

# Retail Insights

October 8, 2020

DJIA: **28,426** | RMZ: **1,097** | 10-Year T-Note: **0.77%**



## Framing a Not So “Small” Problem

### Overview

- Covid has placed unprecedented pressure on many small businesses
- These businesses represent ~15% of total rent in a typical strip center
- Government data allows for an analysis of historical start and failure rates
- Each year ~11% of small businesses fail, but a similar number launch
- The GFC did not cause the failure rate to spike, but formations slowed
- We forecast ~25% of small businesses in strips will close in '20 and '21
- This is only slightly higher than the “normal” pace of failures
- The bigger issue is the formation rate is expected to be at an all-time low
- The two-year net change is expected to be -12%, far worse than GFC
- Retail fundamental forecasts are unchanged in this report



**Important disclosure on page 11**

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# Executive Summary

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## Small-Businesses in Strip Centers

- Small-businesses play a vital role in the strip center value proposition, but typically have weak credit and high turnover
- The most common small-businesses in strip centers are hair and nail salons, restaurants, dry cleaners, and local retail

## Historical Small-Business Activity

- Government data allows for an analysis of small-business start and failure rates over time
- Restaurants and personal care services (hair, nails) have been on the upswing since the GFC; local retail trending down
- Strip center small shop space is flexible and able to adapt to an evolving demand profile
- Approximately 11% of small businesses fail each year, but a similar number of small businesses are launched
- The GFC did not cause the failure rate to materially increase, but the pace of formations dipped slightly
- Surprisingly, restaurants do not have a materially higher failure rate compared to other small businesses

## Small-Business Forecasts in a Pandemic

- Green Street forecasts ~25% of small businesses that typically reside in strip centers will close in '20 and '21
- This is only marginally above the "normal" failure rate, due to the Paycheck Protection Program and rent relief
- The bigger issue for retail landlords is the small-business formation rate is expected to be at an all-time low
- Historically, there has been a local tenant ready to open a store after another one fails; no longer the case during Covid
- The two-year cumulative net change in strip center small businesses is expected to be -12%, far worse than the GFC

## Retail Real Estate Implications

- A typical center derives ~15% of total rent from small businesses; higher for grocery-anchored, lower for power centers
- Strip center small shop space is comprised of roughly 1/3 small businesses and 2/3 regional and national entities
- Small shop occupancy should decline by 750 bps cumulatively in '20/'21; retail fundamental forecasts are unchanged

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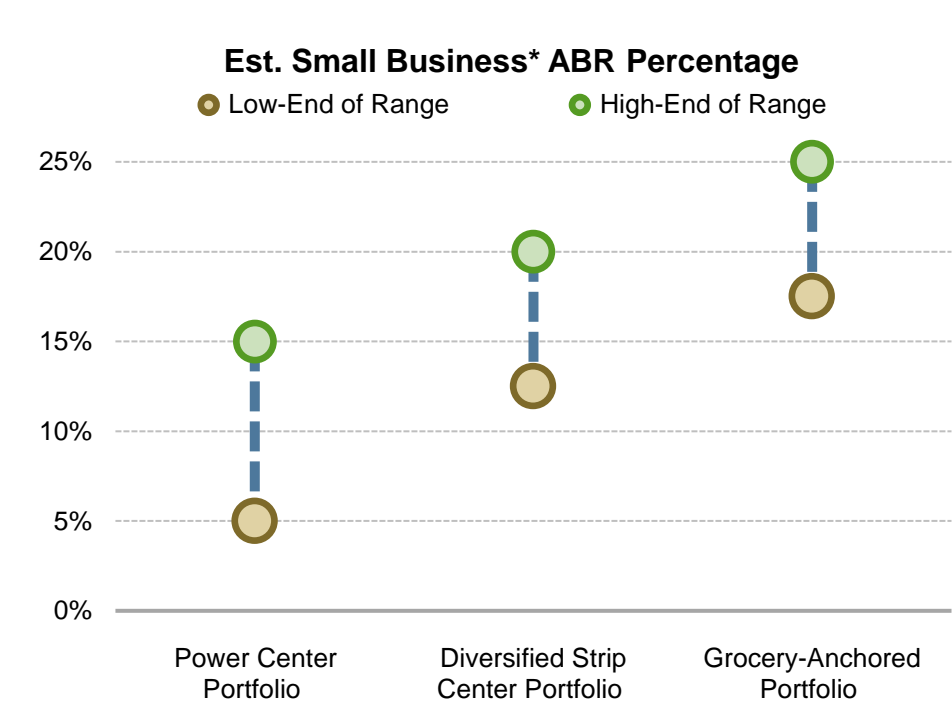
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# Small Businesses in Strip Centers

**An Integral Part of the Retail Ecosystem:** Small businesses are a key source of demand for strip centers and generally represent one-third of small shop space and ~15% of total rent, with grocery-anchored centers having more local tenants and power centers fewer. These tenants typically have weaker credit profiles and higher failure rates than national chains.



