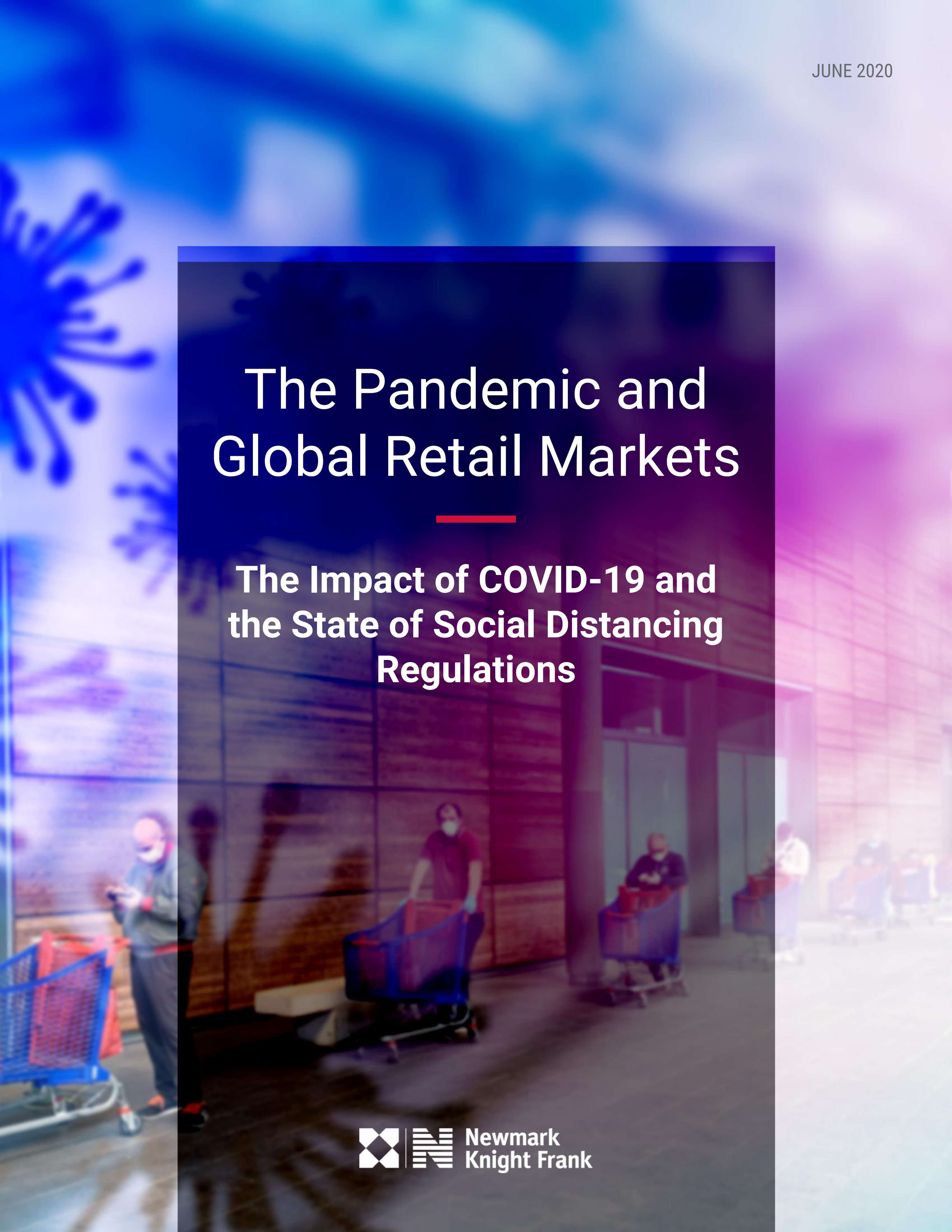


JUNE 2020

The Pandemic and Global Retail Markets

The Impact of COVID-19 and the State of Social Distancing Regulations

Newmark Knight Frank

COVID-19 has shaken retail markets everywhere.

While many other segments of the economy were strong prior to the pandemic, the retail sector was in the midst of a correction, reacting to growth in ecommerce and other changes in consumer spending habits. Experiential retail was paramount to adapting. Now, essential businesses are king, and experiential is dangerous. Major international markets have faced unique and profound obstacles as their density and tourism—typically their strengths—have become their greatest threats.

