LBX Weekly Update #5: Portfolio Update And Commentary On Current Market Conditions

LBX investments

MARKET COMMENTARY APRIL 20, 2020

As April Winds Down, May Rent Relief Requests Heat Up

This Week, We Discuss Our Views On Current Market Conditions As Well As Industry Data Points

Dear Investor,

We hope this message finds everyone healthy and safe. This week, we will provide a brief portfolio update and conduct a deeper dive into COVID-19's impact on retail. Please see below:

Portfolio Update: Rent Collections and Lender Forbearance

- **April Collections Are Close To Finalized; We Topped 62% For The Month**

While there are a few rent checks still trickling in, April collections are largely complete. As of Monday, April 20th, we collected 62.3% of billings from our tenants. While this number is above industry averages, we expect a significant decline in portfolio performance for May as 55% of all retail around the country is now closed, per Cushman and Wakefield. 49.5% of our tenants have requested some form of rent relief, regardless of whether they paid April's rent. Our markets are also operating on a lag compared to New York, California and Washington – this means statewide shutdown orders were issued later and have therefore just begun to fully impact our tenants.

LBX Portfolio Collections and Rent Relief Status (As of April 20, 2020)

Property	State	Statewide Shutdown Order	April Collections (%)	% of Tenants Seeking May Rent Relief
Colony	GA	April 3	77.7%	26.3% (5 of 19)
Oakwood	TN	March 30	71.1%	47.2% (17 of 36)
Alafaya	FL	April 3	70.5%	68.8% (11 of 16)
Harbison	SC	March 29 (Columbia)	57.2%	50.0% (10 of 20)
Terraces	NC	March 30	42.1%	61.9% (13 of 21)
Chapel Hill	GA	April 3	81.7%	26.3% (5 of 19)
North Rivers	SC	April 7	48.6%	64.7% (11 of 17)
Oakbrook	SC	April 7	85.1%	16.7% (3 of 18)
Fultondale	AL	April 4	42.8%	53.8% (14 of 26)
Portfolio			**62.3%**	**49.5% (90 of 184)**
Shutdown Orders	CA, NY, WA	March 19, 22, 23		

Source: LBX Investments

- **Status of Rent Deferrals and Forbearance**

Early this week we will be sending out draft lease amendments to all tenants who have requested relief. For all local and regional tenants, we will be offering sixty days of rent relief paid back over a defined period of time. The national tenants who have requested relief generally require more complicated agreements than the locals so separately we began those discussions this past week.

Simultaneously, as previously reported, we are having ongoing mortgage relief discussions with several of our lenders. Outside of Chapel Hill (where we refinanced) and Alafaya, Colony Plaza and Oakbrook (where we don't need help yet), we are negotiating 90-day forbearance agreements with all the other lenders. These discussions have all been constructive and friendly and we expect positive conclusions to come out of all of them. These agreements take several weeks to fully negotiate, and we will provide investors with more detail once they are finalized.

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Weekly Retail Recap

As investors know, retail has come under significant pressure in recent years for several reasons including prominent bankruptcies, store closures, Amazon (e-commerce), and oversupply. Still, the news coming out of the sector over the past few weeks has been, to say the least, dire. Here's a recap of some of last week's headlines:

- **The Public Markets – Which Are Inherently Forward-Looking In Nature – Are Very Bearish On Retail**

  Public REITs, and in particular, retail, had a brutal quarter. Friday, S&P announced that the Dow Jones U.S. Select REIT fell 28.5% in 1Q20, both underperforming the S&P 500 and suffering its worst quarterly decline since 1Q09. Industrial and self-storage REITs saw minimal declines and outperformed the market, but strip centers and malls were down 50% and 60.2%, respectively. Only hotels fared as badly.

  This matters because public markets are generally viewed as a leading indicator, suggesting widespread pessimism towards these sectors over the next 12 months and, likely, beyond. This is fueled by concerns about much of what we have been seeing on the frontlines: a) we are inundated with rent relief requests from restaurants and non-essential retailers, and b) there is widespread concern that should we enter into a prolonged recession, many retailers will either go away or never fully recover. The public markets are effectively implying there will be severe earnings degradation in the sector over the next 12 months, and that some of these earnings will not return.

