COVID-19 and Retail: A Macy’s Case Study

Introduction

With the US economy poised to contract at an historic rate in the second quarter of 2020, retail properties face an exceptionally bleak near term. Under siege from the pressure of online commerce over the last two decades, retailers like Macy’s were already in a relatively weak position before COVID-19 reached pandemic status. On February 5, Macy’s announced that they were closing 125 stores across 19 states—a decision not related to the coronavirus situation. On March 17, the firm preemptively closed all 775 of their locations to prevent the spread of the virus. Initially, they planned to reopen on March 31, but with social distancing mandates extended at the federal level through the end of April, stores have remained closed.

This brief analysis will focus on retail properties around the nation that have Macy’s as a tenant, and are therefore impacted directly. We will identify which places appear to be at greatest risk. A full custom analysis for specific property types and geographic markets is available as a service for clients of Moody’s Analytics REIS.

The Lay of the Land: Concentration Analysis

COVID-19 cases have been identified in all 50 US states, but tend to be concentrated in specific states and counties. Data as of April 20 shows that there are over 700,000 confirmed cases of COVID-19 in the United States. The top five states (New York, New Jersey, Massachusetts, Pennsylvania, and Michigan) add up to more than half of the national figure. Patterns over time suggest that COVID-19 cases are dispersing across the nation: When statewide data began to be compiled in mid-March, the top three states added up to two-thirds of the total; as of April 3, the top five states captured 65% of the total; but as of April 20, the top five states added up to just over 57%.

3. The COVID-19 shock, of course, affects most retailers except those that provide essential activities. In a paper published April 3, we discuss the general shock to retail as a whole, and what a post-COVID-19 world might look like: “COVID-19 and the Retail Debacle: A Grim Near Term and an Uncertain Future.” (available upon request).
When we overlay properties where Macy’s has retail presence on the heat map above, we begin to get a sense of where COVID-19 cases are concentrated, and which properties might be at greater risk—both in the short run, because of possible delays in reopening; and over the long term, if households and employers decide to move out, preferring other locations that were not hit as hard by the pandemic. The long-run permanent shock to demand is what will spell the greatest risk to the continued viability of retail operations.
Given the inherently local nature of real estate analysis, concentration of COVID-19 cases across counties is more instructive. There are more than 200 counties in the US which contain properties that have a Macy’s retail presence. The majority of these properties are regional malls, but Macy’s is also a tenant in smaller property types like power centers, neighborhood and community shopping centers.

Figure 3. COVID-19 Cases Across Counties, and Macy’s Retail

Source: John Hopkins University (as of April 20, 2020); Moody’s Analytics REIS

**Concentration Risk: COVID-19 Intensity, Macy’s Clusters, and Projected Employment Declines**

Table 1 below presents the aggregate sum of space occupied by Macy’s within specific retail properties in counties. The top 20 counties add up to 32.8% of the total square footage occupied by Macy’s as a tenant in these retail buildings. In addition, two indicative variables are listed on the right side, to help assess relative risk in the intermediate run:

1. Identified cases of COVID-19 (updated by county as of April 20, 2020) give us a sense of where cases are more prevalent.
2. Projected employment declines for 2020 give us a sense of where stress is expected to manifest. An increase in unemployment is expected to directly impact consumer sentiment and retail sales.