But these markets are also often known for their resilience. After several months of quarantine, pause, or social distancing, these cities and countries have begun to reopen. Reports around the globe of “revenge shopping,” where pent up consumers push sales much higher than expected upon an establishment’s reopening, offer hope for many. A recent U.S. Commerce Department report also showed a 17.7% rebound in national retail sales from April to May, though it is still down 6.1% from the prior year. These numbers have larger implications for the consumption-based U.S. economy, in which spending drives around 70% of GDP.

Early sales reports –paired with the strategies and experiences of each market—offer insights for others, and a glimpse into the future for those cities that are further behind.

United States

Across the United States, social distancing regulations and the severity of the virus vary from one region to another. The sector (including retail, restaurants and drinking establishments) has shed more jobs than any other industry, over four million across the country in April and May combined. In most major metropolitan areas, retail and restaurant activity is still very limited. Some include a reduction in capacity and hours of operation, while others are generally limited to in-store or curb-side pickup. Recent civil unrest also impacted the reopening timeline in several markets.

In many ways, the pandemic has accelerated trends that were already underway. **Major brands have filed for bankruptcy or announced significant store closures since the start of social distancing. But many of these businesses were already threatened by ecommerce and other forces before the pandemic.** In some cases, companies will use bankruptcy laws to get out of lease obligations of underperforming stores and rebuild their business. Neiman Marcus filed for bankruptcy in May. Zara announced it would close 1,200 stores globally, and 24 Hour Fitness has filed for bankruptcy and closed stores across the country, following a plan that was implemented pre-COVID-19.

The “buy online, pickup in store” model has been key for many essential and nonessential businesses.

Other **businesses are calling on strategic techniques that had been developed pre-pandemic to compete with ecommerce. The “buy online, pickup in store” model** has been key for many essential and nonessential businesses. Rooted in suburban and big-box retail, the **strategy has been adapted to street retail during the pandemic.** Starbucks recently announced it would close 400 locations nationally while advancing locations that offer only pickup and drive-thru options. In New York, it opened its first of these locations in 2019.

1 New York City

In hard-hit New York City, the onset of COVID-19 completely altered the trajectory of the market, despite healthy activity for most of the first quarter. Quarantine regulations went into effect in mid-March and lasted until June 8, when the governor enacted Phase 1 of reopening. From a retail perspective, this phase is not dissimilar to the prior social distancing measures, allowing restaurants to only offer curb-side pickup, and retailers to offer curb-side or “buy online/pickup in-store.” June 22 is being targeted for the start of Phase 2, when outdoor dining can operate and storefront retail can open, if social distancing and other related health regulations are met. Two additional phases will follow, where indoor dining, gyms and other establishments can open at limited capacity. The details and timing of these phases are yet unclear.

Perhaps the greatest retail event to come from the pandemic thus far is the news that Related Companies would convert Neiman Marcus and other retail space at Hudson Yards to office use, depending on the outcome of bankruptcy court.

While the market remains largely frozen, some requirements have continued, including bank branches, supermarkets, and ecommerce companies, though many are moving at a slower pace. **Despite that, leasing activity is down significantly. The number of deals signed in the first half of 2020 represents a 60% drop from the same period in 2019.** Target recently signed two deals, one for 56,000 square feet at 150 East 86th Street, and another for 24,000 square feet at 795 Columbus Avenue. That marks just one deal signed over 25,000 square feet this year. By comparison, 13 deals over 25,000 square feet were signed in the first half of 2019.

Neiman Marcus in Hudson Yards

2 Miami

Social distancing began mid-March. At the onset of COVID-19, mandatory self-distancing and proper PPE were required for grocery stores, home hardware centers, and other essential businesses. Restaurants were only open for takeout and delivery. Beaches, malls, clothing stores, bars, hotels, and other non-essential street retail operators were not allowed to be open.

Stage 1 of reopening began June 3, allowing restaurants to reopen at 50% capacity, and customers were not required to wear masks. **A previously instituted 9 p.m. curfew was rolled back a few days later. Miami remains in this stage** as of the release of this report.

The pandemic hindered the travel of many college students to the Miami area during the peak of the spring travel season, hurting many local retailers that depend on the annual sales of high-season tourism. It was believed that some national retail investment owners would be working with their tenants in mall and major strip-centers on rent relief, but many requests for rent relief were denied.

Little impact was seen on Miami's retail market at the close of the first quarter, as **vacancy held steady at just under 5.0%** and asking rents did not see a significant change. Retail revenues were significantly down compared to prior year first and second quarter levels. Miami hotels have now opened and are seeing an increase in occupancy, while gyms have begun to open as well.