  Investors should note, however, that public and private real estate is subject to different market forces. At some point, we expect this market dislocation to create excellent opportunities to acquire attractive assets because public REITs are likely to be forced sellers.

Broad-Based Declines: Dow Jones U.S. Real Estate Indices (March 31, 2020)

INDEX PERFORMANCE	Cumulative Total Returns		Annualized Total Returns			STANDARD DEVIATION		
Index Name	QTD	1-Year	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Dow Jones U.S. Real Estate TSM	-25.6%	-17.9%	-0.9%	1.2%	7.8%	17.5%	16.2%	15.7%
Dow Jones U.S. Real Estate	-24.4%	-16.7%	-0.1%	1.6%	7.9%	16.9%	15.9%	15.6%
Dow Jones U.S. Select RESI	-28.5%	-24.0%	-4.3%	-1.4%	6.8%	18.4%	17.2%	16.9%
Dow Jones Composite All REIT Index	-25.4%	-18.0%	-0.8%	1.5%	8.0%	17.3%	16.1%	15.6%
Dow Jones Equity All REIT Index	-23.3%	-15.7%	0.1%	2.1%	8.5%	16.6%	15.8%	15.8%
Dow Jones U.S. Mortgage REITs Index	-54.8%	-50.3%	-16.9%	-6.4%	0.7%	33.9%	27.2%	21.4%
Dow Jones U.S. Select REIT	-28.5%	-24.0%	-4.3%	-1.4%	6.9%	18.4%	17.2%	16.9%
Dow Jones U.S. Select Short-Term REIT	-29.3%	-23.1%	-1.8%	1.3%	9.7%	18.3%	16.7%	17.2%

SECTOR RETURNS		
DJ U.S. Select REIT	QTD	1-Year
Apartments	-25.6%	-18.1%
Diversified	-35.7%	-34.6%
Factory Outlets	-65.3%	-74.1%
Health Care	-40.9%	-38.3%
Hotels	-53.4%	-53.3%
Industrial	-3.9%	13.8%
Malls	-60.2%	-67.2%
Manufactured Homes	-16.7%	5.8%
Office	-30.2%	-24.2%
Self-Storage	-8.0%	-4.8%
Strip Centers	-50.0%	-46.8%

Source: S&P Dow Jones

- **March Retail Sales Declined Sharply; April Likely To Be Worse**

  Supporting the public markets downturn, retail sales plummeted in March, down -8.7% from February. This was the steepest one-month sales decline on record but the headline number represents total retail sales. Excluding auto and gasoline, retail sales fell -3.1% during the period (compared to preliminary estimates of -5.2%).

  The decline was broad-based across most categories, driven by a combination of massive job losses and store closures. April metrics are widely expected to decline further as job losses have continued and non-essential businesses – which were still open in many states through late March – are now closed in most states.

Retail Sales (% Change Month-Over-Month)

Item	Mar 2020 (Act)	Mar 2020 (Est)	Feb 2020 (Revised)
Total Retail Sales	**-8.7%**	**-8.0%**	**-0.4%**
- Ex Auto & Gas	**-3.1%**	**-5.2%**	
By Category:			
Clothing	-50.5%		-1.6%
Furniture	-26.8%		-0.9%
Sporting Goods	-23.3%		-0.2%
Department Stores	-19.7%		-0.2%
Electronics	-15.1%		-0.9%
Building Materials	1.3%		-0.2%
General Merch	6.4%		-0.1%

Source: Creditntell, U.S. Census, Bloomberg

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- **The PPP Ran Out Of Money, For Now**

On Thursday, April 16th – two weeks after opening for applicants – the $349 billion Paycheck Protection Program ("PPP") ran out of money after processing more loans in two weeks than it had handled in the previous 14 years combined. While Congress is expected to authorize additional funds (as much as $370 billion) as soon as this week, there are more than 30 million small businesses in the United States. The SBA said that more than 1.6 million of them have been approved for loans through the program but there are still millions of applications in progress. Uncertainty around the PPP and funding status should continue to plague small businesses in the near-term. This will have a ripple effect on employees and landlords. For example, we have several tenants who are promising to deliver April rents as soon as their loans are approved. In the meantime, we cannot collect that rent. We are all waiting together.