\*The Small Business Administration (SBA) defines a small-business as having fewer than 500 employees.  
Source: Company disclosure, Green Street Advisors

## Most Common Strip Center Small Businesses



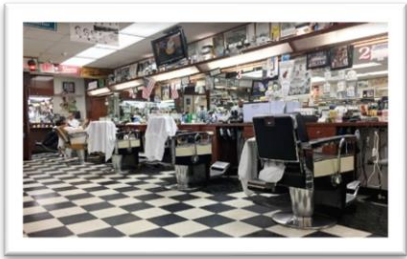
Nail Salons



Dry Cleaners



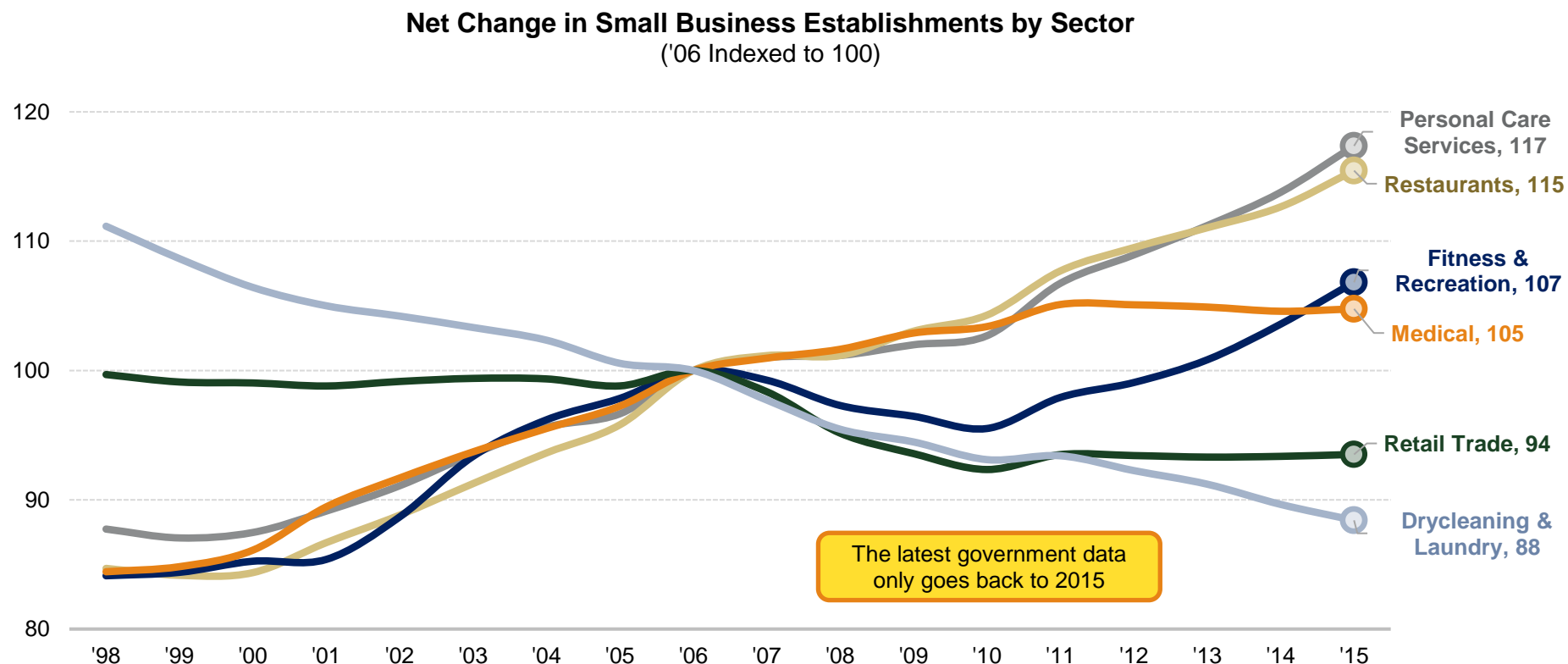
Restaurants / Food Places



Hair Salons / Barber Shops

