and the impact of spending reductions on businesses and workers. Data reveal that almost all of the national reduction in GDP came from a reduction in consumer spending.[24] Nationally, total consumer spending in the U.S., as of June 17, 2020, decreased 8.6% compared to January 2020. Further, a reduction in consumer spending among high-income households is tied to larger decreases in small business revenues and low-income worker employment in high-rent ZIP codes.[25] Key findings from the study include:

- **High-income households reduced spending as the pandemic spread.** As of May 31st, two-thirds of total reduction in credit card spending since January came from households in the top 25% of income distribution; households in the bottom 25% continued to spend at pre-pandemic levels.
- **Small businesses in high rent ZIP codes lost more than 70% of their revenue due to reduction in high-income household consumer spending.** Small business in low rent ZIP Codes lost 30% of revenue when COVID-19 hit.
- **Nearly 70% of low-wage workers working in high-rent ZIP codes lost their jobs compared with 30% in low-rent ZIP codes**. As businesses lost revenue, they laid off employees, particularly low-income workers. These businesses not only laid off more low-wage workers, but also posted fewer jobs as economies re-opened.[26]

NATIONAL RETAIL RECOVERY DEPENDS ON CONSUMER HEALTH CONCERNS & TECHNOLOGY INTEGRATION

In comparing States that re-opened in April to those that waited until the end of May, Opportunity Insights found that the fear of COVID-19, not the orders restricting business activity, was the primary cause of reduced economic activity and job losses. Retail spending increases are tied to receding health concerns.[27] Survey data show consumers will not resume spending until they feel it is safe to do so, both physically and financially.[28] As of June, only 47% of shoppers feel comfortable shopping in person.[29] Retailers with strong technology integration will have quicker recovery, especially when shoppers are hesitant to spend long amounts of time in any store.[30] Researchers noted that in the long term, the only way to drive recovery is to invest in public health efforts that restore consumer confidence and spending.[31] The following outlines three retail business practices.

1. HEALTH & SAFETY

- For restaurants, it is estimated that reopening would cost between $15K and $30K (depending on size of operation) to cover costs of restocking the kitchen, purchasing personal protective equipment, and re-training staff.[32] Nearly 41% of restaurant owners said the slow return of customers will be the biggest challenge to re-opening.[33]
- Shoppers expect to see visible changes in stores to reflect health and safety standards. Examples include dissemination of safety practices; in-store audio reminding of protocols; plexiglass shields; hand sanitizer; and employees wearing masks.
- Even with changes, retailers and restaurants need to offer multiple ways for consumers to engage – pick-up, curbside, delivery, ship-it, and online promotional activities.[34]

2. MOBILE PAYMENT

- Use of cash plummeted during the pandemic due to safety concerns as consumers' use of mobile payment increased.
- PayPal added an average of 250K new accounts per day in April 2020, with 325M accounts worldwide , up from 277M a year ago. One-half of accounts are in the U.S. 50-plus age group is the fastest growing demographic using the payment system.[35]
- The rise of mobile payment disproportionately affects US consumers who do not have a bank or credit card account and those that rely on alternative financial services (e.g., check cashing and paycheck advance services). These consumers are more likely to have lower income, less education, and be in a racial and ethnic minority group.[36]

3. E-COMMERCE

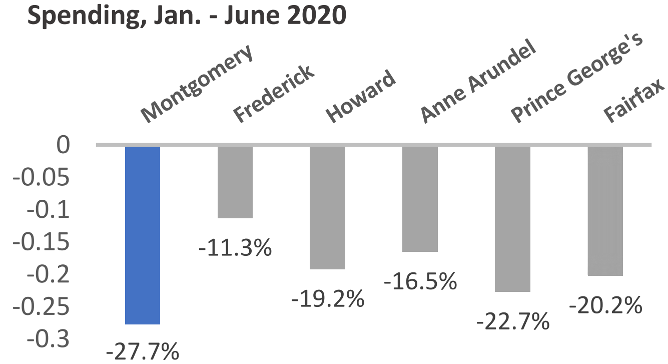
- Online shopping accounts for 10.7% of retail sales. Since COVID-19, surveys have shown that consumers purchased more items online due to health concerns, including non-traditional items (e.g., cars and furniture).
- A shift to e-commerce may spur increased online shopping by older consumers who may be at a higher health risk.[37]
- E-commerce trends favor retailers with strong technology integration. Main Street America found that 63% of small businesses lack e-commerce sale capabilities. The organization recommends adding an e-commerce training program, website development grants, and connections with low-cost e-commerce platforms to traditional redevelopment programs (e.g., façade grants, etc.).[38]

COVID-19 IMPACT ON RETAIL SECTOR IN THE NATIONAL CAPITAL REGION

The Stephen F. Fuller Institute tracks the monthly short- and long-term performance of the Washington Area's economy. Comparing year-to-year trends - April 2020 to April 2019 – the Institute reports:

- Non-durable goods retail sales (e.g., food, clothing, household supplies, etc.) decreased 12% – the largest decrease since 1990. Durable goods retail sales fell 26.9% - the largest decrease on record.
- Consumer confidence (in current economic conditions) decreased 59.5%. Consumer expectations (for the next six months) decreased 21.7%.[39]

County-Level Percent Decrease in All Consumer Spending, Jan. - June 2020



Source Opportunity Insights, Economic Tracker

Opportunity Insight Economic Recovery Tracker includes data on consumer spending by State and County. In Montgomery County, as of June 17, 2020, total spending by all consumers decreased by 27.72% compared to January 2020. This is the largest decrease across the National Capital Region.[40]