PPP: Round 1 By The Numbers

Program Size: $349 Billion	Total Loans Approved: 1,661,397	Total Lenders: 4,975
$150K & Under: 74% of Loans/17% of $	$151K - $1MM: 22% of Loans/37% of $	Above $1MM: 4% of Loans/46% of $

- **Healthier Retailers Are Accumulating War Chests, While J.C. Penney And Other Weaker Companies Struggle**

Over the past two weeks, financially healthy retailers including Dick's Sporting Goods ($500 million convertible note offering and $1.429 billion revolver drawdown), PetSmart ($300 million revolver drawdown), Ross Stores ($2 billion senior note offering), TJX ($4.0 billion note issue) and Big Lots ($725 million gross/$550 million net sale-leaseback transaction) have raised capital not just to be defensive, but to likely position themselves for future opportunities when they arise. Big Lots, for example, paid down all of their debt and are well-positioned to grow in this environment. Leading retailers are demonstrating an ability to access the capital markets at an important time.

Many are predicting, meanwhile, that COVID-19 will hasten the demise of weaker retailers like J.C. Penney ("JCP"). Late this past week, per Creditntell, JCP received an offer for ~$300 million in new financing from creditors who are in a group of first-lien and second-lien lenders. The loan would be secured by real estate that JCP hasn't already pledged to its 2023 term loan. Additional reports state that separately, first-lien creditors are exploring alternatives that could result in the group offering financing also backed by the unencumbered real estate. This news followed rumors earlier in the week that JCP was weighing strategic alternatives after it elected not to make a ~$12 million interest payment due on April 15 on their 6.375% Senior Notes due in 2036. JCP has more than $1.7 billion in cash on its balance sheet, but its burn rate is unclear and the company has deteriorated rapidly over the past few years.

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LBX Views On Today's Market Conditions

Against a historically challenging retail backdrop, LBX held an internal conference call last week to discuss current market conditions and COVID-19's likely impact on the retail sector over the coming months. On the call, which included our managing partners along with Asset Management, Acquisitions, Investor Relations, Research and Leasing, we addressed the following topics:

1) How the 2020 downturn differs from the 2008-2009 downturn
2) The extent to which COVID-19 may lead to permanent structural changes within the retail sector
3) Health of mom-and-pop retailers and their ability to survive the pandemic
4) The strength of our portfolio and the ability, therefore, for LBX to withstand the impact of the pandemic

Below, we discuss our responses:

1. How the 2020 downturn differs from the 2008-2009 downturn

- **Credit vs. Demand:** Our team believes the major difference between 2008-2009 (the last financial downturn) and 2020 is that the last downturn was a credit market-driven dislocation whereas today's is demand-driven, coming from a very different direction because of a health crisis. The reaction – required widespread shutdowns of businesses – and the steepness of the current decline is far more pronounced than what happened in 2008-2009. That economic/financial downturn really started in the middle of 2007 and did not bottom until late 2009 whereas over the past month we have lost more than 22 million jobs.

- **Potential Offsets Offer Hope:** Today's downturn is likely going to be deeper than the last one, but there are some potential offsets. We believe banks' balance sheets are significantly healthier today than they were during the Great Recession. In addition, government reaction has been much quicker and more significant this time around and maybe – despite the PPP bottlenecks – more effective. It took the government many months to react to what was occurring in 2008-2009 whereas a financial aid package roughly three times (in unleveraged dollars) larger than 2009's bailout was cut within a few weeks in response to the pandemic. Regardless, we expect market conditions to be difficult for some time and expect a recovery to be more U-shaped than V-shaped.

- **Consumer Behaviors May Change In The Short-To-Medium Term:** We are also paying attention to changes that the current pandemic may spark: after the Great Recession, people began budgeting more, we saw the rise of the discounters like Ross and dollar stores and the decline of department stores, and there was a new-found focus on financial regulatory reform. This time, putting malls aside, we think most retail is not going to look very different in two years than it did two months ago. We believe people are inherently social animals, and expect consumers to get back to pre-pandemic levels of shopping and entertainment if communities, governments and retailers can address their concerns about health, safety and cleanliness.