## An Evolving Small-Business Mix

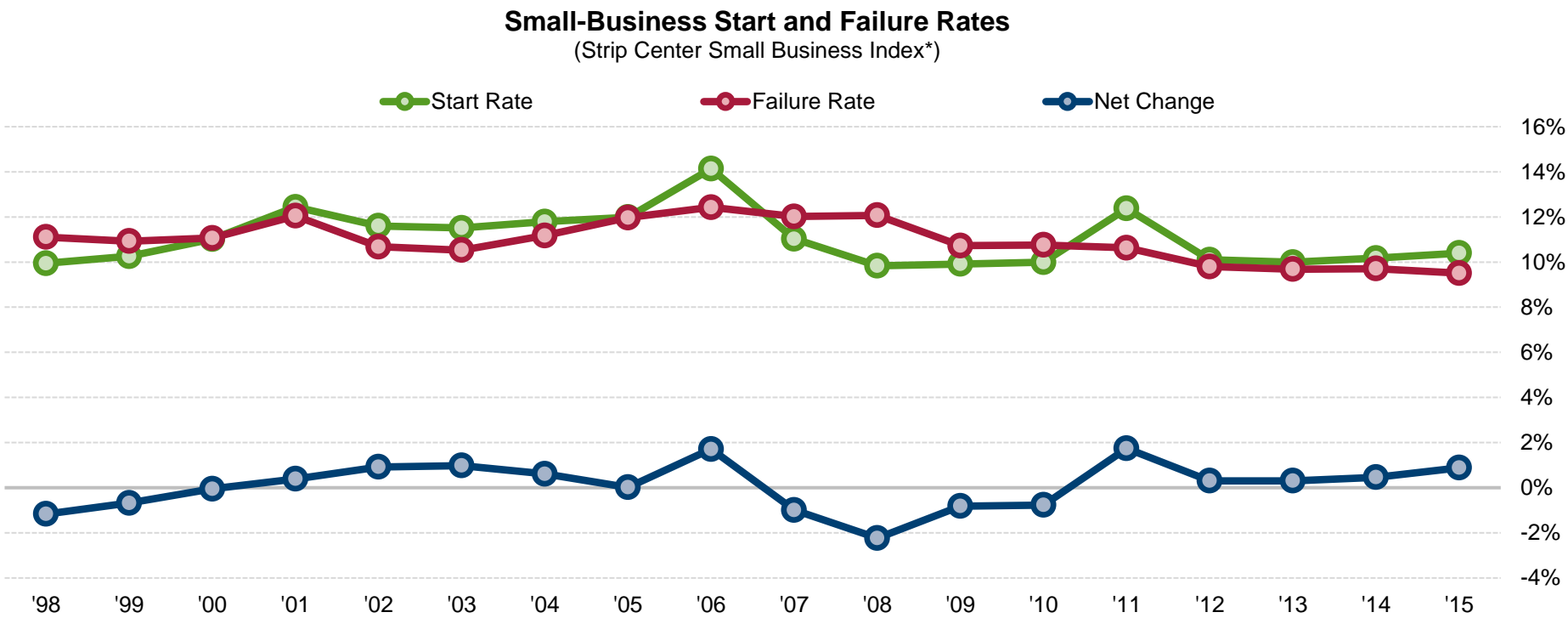
**Darwinism:** The number of small businesses selling services, such as personal care (e.g., hair, nails), restaurants, and fitness, have grown since the Global Financial Crisis while the number focused on retail has shrunk. Small shop strip center space is flexible and able to adapt to an evolving demand profile.