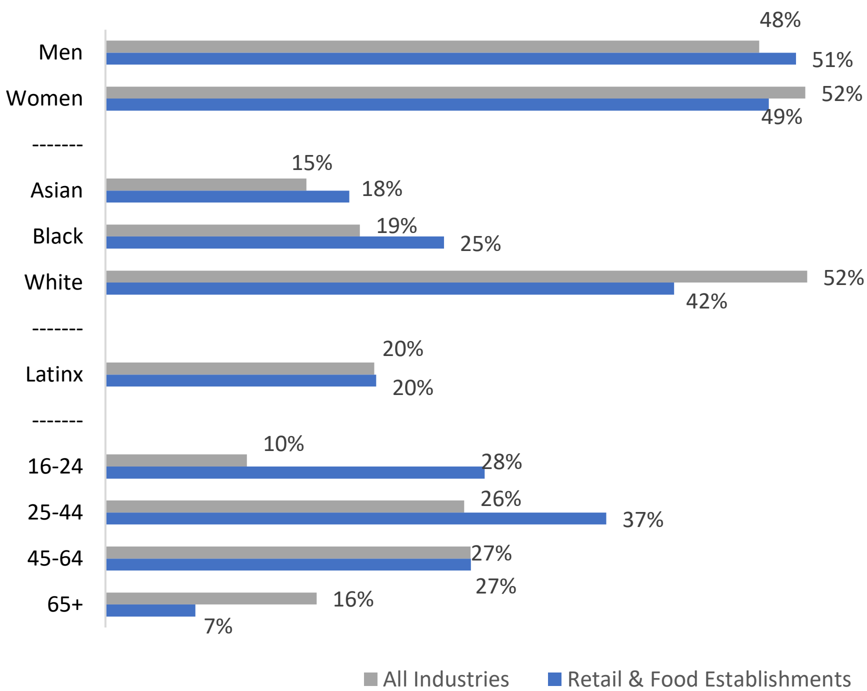
Projected Retail Vacancies and Closures

The pre-COVID DC area vacancy rate was 6.2% (Montgomery County, 6.8%).[41] Moody's Analytics estimates an increase in DC area vacancy rates from 9.5% to 13% - 15% by the end of 2020.[42] Applied to Montgomery County's 40.6M sq. ft., this would imply an increase of 1.5M to 2.2M sq. ft. of empty retail space. For scale, Westfield Wheaton Mall, the County's largest retail property, is 1.5M sq.ft.[43] The Restaurant Association of Metropolitan Washington estimates that 25% to 35% of its members will close permanently. Restaurateurs are expecting recovery to take between 12 and 18 months.[44]

MONTGOMERY COUNTY WORKERS IN RETAIL INDUSTRIES LIKELY TO BE DISPROPORTIONATELY AFFECTED BY COVID-19

U.S. Census American Community Survey reports annual worker demographic data at the county level by industry. The industries included in this analysis, and the number of workers employed, are as follows: Food services and drinking places (38.5K) and Retail Trade (52.5K). Younger workers comprise a larger share of the retail workforce – 65% of the overall retail workforce compared to 36% of overall employment (ages 16-44). There are fewer White workers in selected industries compared to their share of the County workforce overall, while Black and Asian workers have a larger presence in these sectors.[45]

Share of County Workers Overall & Retail & Food Establishments



Source: U.S. Census American Community Survey, 2018 https://www.census.gov/programs-surveys/acs.html

Understanding COVID-19 Impact
RETAIL INDUSTRY TAKEWAYS

The retail industry was impacted by mandated business closures and stay-at-home orders but is recovering slowly as states begin to re-open. Key short- and long-term impacts include:[46]

SHORT-TERM NATIONAL TRENDS
States re-open with social distancing and virus containment

- Consumer spending increases as health concerns decrease
- Increased use of e-commerce and mobile payment and alternative shopping experiences
- Increased focus on store and restaurant cleanliness
- Retailers look to negotiate rent concessions until economy rebounds

LONG-TERM NATIONAL TRENDS
States have re-opened and activity is resumed

- Possibility of reclosing stores if pandemic spikes
- Consumer spending rebounds to pre-COVID levels
- Use of mobile pay and e-commerce grows
- Reduction in retail square footage as retailers and restaurants adjust to new normal

Key questions for Montgomery County

- What could be the impact of rent concessions or nonpayment of rent on County revenues and local landlords and REITs ? Were smaller retailers and businesses able to negotiate rent concessions?
- How would County processes and operation costs change to aid smaller retailers in rent negotiations or navigating the commercial eviction process in the long-term?
- What could be the impact of decreased consumer spending on communities in the County? Are there areas or populations within the County that will experience a slower path to economic recovery?
- Are there opportunities for County to promote e-commerce for small retailers?
- How should the State and County Governments regulate health and safety in retail stores and restaurants post-pandemic? Could health and safety regulations increase consumer confidence and spending?
- How will new health and safety standards impact retail and restaurant operation costs and how could this impact retail workers and consumers?
- What are the impacts to the County retail workforce if recovery is protracted?

Practical next steps for County consideration

- Measure the impact of retail market trends on property taxes and vacancy rates
- Evaluate relevant health and safety codes to meet new store cleanliness requirements, including inspections
- Review existing County economic development and commercial redevelopment programs to create opportunities to include e-commerce training and resources; See OLO Report 2020-6 for further discussion on encouraging retail in the County, https://www.montgomerycountymd.gov/OLO/Resources/Files/2020%20Reports/OLOReport2020-6.pdf
- Track data related to County business-relief programs created during the pandemic and consumer spending to better evaluate economic recovery of the County

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