2. The extent to which COVID-19 may lead to permanent structural changes within the retail sector

Generally, we think that many of the changes that had been impacting the retail sector prior to the emergence of COVID-19 will now accelerate. We expect better retail to survive but weaker real estate and retailers will struggle and, in many cases, go away.

We expect structural changes to include:

- **Flight To Quality:** We expect healthier mall retailers to continue leaving malls for smaller footprints in strong open-air centers, reducing the overall supply of retail and enhancing the strength of these stronger properties.

- **Weaker Retailers Will Probably Die Off Sooner:** We expect weaker retailers to struggle and many to fold. Department store chains like JCP and mall retailers like Ascena are burning through cash while their stores remain closed.

- **Supply Chain Reliance on China May Lessen Over Time:** We expect companies to diversify their access to product and slowly decrease their dependence on China. We are only several weeks into this pandemic but it is easy to forget that the first few weeks of this financial crisis were characterized by supply-chain driven problems because China was at one point the only superpower grappling with COVID-19. We expect companies to address this issue going forward.

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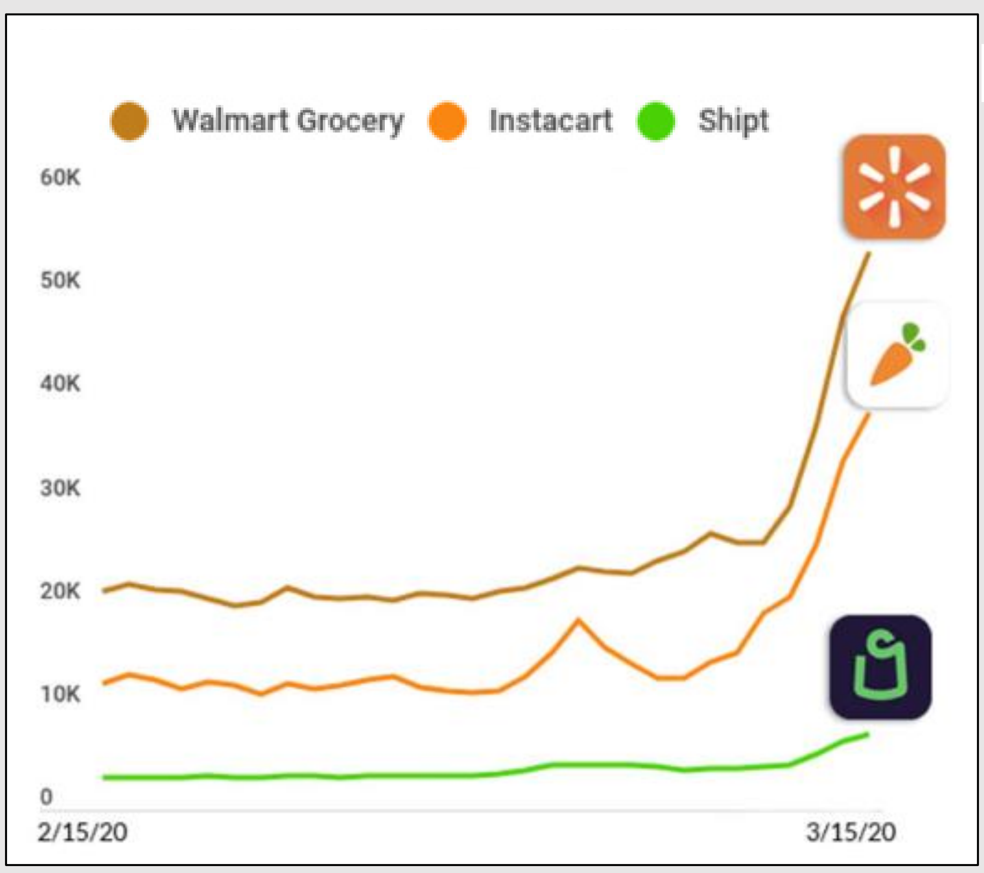
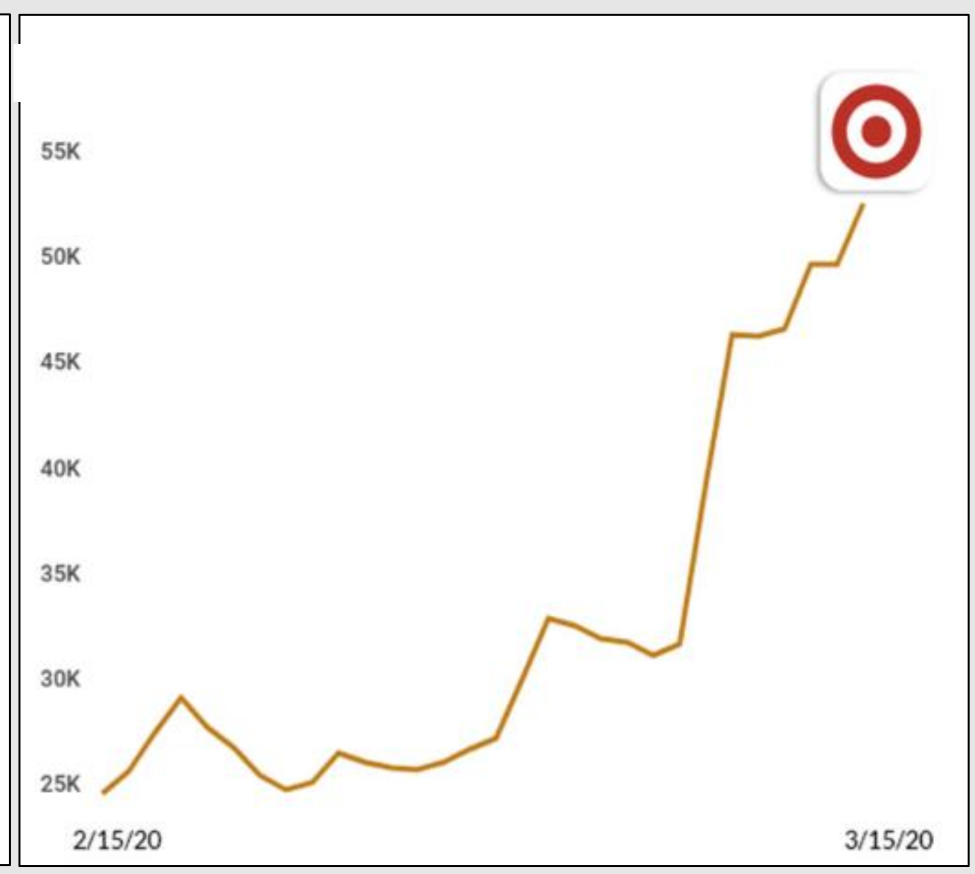
- **Work-From-Home Will Be an Established Category:** We don't understand why Zoom's stock is valued (as of April 7th) at 40 times 2020 consensus revenue, but we do expect work-from-home (and other "from-home" trends) to remain in the public consciousness after stay-at-home restrictions are lifted.