Brickell City Centre in Miami

In Brickell, Equinox, Soul Cycle and LA Fitness opened on June 8 by appointment with social distance protocols still in effect. Many restaurants stayed open in Brickell for 100% takeout and offered groceries in addition to their regular offerings. Many also offered discounted wine and beer for takeout.

Miami may see significant store closures and downsizing, as the retail sector, including many national retailers, was already struggling. Southland Mall in Cutler Bay could be the first victim as Wells Fargo is attempting to seize one of the region's largest malls in foreclosure. Steve Madden recently announced it would be closing its Lincoln Road store in Miami Beach. **In April, South Florida reported the third highest CMBS exposure of any metropolitan statistical area after New York City and Los Angeles, with an outstanding CMBS loan balance of $6.3 billion**, according to data provided by Trepp. In Mary Brickell Village, most Tenants received 100% abatement for the month of April only. Some tenants that asked for extended abatement will repay rent amortized in 2021.

3

Chicago

The City of Chicago allowed restaurants and bars to open with outside seating in early June. Home improvement stores, grocers and retailers, such as Costco, implemented social distancing early in the process and were able to do so smoothly and effectively, instituting carry out and curb-side pickup only. **Retail is now open with limited occupancy.** Grocers, discounters and home improvement stores restricted the number of customers at the beginning of the crisis but appear to have relaxed those guidelines the last several weeks. Many stores are continuing to promote social distancing with signs and markers on the floors. Social distancing and stay-at-home measures were broadly followed, with most of the city staying home.

Retail activity was halted until early June, with limited categories expanding, such as coffee shops, healthcare, auto, cannabis and fast food. Foot traffic was outstanding at essential retailers, including grocers, discounters and home improvement stores during the pandemic. **Deals that were in process all went on hold. Limited movement is beginning to be seen with smaller, "mom and pop" tenants.**

While it is too soon to tell how severe the effects will be, there will be closures and rents will be negatively impacted. **The market is beginning to see creative deal structures being discussed.** Some retailers were able to negotiate some type of abatement or rent relief, while other negotiations are ongoing. Agreements have included abatement or reduced rent for a limited period, with extensions to base leases.

Millennium Park in Chicago

Long Beach in Los Angeles

4 Los Angeles

The county's "Safer at Home" orders were issued March 19. Although there were many components to the mandate, restaurants were permitted to offer food by takeout or delivery only; bars and nightclubs (that do not serve food) closed; and malls and non-essential retail closed. Social gatherings were prohibited, while schools, parks and beaches closed as well. All residents were required to wear masks starting mid-April in public and in business spaces.

The county revealed a five-stage recovery roadmap, which began May 8 and initially allowed curb-side pickup for bookstores, clothing stores, florists, music stores, sporting goods stores, toy stores and car dealership showrooms. Two weeks later, indoor shopping malls could reopen. **Stage three permitted the reopening of all retail stores at 50% capacity starting May 26. Restaurants commenced indoor dining with 60% capacity a few days later.** Offices, film production, movie theaters, fitness centers, sporting events without audiences, and hotels were permitted to reopen in mid-June, if they maintained capacity restrictions and health safety protocols. Nearly all aspects of the economy are open again.

California's minimum wage increase, set to reach $15/hour by 2022, complicates matters. Retailers that were on shaky ground prior to the pandemic are especially vulnerable now. Companies that have announced store closings include Papyrus, Active Ride Shop, Forever 21, GameStop, Pizza Hut (dine-in restaurants), GNC, Party City, Bed Bath & Beyond, Payless, Victoria's Secret, JCPenney, and Nordstrom. While some landlords are offering rent deferments, many retail tenants will be unable to recoup their sales due to social distancing and the general state of the economy. **The California State Senate is considering Bill 939, which would shield smaller "mom and pop" commercial tenants from eviction and grants them lease termination rights.**

5 San Francisco

Social distancing regulations officially started on March 17. Through May, restaurants were limited to takeout/delivery, and only essential goods retailers could remain open, such as grocery and hardware stores. Those retailers were required to have plans to safely limit the number of people in the store at any given time, with capacity based on the total square footage. Face masks are mandatory in public spaces outside of the home.