Table 1. Top 20 Counties by Square Footage

<table>
<thead>
<tr>
<th>COUNTY</th>
<th>STATE</th>
<th>MACY'S SPACE</th>
<th>NUMBER OF CASES</th>
<th>DECLINES IN EMPLOYMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Los Angeles</td>
<td>California</td>
<td>3829774</td>
<td>12341</td>
<td>-2.3%</td>
</tr>
<tr>
<td>Harris</td>
<td>Texas</td>
<td>2015453</td>
<td>4823</td>
<td>-1.9%</td>
</tr>
<tr>
<td>Cook</td>
<td>Illinois</td>
<td>1525248</td>
<td>21272</td>
<td>-2.1%</td>
</tr>
<tr>
<td>San Diego</td>
<td>California</td>
<td>1497901</td>
<td>2213</td>
<td>-1.9%</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>California</td>
<td>1421167</td>
<td>1870</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Miami-Dade</td>
<td>Florida</td>
<td>1372431</td>
<td>9354</td>
<td>-3.7%</td>
</tr>
<tr>
<td>Orange</td>
<td>California</td>
<td>1287200</td>
<td>1636</td>
<td>-2.5%</td>
</tr>
<tr>
<td>Fairfax</td>
<td>Virginia</td>
<td>1193273</td>
<td>1809</td>
<td>-1.4%</td>
</tr>
<tr>
<td>Clark</td>
<td>Nevada</td>
<td>1042516</td>
<td>2940</td>
<td>-5.1%</td>
</tr>
<tr>
<td>Suffolk</td>
<td>New York</td>
<td>1029143</td>
<td>26888</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Alameda</td>
<td>California</td>
<td>1004462</td>
<td>1164</td>
<td>-2.5%</td>
</tr>
<tr>
<td>Broward</td>
<td>Florida</td>
<td>943802</td>
<td>3971</td>
<td>-3.2%</td>
</tr>
</tbody>
</table>

*Macy’s provides an overview of their stores here: [https://www.macysinc.com/about/store-count-and-square-footage](https://www.macysinc.com/about/store-count-and-square-footage)*
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</thead>
<tbody>
<tr>
<td>Maricopa</td>
<td>Arizona</td>
<td>935812</td>
<td>2589</td>
<td>-3.0%</td>
</tr>
<tr>
<td>Hennepin</td>
<td>Minnesota</td>
<td>909490</td>
<td>924</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Essex</td>
<td>New Jersey</td>
<td>907100</td>
<td>10304</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Wayne</td>
<td>Michigan</td>
<td>885945</td>
<td>13692</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Nassau</td>
<td>New York</td>
<td>851078</td>
<td>30013</td>
<td>-2.5%</td>
</tr>
<tr>
<td>Hamilton</td>
<td>Ohio</td>
<td>846059</td>
<td>718</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Bergen</td>
<td>New Jersey</td>
<td>799243</td>
<td>12639</td>
<td>-2.7%</td>
</tr>
<tr>
<td>Contra Costa</td>
<td>California</td>
<td>795276</td>
<td>693</td>
<td>-2.6%</td>
</tr>
</tbody>
</table>

Source: Moody’s Analytics REIS; John Hopkins University (as of April 20, 2020)

These various factors now need to be taken in context, to provide perspective on how to assess overall risk. Los Angeles (LA) is at the top of the list, given the amount of space occupied by Macy’s. There are also over 12,000 confirmed COVID-19 cases in Los Angeles county, making up about a quarter of all cases in the state of California. Projected job declines, however, are not as severe (-2.3%)—LA’s employment base is diverse, and though it will not be spared from job losses in this economic downturn, it is projected to fare relatively better than other counties.

By contrast, Clark County in Nevada is forecasted to take the largest hit in terms of job losses (a decline of 5.1% for 2020). This is where Las Vegas is located, and Las Vegas is the metropolitan area with the largest share of jobs in leisure and hospitality relative to total employment base (28.9%, versus the national average of 11.0%) in the country. Given the shutdown in personal and business travel, it is no surprise that job losses in Clark County are expected to be severe.

There are, however, only a handful of properties in Las Vegas where Macy’s has retail presence, adding up to a total of just slightly more than 1 million SF. Los Angeles has over 20 properties where Macy’s occupies close to 4 million SF of space. From the point of view of potential reduction in rent revenue for retail properties in the area, Los Angeles County takes center stage.

The Case of the Los Angeles Retail Property Market

Consider the case of Los Angeles retail properties as a whole, given that this is the largest county in which Macy’s has a presence. The LA County retail property market did not enter the current downturn in a position of strength. During the Great Recession of 2008 to 2009, property fundamentals collapsed over several years. Net absorption was negative from 2007 to 2012. Effective rents fell by 7.4% from 2008 to 2010. Vacancies spiked to a high of 6.6% in the first quarter of 2012. The “recovery period” over the next few years was not marked by robust occupancy patterns: vacancies remained elevated at 6% or above, and actually began to rise starting in 2015. Year-end-2019 vacancies were at 7.3%, just 50 basis points below the record high from 1981.
Moody's Analytics REIS projects that vacancies will break record highs by year-end 2020, continuing to rise through 2021, under a Protracted Slump economic scenario. With COVID-19 cases continuing to rise for LA County, planned reopenings are likely to be delayed, and perhaps more than in other places that are not as affected.

