Commercial rent payments questions

One of the places I've been spending the most time thinking about and looking at is anything connected to commercial real estate (I mentioned some thoughts on malls here and I've covered some distressed prefs too). There's never been a dislocation like today's, with huge swatchs of the economy forced to close and all sorts of businesses seeing their revenue go to zero overnight. That dislocation is a bunch of things. It's scary. It's horrifying (for how many people are going to lose jobs). But, as an investor, dislocation can present opportunity. Basically anything connected to commercial real estate is down 75%+; it's impossible for me to imagine that there aren't some companies that have been hit significantly harder than the fundamentals would warrant, and if you can successfully identify those companies there's probably a lot of upside waiting for you on the other side.

Anyway, I was about to start a tweet storm with some thoughts on this, but I figured I'd put a blog post out. If you have thoughts (or answers! Though I'm not sure anyone has definitive answers at this point), I'd love to hear them.

Before I get into it: there are several out there thoughts in here. Normally, I'd feel really comfortable that contracts would hold up in court and it would be business as normal. But today's business environment is the strangest the modern economy has ever seen. It's worth thinking through some out there possibilities. So I apologize if some if the answers to some of these seem basic, but in such a weird environment it's worth rethinking basic assumptions. (Also note that malls in particular are top of mind for me right now, but I'm super interested in all commercial retail space).

- Near term rent payments: what happens to them? I've been thinking about this a lot, and reading Dave and Buster's (PLAY) earnings call early today is what sparked this thread. Dave and Buster's isn't paying their April rents. That makes tons sense... but what happens to those rent deferrals? Yes, rent is contractually owed, so if you're a landlord and defer rent you should get it at some point in the future. But will you? Once the country starts opening up, it's tough for me to see tons of demand for empty boxes / store fronts. Won't retailers (particularly smaller ones) be going to landlords and saying "we'd love to reopen, but we'll never be able to pay that deferred rent. Zero it out or we're done." Yes, a landlord is contractually owed that rent, but if they're facing the choice between fifteen stores being empty or forgiving some of that rent to keep occupancy high and keep their network intact, isn't the choice obvious?
    - Pier One's bankruptcy doc had some interesting data on early rent concessions / deferrals at their stores.
    - Does how the landlord treat a company depend on if they're fully open or running modified hours? I.e. is a landlord more likely to forgive or defer rent for a small fashion shop that's forced closed than for a restaurant that is running only takeout / delivery right now?
    - What the heck happens to movie theaters? These are fantastic tenants for landlords normally; they take up a ton of space, they draw huge and consistent foot traffic, etc. I personally think pretty much every movie theater is going to need to restructure on the back of this; what do the landlords do with them? Obviously they'll lose most of the deferred rent in a potential bankruptcy, but how are they going to negotiate new leases with potential successor companies?

Movie theaters can rightly point out that a lot of the stores around the movie theaters need the foot traffic from the movie theater to survive; isn't that a pretty big stick to wield against landlords in a bankruptcy scenario ("hey, all your boxes are dark. Give us a huge rent cut or we won't be coming back in, there's no other movie theater company looking to take on leases, and your whole box is unprofitable")?

- What about the large stores that everyone wants to have (Apple is the gold standard here)? Yes, they can easily make all of there rent payments. But if everyone else is getting rent concessions and deferrals, why wouldn't they ask for one? Sure, you can say "they signed a contract, and they'll keep to it." That's probably right.... but (similar to the malls) these stores draw huge amounts of foot traffic and will be critical to restarting the malls as the country opens up. What if Apple went to a landlord and said "we could open up the store in early October.... but if you cut our rent by 5%, we could have the store up in early September." Yeah, that seems kind of extreme, but getting a store open a month earlier would be mammoth for foot traffic for a lot of these malls, and that might make the foot traffic / opening one month earlier could be the difference between a small business needing to close or making it through this. Wouldn't that be worth it for a landlord?
    - Does it make a difference if you're a developer with a larger portfolio versus a one off tenant? For example, if you're a mall company that owns 50 different malls and 20 of them have Apples, are you more or less likely to hold Apple to their contract? On the one hand, cutting Apple's rents

across 20 malls is a bigger hit to you. On the other hand, there are 30 malls that don't have Apple in them that I bet you'd like to have an apple in them....

        - Of course, you could make the case that Apple wants to get its stores open ASAP no matter what. That makes sense, but wouldn't they at least try to bluff in a negotiation to get some concessions?
    - Anyone can sue anyone for anything... but isn't there some risk that tenants start arguing that forced closure of malls is a breach of contract and they can break the lease (similar and probably argument can be made around force majeure)? I doubt they win with that argument in court, but isn't it a risk? And, at minimum, it results in a big loss of cash flow in the near term (and a lot of legal expense).
        - On force majeure: here's a law firm suggesting it comes down to the wording of the lease (h/t value)
    - Again, I don't know. I'm just spitballing. There's so much uncertainty here that it's tough to tell.
    - PS- Dave and Buster's is exploring a PIPE. I love Dave and Buster's, and I love investing into distressed situations.... but I can't imagine how you could PIPE into them today. It's tough to think of something that is hit harder than Dave & Busters. The whole model is mammoth stores that pack tons of people into them, and then have those customers pay to play a bunch of games that hundreds of other people have touched throughout the day. This has to be one of the last businesses that is allowed to reopen, and even then it's tough for me to imagine people flocking to these stores (note that the games piece of the business is ~90% margin; perhaps they could open without