The lifting of regulations began June 1, and will slowly roll out through the summer. Starting June 1, curb-side retail is allowed, but with limitations. These include clear access to sidewalk, street or alley for pickup; fewer than 10 employees handling the site at once; and the store must be outside of an enclosed shopping center. **Starting June 15, outdoor fitness, outdoor dining and indoor retail began to open, although malls require approved plans.** Hair salons, barber shops and indoor dining is expected to commence on July 13. In mid-August, gyms, limited indoor leisure (movie theaters, bowling alleys), all bars, and all other personal services, such as tattoo parlors and nail salons, will open.

Specialty's Café & Bakery – a regional sandwich chain – closed its more than 50 locations for good after 33 years in business. They were heavily located in dense downtown areas and served both the lunch-time corporate crowd and office catering. The Golden Gate Restaurant Association, a trade group for restaurants in San Francisco, predicted in late April that only 50% of San Francisco restaurants will reopen.

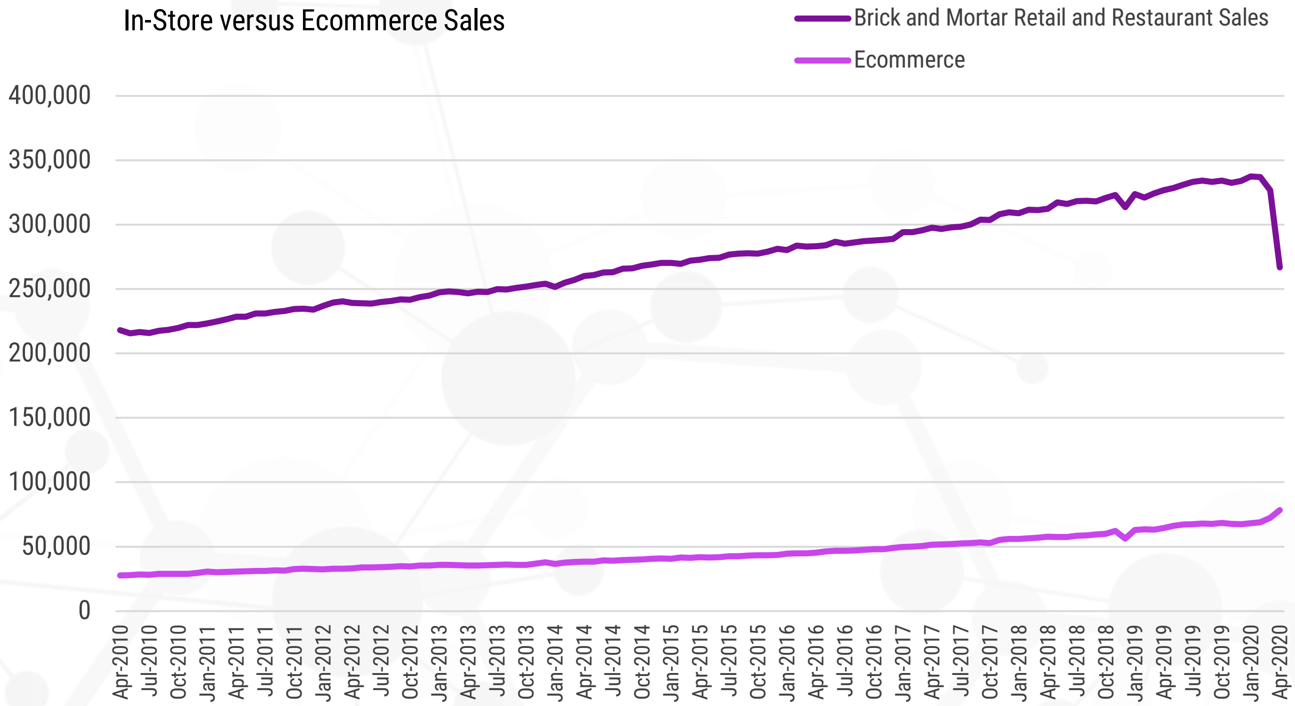
There is uncertainty surrounding rent rolls, and a considerable gap between buyers' and sellers' expectations for pricing. These factors have created a standstill on investment activities with limited financing available. Sales post-COVID-19 range from 0% of pre-COVID-19 levels if stores are closed, to twice what they were pre-COVID-19. Those seeing rising sales include grocery stores and liquor stores. The impact of this pandemic on the retail real estate industry is still unknown, but the consensus is that there will be a fallout on rents and occupancy.