Source: Census Bureau, Bureau of Labor Statistics, Green Street Advisors

# Small-Business Start and Failure Rates

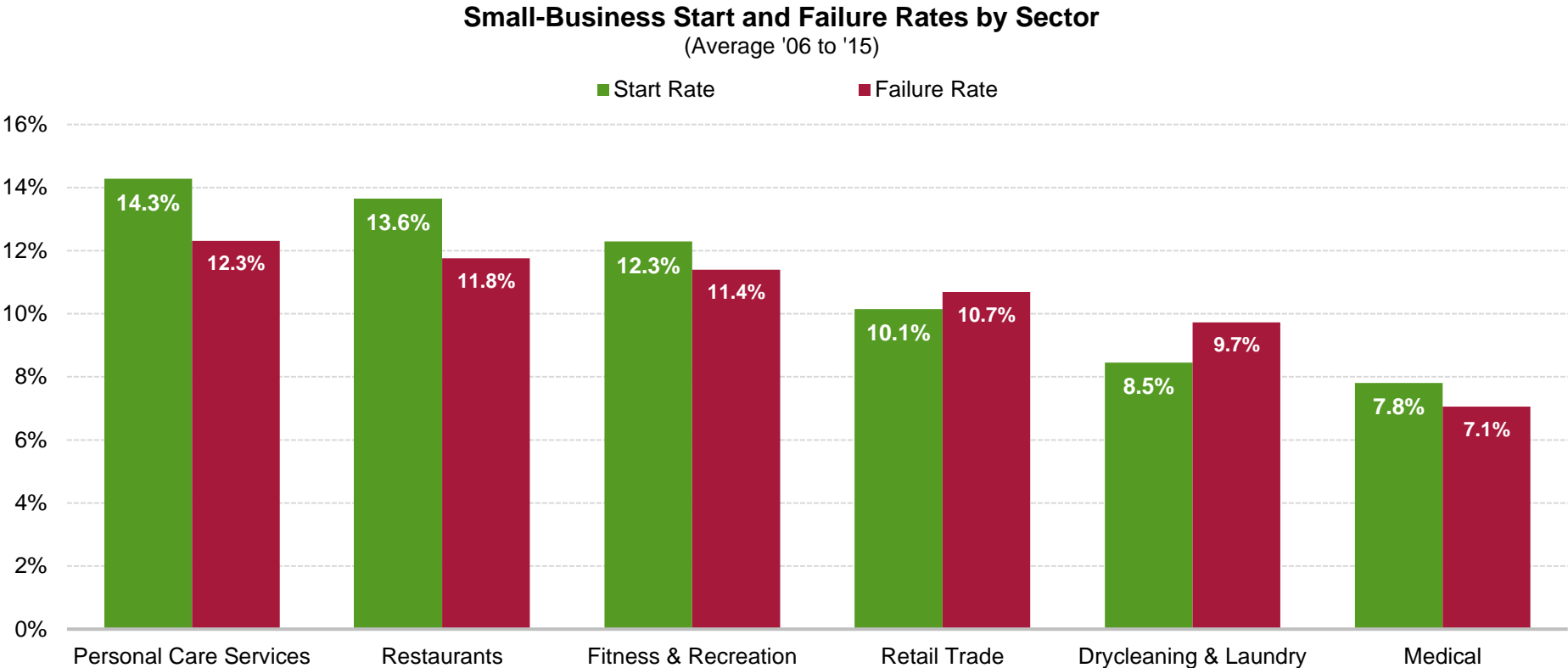
**Putting Together the Pieces:** Over the past two decades on average, approximately 11% of small businesses fail each year, but a similar number of small businesses are launched. Historically, there has been a local tenant ready to open a store after another one fails. Surprisingly, the Global Financial Crisis did not cause the small-business failure rate to spike, though the pace of small-business starts dipped modestly during that period. The number of small businesses declined each year from '07 to '10.



\*Green Street created an index representative of the typical small business category mix in a diversified strip center portfolio. Weightings are adjusted to reflect the changing category mix over time.  
Source: Census Bureau, Bureau of Labor Statistics, Green Street Advisors