the games for a while but without the games the business is structurally unprofitable). On top of that, a huge chunk of business is done around sports events... those are gone too. I completely understand the counter is "yes, but two years from now sports will be back and (hopefully) this will be behind us, and if you think about earnings even approaching where they were last year, this would be a grand slam". I 100% get the general vibe there, but I'm not sure why you'd PIPE into D&B instead of take them through a bankruptcy process and go back to all those landlords and demand some type of rent concessions (these are big boxes, and all the game space will be worthless for a while. You'd at least want some concessions until the game space came back, right?) plus use the bankruptcy process to cut into those deferred rent payments. Perhaps I'm too pessimistic though.

- What does traffic look like for malls (I mean stores in general, but I'm particularly thinking of malls) when they re-open (and when are they allowed to re-open)? What stores re-open immediately versus a few months later and how does that impact rent discussion above?
    - Let's say the country fully reopens in September (though even that may be aggressive?). What does mall traffic look like then? It's tough for me to imagine traffic isn't down substantially; people's finances are going to be in shambles, and I would guess it takes a while for people to get fully confident in going out to mass gathering type places.
    - Stores probably reopen in waves. I would guess the first wave seems more everyday type things open (Apple stores being a prime example, as would restaurants). Maybe clothing stores come after that. I would guess the last thing to reopen are experience (theaters) and fitness centers. That's

pretty bad for malls; theaters and fitness centers are huge draws for foot traffic and take up huge chunks of space (and thus are big rent payers).

    - I've said a few times that a mall is like a network. How many stores (and which stores) are enough to keep the network intact or restart the network? Is an Apple store plus some good restaurants alone enough to keep the spark of a network there? Or is the network destroyed and vulnerable till they can fill the entertainment / experience / fitness center spaces?

- Random other thoughts on malls and stores
    - Retail sales had, in general, been shifting from lower end mall and retail stores to ecommerce (duh!) and class A malls. I'm guessing that the current shutdown accelerates the shift to online sales... but what about class A malls? Is there a small benefit to them on the back end of this (maybe lower end malls and other smaller store fronts never reopen, so higher end malls pick up a little share there?
    - If you're under contract with any type of contractor for a new store or upgrade, how on the hook are you? I'm guessing you can get some relief / defer the project until the states will allow the construction crews to resume business.... but is that guess right? If you want to cancel these contracts, how much are you going to owe?
        - If you're under contract to open a new building and deliver it to a tenant, and the building is going to be months behind schedule because all construction has stopped, is the tenant going to be able to get out of that lease?
    - A lot of malls have department stores anchors that were... creaky to say the least (think of a mall anchored by a Sears). This was often super

suboptimal; in fact, a lot of the thesis for the department stores has been that their anchor leases are crazy valuable as they're in great spaces with extremely low rent long term leases. Does the current crisis accelerate some redevelopment activity?

    - An example might show this best: imagine you're Macy's and you have a slightly profitable anchor store in a prime location in a major city. Right now, your whole company is undergoing a liquidity crunch and all your stores are closed. That location would probably be a lot more profitable if it was turned into something else (condos? a hotel? etc.), and the back half of this year would probably be the best time to close a store down and to a major remodel since their will be lots of people looking for jobs and not a lot of people looking to shop. If a developer came to you with a reasonable offer to buy you out of that lease, aren't you likely to just jump at that offer and take the liquidity?
    - Of course, the example above assumes there's a developer with the liquidity to make an offer as well as the longer term vision and confidence to do it now.
- If you have a mall that has some type of mortgage due in the next year, how the heck do you refinance that? Sure, banks could refuse to roll their financing and take the keys, but do they really want to operate a mall? What if they wanted to put the mall up for sale to pay off the debt? How would a potential buyer value a mall right now? Do they only value it at land value (i.e. the malls as we knew them are dead; we need to put tons of capital into it to turn it into a mixed

use facility).

    - Something similar would apply to hotels. Occupancy is basically zero currently. It's tough to see it recovering over the next year, and even when it does you have to think there will be some vicious competition (pricing) to try to get occupancy. How is anyone going to refi a mortgage? Just extend and pretend? How do you value a hotel right now?

  - Do people return to open air malls more quickly than enclosed?
  - Do people rethink financing for commercial real estate going forward? Some of the safest properties in the past were triple net leased properties leased to something relatively recession resistant, and you could generally get pretty attractive financing on these with pretty big LTVs. Do people rethink that going forward? Obviously having Walmart or Apple on the other end of a lease remains attractive, but are people ever going to think a triple net lease movie theater is a safe-ish investment again? And, even with something like an Apple, do people start being more conservative on financing just because there is some pandemic / shutdown risk?

Again, I more just wanted to throw out questions here then give anything definitive; I'm certainly no expert in a lot of these areas, but they're important to the valuation case for a lot of businesses right now so I'm trying to sharpen up on them. A lot of these were just stream of thought, and I don't know the answers to a lot of them; a month ago, I would have thought I knew the answers pretty clearly and that the law was pretty clearly defined, but things are so different today I'm not sure. If you've got practical examples, thoughts, or answers to any of these, I'd love to hear them.