September 1, 2020

PIVOT OR STAY THE COURSE?

LEASING THROUGH A PANDEMIC

FLOCKE & AVOYER
Commercial Real Estate
BRYAN CUNNINGHAM
Senior Vice President
bcunningham@flockeavoyer.com
858.875.4676
License ID: 01348498

Even in the best of times, landlords are always interested in the strategies implemented by other owners of real estate. Whether its lease comps, asking rents, CAM expenses or opinions about specific retail operators, we as brokers are routinely asked by our clients what is happening in competing projects. This information (we hope) helps landlords make decisions that keep their projects both competitive and relevant, which in turns allows the owner to maximize the value of the property.

In today's environment, however, the strategies being deployed are much more creative and interesting than in "normal" times. Forced retail closures, regulations limiting retail traffic, forcing businesses to operate outside as well a shift in consumer behavior have left landlords of all sizes wondering how to respond to this unprecedented predicament that we all find ourselves in. The answers to the questions about how best to operate real estate assets in todays environment have become much more complicated.

We are seeing two different strategies being implemented by both individual and institutional Landlords, both of which have their advantages. The first is centered on maximizing short term cashflow. Several of our clients have reduced rents, offered increased free rent or incentives such as discounting the rent by up to fifty percent in the first year in order to generate interest in the project. This approach, if successful, makes a lot of sense for owners worried about servicing their debt and has, in some cases, also been applied to existing tenants that have been hurt by the pandemic and looking to the landlord for relief. It keeps occupancy levels up, gives tenants a better chance of survival and limits the pain that we are all experiencing. The downside, of course, is that maximizing your cash flow now may ultimately hurt the value of your asset if and when the market returns to pre-pandemic levels.

The second approach couldn't be more different than the strategy outlined above. Some landlords, specifically large institutional owners, are taking a much longer view of our current situation and are opting to stay the course relating to deal rents and tenant criteria. These operators, many of whom are publicly traded, are taking the position that the pandemic is temporary and that making a "Covid deal" will ultimately hurt the value of the asset, portfolio, stock price, etc. This position makes sense if you are not as concerned with immediate cash flow or debt service and you would rather pause, take a deep breath, and wait for a time when market conditions are in your favor. The downside to this approach is none of us know when that will be.

The answer to which of these approaches is more prudent will not be known until we have a clear picture of how the consumer responds once all of the governmental restrictions are lifted. Will we return indoor dining on a regular basis? Is your peloton going to replace your gym membership? Have you learned to enjoy cooking at home? And of course the big one, is the American consumer going to have the income necessary to drive retail sales. As complicated as our business can be, one part of it is very simple...rent is determined by Tenant sales.

2020 has been a year like no other and, hopefully, the worst is behind us. Certain behaviors have been forever altered, but we are a resilient society with a historically short memory. The same way the airlines bounced back from 9/11, retail will recover from Covid-19. What you need to consider as an owner, is what is the best way to get to the other side of this terrible pandemic. Talk to your broker, he/she can most likely help you come up with a plan to fit your specific situation.

Here's to 2021!