# Start and Failure Rates by Sector

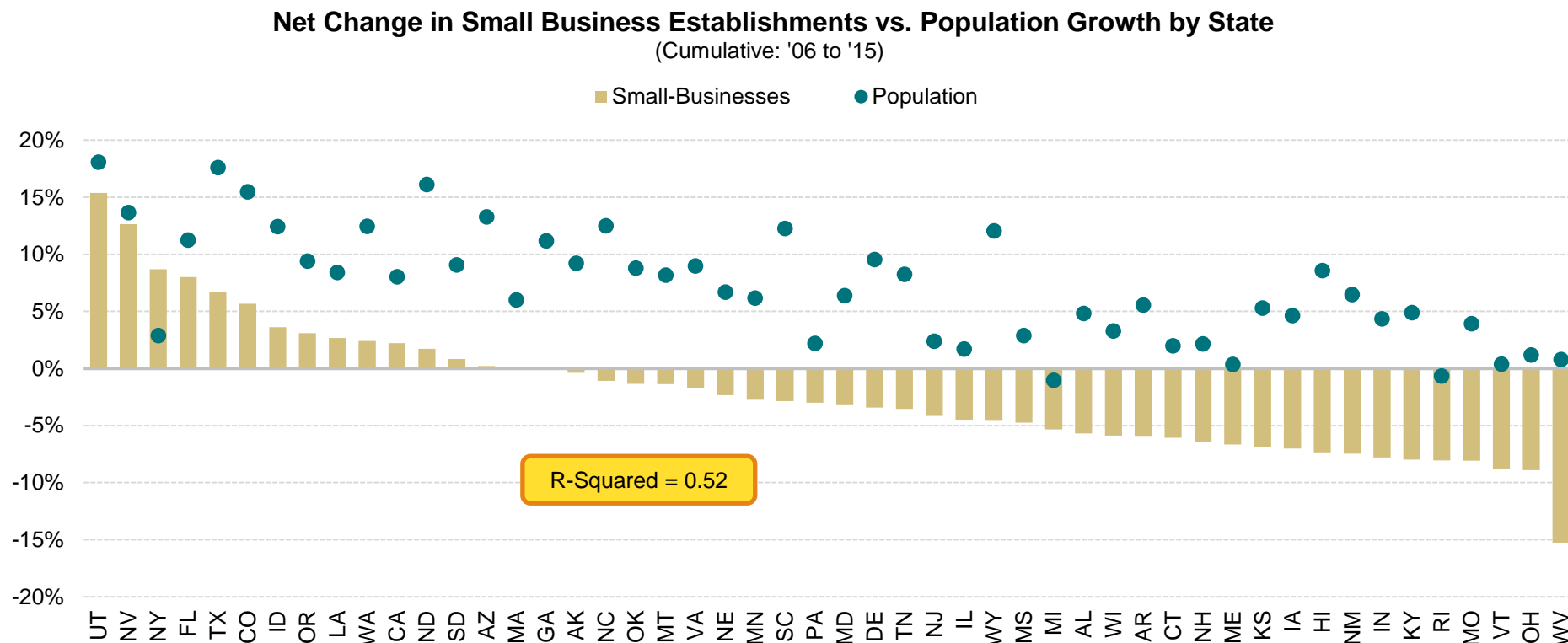
**Common Misperception?** Restaurants are generally perceived to have poor underlying economics. However, restaurants do not have a materially higher failure rate compared to other small businesses, especially after considering the higher rate of starts. For retail landlords though, re-tenanting restaurant space (even for another restaurant) comes with a hefty cap-ex bill. Medical uses have the lowest failure rate.



Source: Census Bureau, Bureau of Labor Statistics, Green Street Advisors

## Geographic Analysis

**Wide Range:** The net change in small business establishments has lagged population growth in every state except New York from '06 to '15. Only 30% of U.S. states have seen the absolute number of small businesses expand over this period. Negative net demand often leads to a dire real estate fundamental outlook. Strip center REITs have sold out of many of these tertiary-market states where net small-business demand has turned negative.



Source: Census Bureau, Bureau of Labor Statistics, Green Street Advisors

# Forecasting in a Pandemic: Paycheck Protection Program

**Is the Aid Enough?** The Covid-induced recession is different from its predecessors for many reasons, one of which is the speed and magnitude of financial assistance offered to small businesses through the U.S. government's Paycheck Protection Program (PPP). This program could help some small businesses get through the crisis. However, the sub-sectors most impactful to strip centers (e.g., services, retail trade, restaurants) received proportionally less aid relative to the number of employees.