Concentration Opportunities: Where Macy's Tends to be Strong

Any balanced analysis needs to consider not just risks, but also opportunities. In assessing its own strengths and opportunities, Macy’s has identified what it terms its “Growth150”: 150 stores it has identified as outperforming all its others. In their most recent earnings call, Macy’s noted that these 150 stores (out of a base of 775) make up approximately 50% of all Macy’s store sales. These same Growth150 stores outperformed the rest by approximately three percentage points in the fourth quarter of 2019.5

Table 2 below presents the percentage of Macy’s Growth150 store space relative to the space occupied in retail properties, by county. While all of Macy’s stores are still closed, these stores may well represent relative positions of strength, given how they tend to outperform other Macy’s locations.

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The case of Hennepin County in Minnesota argues for less concern or worry:

1. The number of confirmed COVID-19 cases there is relatively low (924).
2. Projected employment declines for the county are ranked close to the bottom of the list (-1.8%; the only place with a lower figure is Fairfax County in Virginia, which includes Washington, DC).
3. Almost the entire share of space occupied by Macy’s as a tenant (75%) is classified as a Growth150 store. This includes the Macy’s store at the Mall of America, the largest mall in the United States. Prior to its closure because of the coronavirus outbreak, it did not have significant problems attracting foot traffic.

The case of Los Angeles County is still somewhat inconclusive: As discussed in the previous section, there are causes for concern (high number of COVID-19 cases; large concentration of Macy’s space) that now need to be weighed against the perspective that 50% of Macy’s space in the area is classified as Growth150.

Clark County, Nevada gives us even more of a cause for concern, given that less than 30% of its Macy’s retail space is composed of Growth150 stores.

That Double-Edged Sword: COVID-19 Changes, and Contagion Effects

It is also important to note, however, that the very strength of Macy’s Growth150 stores in the past, and its outsized contribution to total revenues, may also be its Achilles’ heel. If the company is so dependent on these key stores, and retail and purchasing patterns change because of the COVID-19 pandemic, then any decline in revenues from the top 150 stores will also have an outsized effect on Macy’s performance.
Furthermore, Growth150 stores tend to be anchor tenants in their respective regional malls and retail centers, given their good performance. If performance stumbles and anchor tenants end up closing, there will be a contagion effect for the retail property as a whole. Not only will relatively large space go dark: tenants that remain can invoke co-tenancy clauses and renegotiate for more favorable lease terms, leading to revenue declines for landlords.

Conclusions

The next step for risk analysis is to assess the actual financial statements of specific firms that own and operate properties at risk. This is outside the scope of this short analysis, but it is worth noting that while all retail properties in the US are at risk—with the possible exception of those with groceries and pharmacies as tenants—some operators are better positioned than others to withstand economic pressures over the next few weeks. Simon Property Group (SPG) is widely perceived to be one of the best performing REITs in the retail space, for example. Among the more than 200 properties SPG owns and operates are the Del Amo Fashion Center in LA County and Livingston Mall in Essex County, New Jersey, both of which have Macy’s as a tenant, and both of which are included in Table 2 above.

Prior to shutting its stores on March 18, SPG secured debt financing, giving it close to $10 billion of liquidity that it could use to weather the storm. Still, SPG had to furlough 30% of its employees on March 31, and its stock is down by 62.6% relative to its 2020 high from late January.

As of April 20, Macy’s stock is down by 68.1% relative to its 2020 high from early January. It announced on March 30 that it would put the majority of its 125,000 employees on furlough. The company has not announced that it plans to stop paying rent, but this is only the beginning of what will likely become the worst second quarter for the US economy in history. Accordingly, the next few quarters are projected to be the most challenging period for the US retail sector in Moody’s Analytics REIS’s forty years of tracking the property type.

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6 A co-tenancy clause in retail lease agreements provides for the ability of tenants to renegotiate terms and reduce their rents if key tenants (or a large number of tenants) leave the property.
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