Specialty's in the Bay Area

Sir Francis Drake Hotel in San Francisco

Retail and Food Services Sales
National Seasonally Adjusted

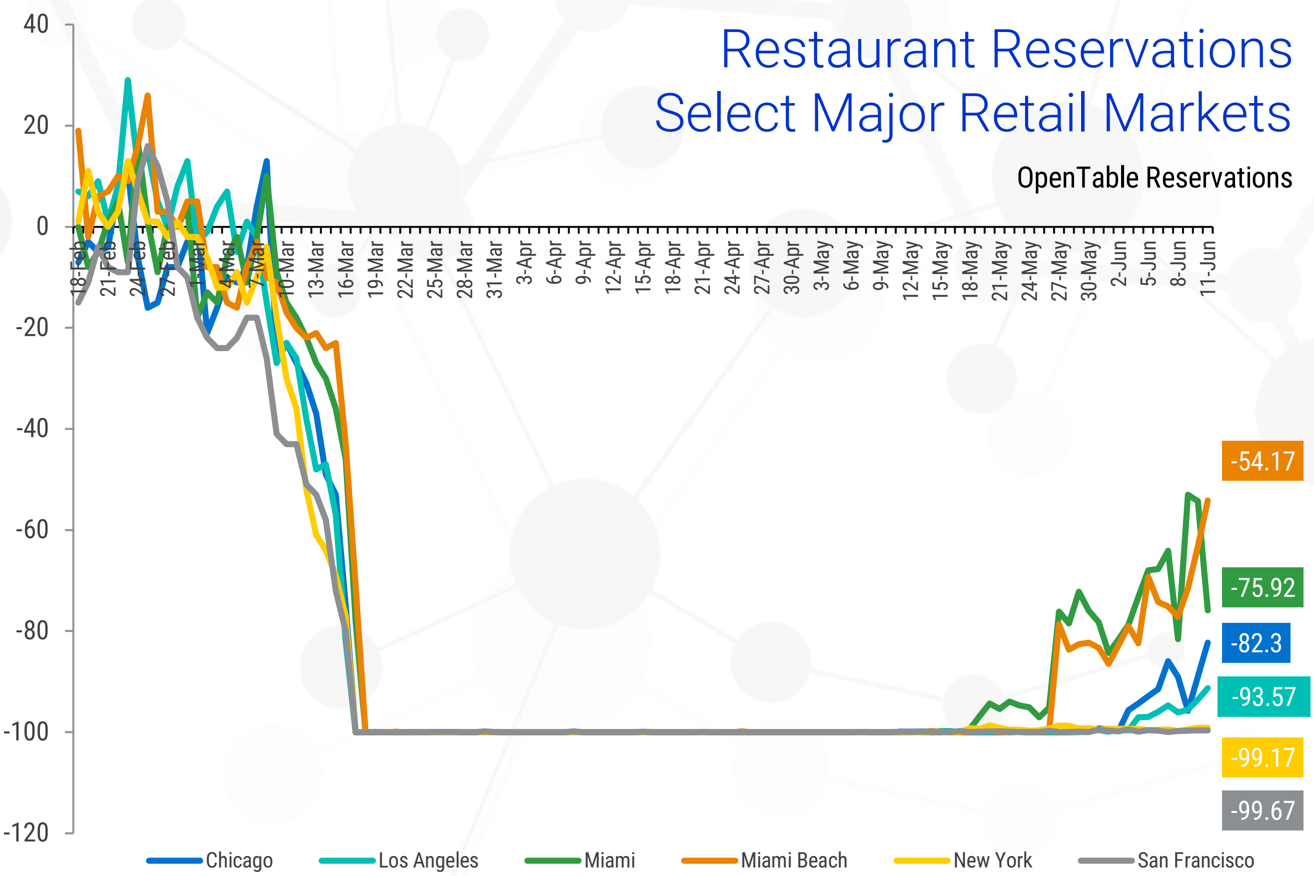
In-Store versus Ecommerce Sales



Source: NKF Research, U.S. Census Bureau

Restaurant Reservations
Select Major Retail Markets

OpenTable Reservations



Source: NKF Research, OpenTable

International

Disney in China

Mall of Emirates in Dubai

6 China

The restrictions were lifted at the end of March in the cities under lockdown, except for Wuhan, which opened on April 8. All travel is regulated by a QR code. **The retail sector has returned to normal with almost 100% of stores open** with strict social distancing procedures in place. Some major tourist sites are also accessible, but with limited access, including the Great Wall of China, and Disneyland Park in Shanghai. Although sales fell sharply in the first quarter of 2020, some shopping center properties have seen a marked improvement in sales and foot traffic. As a result, **consumer sales have seen a notable improvement, with May sales in Shanghai up 0.6% year-over-year** compared to a 20.7% decline in March, while Beijing's May sales were down 9.3% compared to 28.3% for March.