- **Online Shopping Will Become Further Ingrained In The Consumer Psyche, Though Is Not A Death Knell For Bricks And Mortar:** The necessity of buying groceries and other products online during the pandemic has rapidly lead to more widespread adoption of online shopping. For example, per the Brick Meets Click/ShopperKit Online Grocery Shopping Survey, monthly e-grocery users spiked from 13% of U.S. households (16.1 million) in August, 2019 to 31% of U.S. households (39 million) in late March, 2020. Adobe also reported that BOPIS (buy online, pick up in store) saw a 62% year-over-year increase from February 24 to March 21, 2020. While some of these increases are no doubt temporary, some will be permanent. The charts below show sharp increases in daily downloads of grocery delivery apps and Target's mobile app between February and March 15.

Daily App Downloads For Target And Grocery Delivery Apps, (February-March)





Source: Apptopia

Additionally, Walmart Grocery hit an all-time high in downloads in early April, hitting the top rank across all U.S. shopping apps and surpassing Amazon downloads by 20%. While the standard retail narrative over the past few years has been the rise of Amazon and online sales, these metrics suggest that increases in online shopping are likely benefitting traditional bricks-and-mortar retailers that have invested heavily in their online offerings. Amazon, of note, has struggled to keep pace with demand during the pandemic. In a March RSR Research consumer survey, 42% of respondents said that Amazon would get their products delivered on time, while 58% said other retailers provided a superior or comparable shopping experience. This is not to say that Amazon is weak, of course – it is far from it – but strong bricks-and-mortar retailers are in many cases getting stronger during this period. March sales metrics for Walmart, Costco and Target below support this view.