## Total PPP Loans Granted\*

~5,200,000

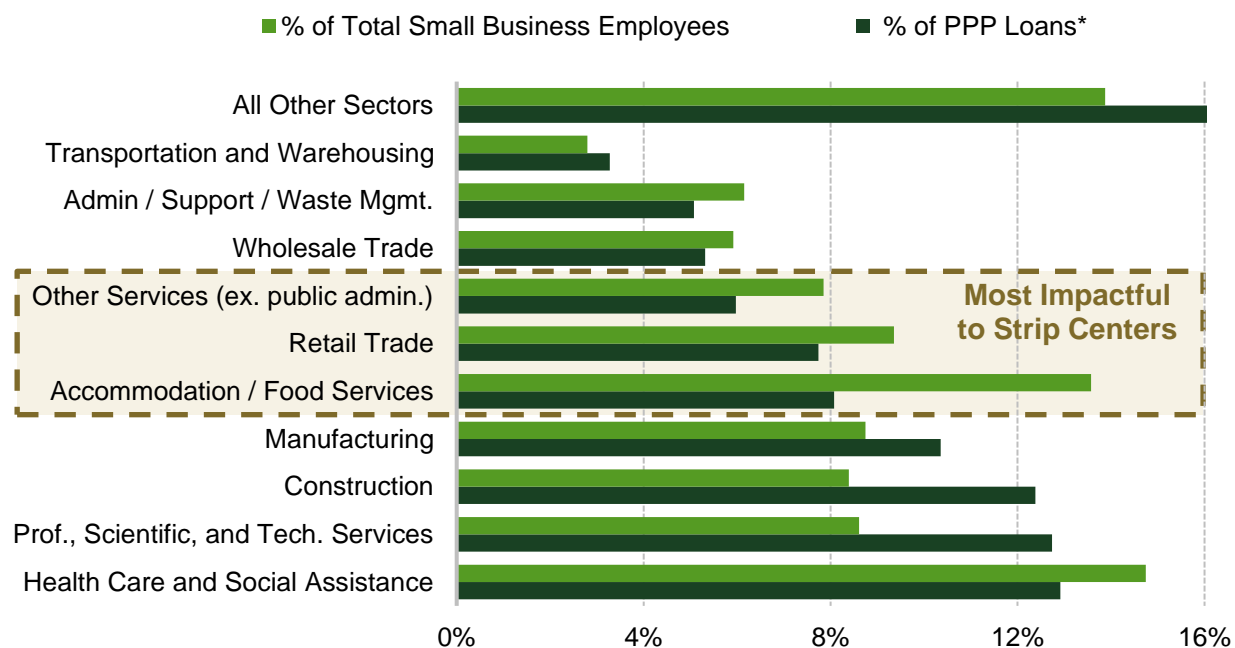
## Aggregate Loan Amount\*

~\$525,000,000,000

## Average Loan Size\*

~\$100,000

## Share of PPP Loan Amount by Small Business Sector



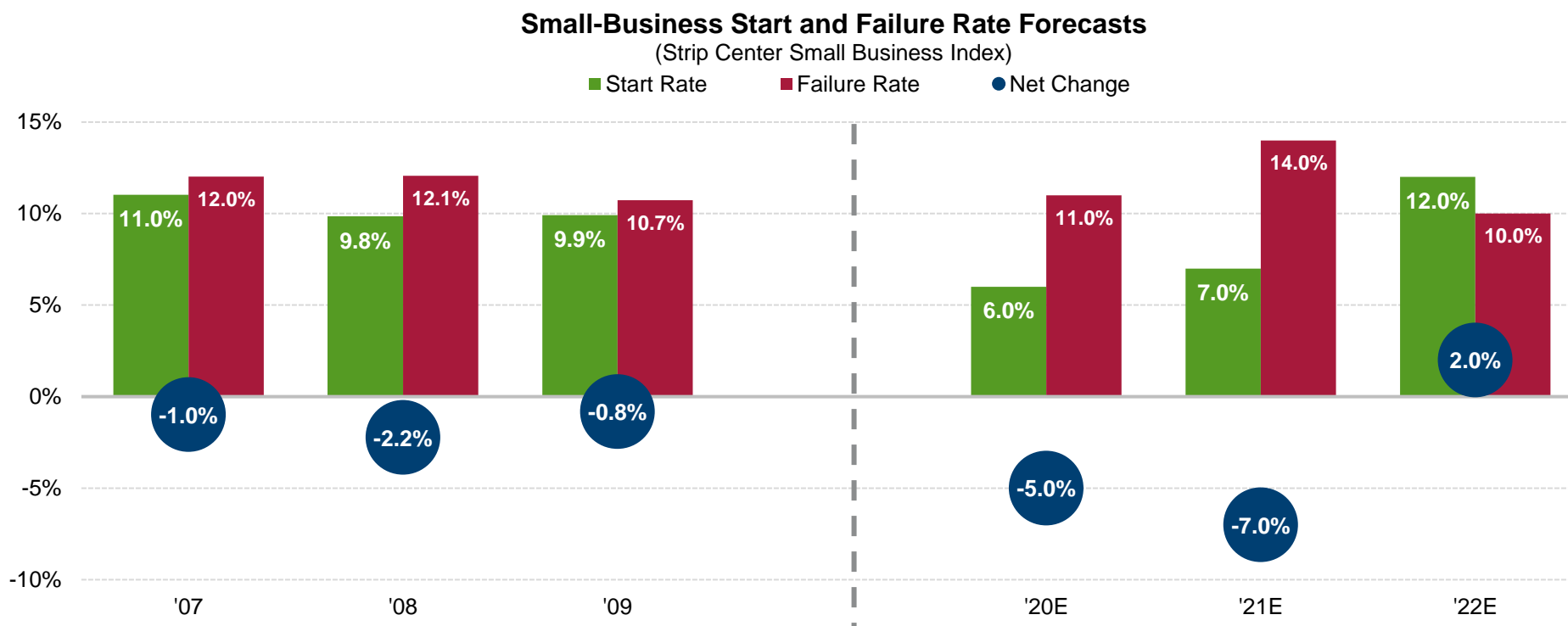
\*As of August 2020

Source: Census Bureau, Bureau of Labor Statistics, Small Business Administration, Green Street Advisors