7 Dubai

Retail slowly reopened in Dubai with occupancy caps and curfews in place. The occupancy cap was initially set at 30%, then lifted to 70% in malls. The same limit of 70% also applies to staffing. Normal hours for malls have also resumed. Those under 12 years old and over 60 are still not permitted in malls and sports facilities. Cinemas reopened with a 30% cap on occupancy and implemented various rules on seating arrangements. Gyms reopened with a 50% occupancy cap, with most gyms operating for one hour before closing for 30 minutes to sanitize. Consumers are required to schedule a specific time slot through an app. Bars that serve food reopened, with social distancing required. **As of June 3, retail returned to 100% capacity and curfews were relaxed to 11 p.m. to 4:30 a.m.**

Dubai has a population of 3.3 million residents, but the city's 17 million tourists drive the retail sector. As European and Asian markets begin to reopen, Dubai should begin to see a significant improvement. Dubai's Emirates airline has resumed limited flights, with plans to ramp up operations.

8 Spain

Since March 14, the government declared a state of alarm to prevent the spread of COVID-19. Only essential stores, including supermarkets, basic goods stores, pharmacies, gas stations, tobacco shops and dry cleaners, were permitted to stay open. As a result, April retail sales were down 31.5% year-over-year. **On May 4, nearly the entire country began Phase 0 of reopening, which allowed service businesses to open if health and safety conditions were met.** Inside an establishment, different security measures must be kept, such as distancing. There must be one client per worker, with priority shifts for the elderly and dependents. Restaurants and cafes also opened with takeout.

Subsequent phases vary by province. Under Phase 1, small shops opened under secure conditions. These excluded shopping centers, except for premises that had an independent entrance from the outside. Libraries and indoor cultural events with a capacity of less than 30 people could resume, and outdoor events had a maximum capacity of 200 people. Museums could open at a third of their capacity, and gyms could operate by appointment only.

In Phase 2, shopping centers opened to the public. The capacity is limited to 30% for common areas and 40% for establishments respecting five feet of social distancing, or where there is only one customer inside. There are also preferential hours for people over 65 years old. Consumption indoors with table service is allowed, operating at one-third capacity. Cinemas and theaters may also reopen with a third of their capacity. In hotels, common areas open at a third of their capacity.

More than 50% of regions (which incorporate several provinces) are currently in Phase 3, which incorporates greater flexibility and **is generally considered to be the new normal for the foreseeable future.** People must maintain a distance of six feet and wear masks. Shopping centers operate at 50% capacity in the common and recreational areas, with social distancing. Bars and restaurants operate at half capacity, while indoor sports and activities are authorized to resume with capacity control.

Madrid and Barcelona were among the last to enter Phase 1 on May 25. By June 22, all of Spain is expected to be in Phase 3.

Shopping mall in Spain

9 United Kingdom

Social distancing in the UK began in March and included six-feet restrictions on contact and restrictions on going outside, except for exercise. This has been relaxed, as people can now go out as often as they want. **Non-essential shops reopened June 15. There will still be six-feet restrictions in place, likely for the foreseeable future, though the government is exploring reducing this.**

All non-essential shops were closed at the start of the pandemic, leaving only essential stores open, including grocers and pharmacies. In-door capacity restrictions led to significant lines. Deal activity, sales and foot traffic significantly declined, with variable impact by retailer and sector. The lockdown has impacted UK retailers and property owners significantly. The UK has been hit harder than most other European countries. With no airport screenings and some people failing to follow lockdown regulations, the UK may recover less quickly than other economies, unless the UK Government passes further economic stimulus, which is under review at the time of release of this report.

Many of the brands planning to open new stores at the beginning of the year have put expansion plans on hold, as current market conditions create a significant drain on their finances. However, those with deep cash reserves, strong online revenues or smaller store portfolios will be in a better position to negotiate favorable deals with landlords when the market returns to some semblance of normalcy. Some sectors, such as grocery, have posted record sales growth numbers as people have been panic buying, both in-store and online.