On April 1, Chris Walton in Forbes wrote: "whether a customer ever steps foot inside a Kroger, Starbucks, or even a Walgreens is no longer relevant. What the coronavirus has elucidated is that one of the most important jobs a retailer does is to help its customers to acquire products. That's it. It is to get people what they need quickly and easily, case closed, and, especially right now, at a time when people cannot touch or talk to anyone."

March Sales Metrics, Leading US Retailers

Retailer	Sales Metrics For March
Walmart	In-Store +20%, Online +30%
Costco	In-Store +20%
Target	Overall Sales +25%
Kroger	Overall Sales +30%

Source: Company Reports

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3. **Health of mom-and-pop retailers and their ability to survive the pandemic**

- Roughly 35% of our portfolio tenants are local mom-and-pop retailers occupying less than 5,000 SF. Many of these retailers are being hit especially hard by the pandemic. Thus far, 88 of our tenants have requested some form of rent relief. Forty-one (46.6%) of these are small local retailers and we expect this number to rise sharply over the coming weeks.

- As discussed earlier, these tenants have been looking for government assistance through the PPP. 1,229,893 of the PPP's approved loans were for less than $150,000. These accounted for 74% of total loans but just 17% of total loan dollars. And per the chart below, just 11.2% of approved loans (and 8.6% of total loan dollars) went to the retail trade. As a result, while they wait for assistance in an environment where foot traffic is almost nonexistent, smaller stores are struggling.

March Jobs Losses and PPP Loan Breakdown by Sector

Category	March Jobs Report One Month Net Change	SBA PPP Statistics Approved Loans	Percentage of Total	Approved Loan Dollars	Percentage of Total
Leisure and Hospitality	(459,000)	161,876	9.74%	$30,500,417,573	8.91%
Healthcare and Social Assistance	(61,200)	183,542	11.05%	$39,892,493,481	11.65%
Professional and Business Services	(52,000)	208,360	12.54%	$43,294,713,938	12.65%
Retail Trade	(46,200)	186,429	11.22%	$29,418,369,063	8.59%
Construction	(29,000)	177,905	10.71%	$44,906,538,010	13.12%
Manufacturing	(18,000)	108,863	6.55%	$40,922,240,021	11.96%
Mining and Logging	(7,000)	11,168	0.67%	$3,894,793,207	1.14%
Transportation and Warehousing	(4,900)	44,415	2.67%	$10,598,076,231	3.10%
Financial Activities	(1,000)	60,134	3.62%	$8,177,041,995	2.39%
Utilities	800	3,247	0.20%	$1,027,575,137	0.30%
Wholesale Trade	900	65,078	3.92%	$19,489,410,472	5.69%
Information	2,000	22,825	1.37%	$6,675,630,276	1.95%
Government	12,000	0	0.00%	$0	0.00%
Other	N/A	427,525	25.73%	63,480,699,699	18.6%
Totals	**(662,600)**	**1,661,367**	**100.0%**	**342,277,999,103**	**100.0%**

Source: Apptopia

4. **The strength of our portfolio and the ability, therefore, for LBX to withstand the impact of the pandemic**

- Our belief is that until COVID-19 testing is more widespread or a vaccine/effective treatment is developed, weaker tenants will struggle to survive across the country as the demand shock is simply too great. Within our portfolio, we could see an accelerated decline and removal of certain weaker tenants. In the short term this would lead to increased vacancy but we also see opportunity. First, there are glimmers of hope. We have seen an uptick in tenants – particularly restaurants – offering curbside pickup in an effort to survive, and expect the development of new concepts to replace weaker tenants over time. Second, we positioned our existing portfolio to attract demand in both up and down markets, by buying strong real estate in strong locations. We expect to withstand this downturn and be able to attract tenants from lesser-positioned centers when the smoke clears.

Coming Up

Next week, we will summarize rent relief and forbearance activities and provide initial projections for May collections. Additionally, we'll examine consumer behaviors, how they might change going forward, and potential impacts on the retail sector.

Sincerely,
Rob Levy, Phil Block and Heath Binder

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