## Forecasting in a Pandemic: Start and Failure Rates

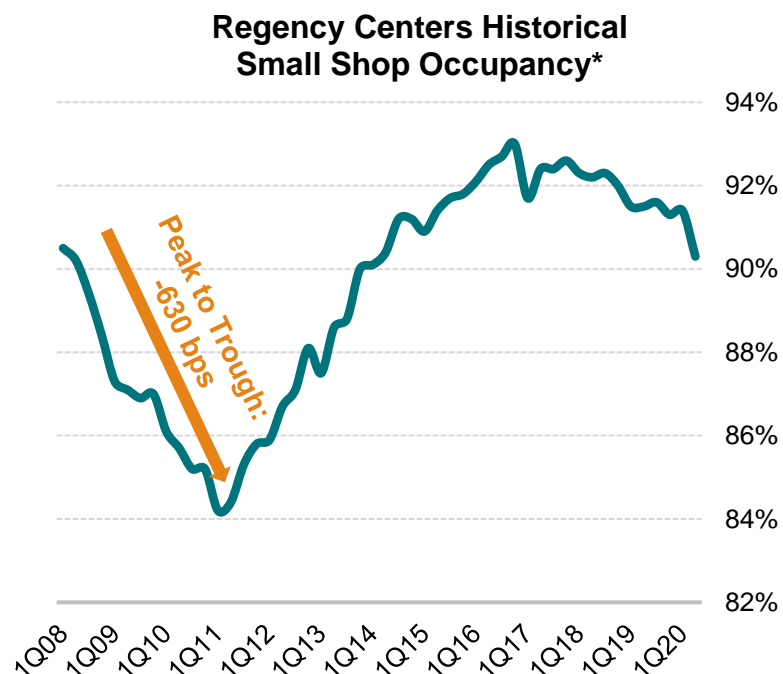
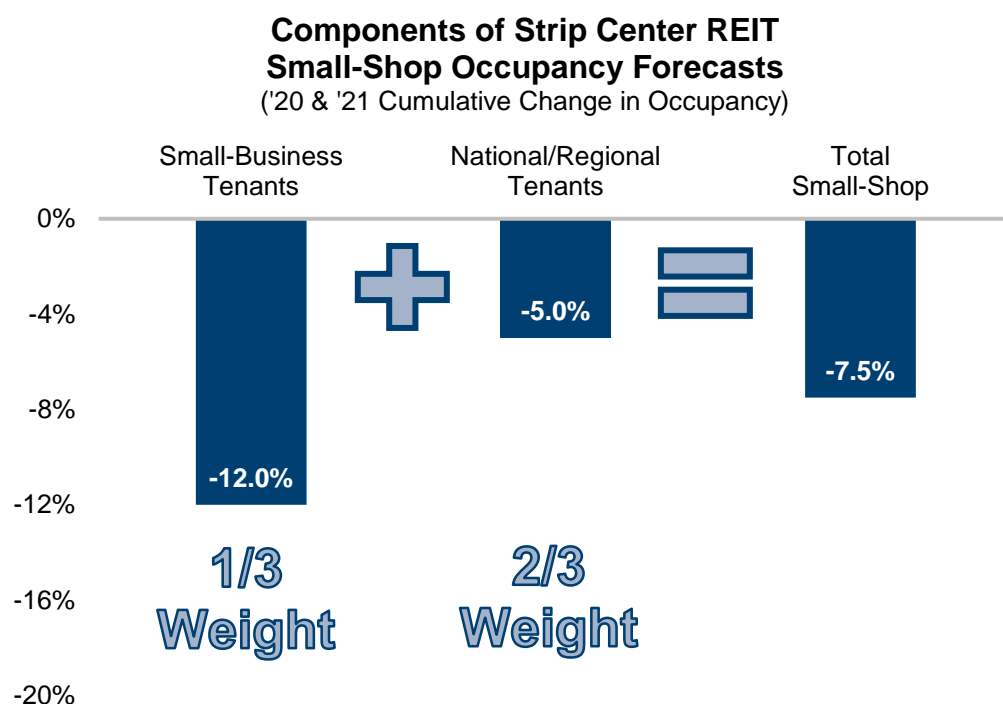
**Outlier Forecasts in Unprecedented Times:** Green Street forecasts ~25% of small business establishments that typically reside in strip centers will close in '20 and '21 due to the impact of Covid and associated economic contraction. This is only marginally above the "normal" pace of small-business failures due to PPP, a historically low pace of new starts (many new enterprises fail in year one), and landlord rent relief. However, the lack of new openings is the bigger issue for retailer landlords. In a pandemic, there is no longer a new local tenant looking to open a store after another one fails. The two-year cumulative net change in strip center small businesses is expected to be -12%, far worse than the GFC.