Retail outlet Jack Wills in UK

Leisure and other sectors have been hit extremely hard, given the closure of all restaurants, bars and pubs. It is hard to see how Leisure will recover in the foreseeable future, as people are likely to avoid medium and large, perhaps until a vaccine for COVID-19 is created.

Retailers struggling prior to the crisis, such as Laura Ashley and Oasis/Warehouse, have fallen into administration, while others such as Debenhams, Arcadia and Jack Wills have accelerated the pace of store closures. Others, such as All Saints and Monsoon, are looking to rationalize real estate portfolios. While the government has provided business rates holidays for retailers and the opportunity to furlough staff, retailers have had to negotiate rent relief from landlords, with some very reticent to offer such concessions – even threatening to issue statutory demands for non-payment of rent.

Securing rent in the current climate has proven extremely difficult for landlords, given that the government is backing retailers if they choose not to pay. Some retailers, such as H&M, have even introduced 'pandemic clauses' which would empower them to break a lease if turnover for that store does not return to at least 90% of pre-pandemic levels. **Vacancy rates will be substantial** given the volume of business failures that will occur before the pandemic is over**. Rents will be forced down further** as retailers seek to cut costs to counter the effects of lower demand and pure percentage of sales deals will become the norm.

Shops in Paris, France

10 France

The decrease in the spread of COVID-19 and the need to revive the economy prompted French authorities to lift the strict lockdown introduced on March 17, which had led to the closure of all shops that were non-essential. **Certain restrictions were lifted on May 11, allowing most shops to reopen,** except for cafes, restaurants, cinemas and certain Parisian department stores and large shopping centers (greater than 430,000 square feet). Since then, the restrictions have been eased further, allowing all restaurants and cafés to reopen. **The Greater Paris Region was initially limited to offering dining on terraces only, but that expanded June 15 to full reopening.** Most of the country's department stores and shopping centers have also been allowed to reopen.

The situation is still far from normal. The new standards of social distancing notably impose a minimum area of about 43 square feet per person in enclosed spaces, which significantly limits capacity. The psychological aspect can also influence the frequency of visits to shops. **Nevertheless, the first indicators released since the beginning of the lifting of lockdown are encouraging.** For example, **Unibail-Rodamco-Westfield announced that visitor numbers at its French shopping centers, which have been open since May 11, reached more than 60% of last year's level** for the same period. Some activity sectors are also reporting strong results, such as hardware stores, while others are seeing their problems worsen. Fashion, for example, saw sales fall by 31% between January and April 2020, and could fall by 17% to 25% over the course of the year.

Recovery also remains very uneven depending on the retail format. For example, retail traffic in the densest office districts has fallen sharply due to reduced commuting and the widespread adoption of remote working. Current restrictions on inter-regional and international travel also penalize main retail streets, which usually attract the largest consumer foot traffic.

International tourism is a key driver of Parisian retail. In 2019, foreigners accounted for 47% of hotel arrivals in the Greater Paris Region, including a large proportion of North Americans and Chinese. Luxury retail streets will consequently experience a slowdown in 2020 and even 2021. This is likely as the leading retail brands in the sector are expected to concentrate their efforts in Asia for the time being, where sales have already started to rise again. Conversely, the current situation is more favorable to suburban shopping areas, which depend on the use of private cars and where drive-through points have been experiencing an upsurge in traffic since the beginning of the epidemic.

11 Sydney

In Australia, where partial lockdown of shops was introduced in March, restrictions are now being eased depending on the region and activity sector. **Retail shops have reopened, as have cafes and restaurants, but with social distancing measures in place, including restrictions on the number of customers permitted. Food markets, gyms, cinemas and other entertainment venues remain closed, but a further easing of restrictions is expected in July.**

Rent collection is under severe pressure due to store shutdowns in April and May and higher cap rates. According to National Australia Bank, retail sales fell 18% month over month and reached their lowest levels since 2015. It is expected that May sales will also be weak. While it is too early to determine sales increases as a result of removing restrictions, with an outlook for higher unemployment and constrained retail sales for the foreseeable future, it can be assumed that there is additional downside to rents and values still to come.

National Australia Bank in Australia

Conclusion

Cities and businesses across the world are grappling with the evolving public health crisis, changing regulations and shifting consumer spending habits. Learning from neighbors is one of our greatest strengths at a time of deep uncertainty. While the global retail market has been dramatically affected in the short-term, businesses will adapt and look to other markets for best practices.

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