Source: Census Bureau, Bureau of Labor Statistics, Green Street Advisors

# Forecasting in a Pandemic: Retail Real Estate Fundamentals

**Occupancy Forecasts Seem in the Right Ballpark:** Strip center small shop space is comprised of approximately one-third small businesses and two-thirds regional and national entities. Green Street forecasts assume strip center REIT small shop occupancy will fall by 750 basis points cumulatively in '20 and '21. A net decline in small businesses over this period of 12% implies occupancy from regional/national chains will decline by ~5%. This seems reasonable based on small shop occupancy changes during the prior recession. Our retail fundamental forecasts are unchanged in this report.



\*Most strip center REITs did not provide small shop occupancy prior to the GFC; Green Street's Small Business Index does not perfectly align with Regency's occupancy losses during GFC

Source: Green Street

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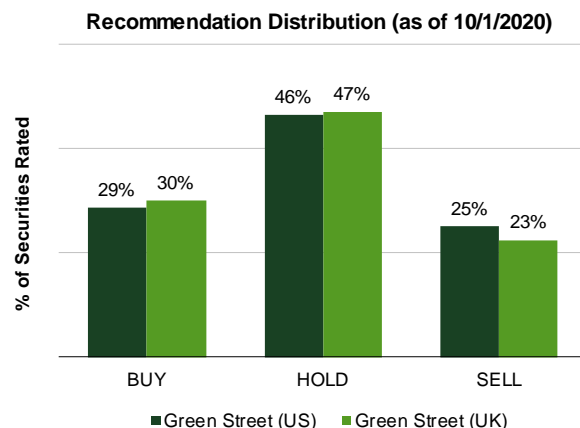
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Year <sup>3</sup>	Buy	Hold	Sell	Universe
2020 YTD	-12.7%	-27.7%	-34.7%	-25.2%
2019	31.6%	22.4%	17.8%	24.0%
2018	-5.1%	-6.6%	-9.2%	-7.0%
2017	6.4%	0.2%	2.1%	2.6%
2016	14.9%	14.7%	13.1%	14.4%
2015	8.3%	0.9%	-1.7%	2.4%
2014	41.6%	31.5%	27.3%	33.3%
2013	4.1%	0.6%	1.7%	2.2%
2012	24.5%	24.7%	18.9%	23.0%
2011	18.9%	7.6%	-4.7%	7.6%
2010	43.3%	32.8%	26.6%	33.8%
2009	59.0%	47.7%	6.0%	37.9%
2008	-28.1%	-30.9%	-52.6%	-37.3%
2007	-6.9%	-22.4%	-27.8%	-19.7%
2006	45.8%	29.6%	19.5%	31.6%
2005	26.3%	18.5%	-1.8%	15.9%
2004	42.8%	28.7%	16.4%	29.4%
2003	43.3%	37.4%	21.8%	34.8%
2002	17.3%	2.8%	2.6%	5.4%
2001	34.9%	19.1%	13.0%	21.1%
2000	53.4%	28.9%	5.9%	29.6%
1999	12.3%	-9.0%	-20.5%	-6.9%
1998	-1.6%	-15.1%	-15.5%	-12.1%
1997	36.7%	14.8%	7.2%	18.3%
1996	47.6%	30.7%	18.9%	32.1%
1995	22.9%	13.9%	0.5%	13.5%
1994	20.8%	-0.8%	-8.7%	3.1%
1993	27.3%	4.7%	8.1%	12.1%
<b>Cumulative Total Return</b>	<b>18437.0%</b>	<b>951.7%</b>	<b>-7.3%</b>	<b>1184.9%</b>
<b>Annualized</b>	<b>20.8%</b>	<b>8.9%</b>	<b>-0.3%</b>	<b>9.7%</b>

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- (2) Beginning July 5, 2017, all companies in Green Street's North American coverage universe are included in the performance calculation. Previously, inclusion in the calculation of total return had been based on whether the companies were listed in the primary exhibit of Green Street's "Real Estate Securities Monthly" and had a rating other than "Not Rated".
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