Coronavirus Is Crushing Retailers: 1 Retail REIT to Avoid

Description

The coronavirus pandemic has hit bricks-and-mortar retailers hard. This is a disaster for an industry already under considerable pressure. The consensus among many analysts is that it will cause the existing retail apocalypse to accelerate and wipe out even more stores.

To stem the COVID-19 pandemic, governments across the world have closed their borders, implemented travel restrictions, and shuttered non-essential businesses. That, combined with people being forced to stay at home for all but necessary activities, is hurting bricks-and-mortar retailers. This makes retail real estate investment trusts (REITs) even more vulnerable.

Already, two leading U.S. retail REITs, **CBL & Associates** and **Washington Prime,** are bleeding red and have been priced for bankruptcy. There are signs that Canadian retail REITs will increasingly come under pressure. Canadian REITs have avoided much of the fallout from the retail apocalypse. Nevertheless, retail REITs like **Slate Retail REIT** (TSX:SRT.UN) look like unattractive long-term investments.

Growing vulnerability

There are a variety of reasons for the resilience of Canadian retail REITs. These include better designed and higher quality shopping malls. There also wasn't the proliferation of lower-grade shopping malls in Canada as in the United States.

Most Canadian retail REITs own properties where grocery stores and other necessity-based retailers are anchor tenants. Those factors have shielded Canadian retail REITs from the impact of the retail apocalypse.

Nonetheless, the perfect storm created by the coronavirus pandemic, social distancing, and travel bans, along with the rapid uptake of online shopping and e-commerce, means they will eventually come under pressure.

The pandemic, harmful to bricks-and-mortar retailers, cinemas, and shopping centres, will accelerate the uptake of online shopping. Consumers can go shopping from the comfort of their own homes without the risk of breaking social distancing and other restrictions.

Unsurprisingly, there is expected to a be a spike in online sales during 2020. That will further boost the presence of online retailers to the detriment of traditional retailers and associated real estate. Online shopping giant **Amazon** is aggressively expanding its presence in fresh foods and groceries. That will weaken the presence of major grocery store chains.

Amazon announced that it is experiencing a crush in demand for food and grocery services since the coronavirus pandemic began. That, along with its plans to expand into that retail segment, will strengthen the online behemoth's dominance of the retail industry. The economic downturn triggered by the coronavirus, which economists are tipping will be worse than the 2008 Great Recession, will weigh heavily on Canadian retail REITs.

A REIT to avoid

Slate Retail is particularly vulnerable. After losing a whopping 48% since the start of 2020 it is now paying a distribution yielding an unbelievable 17.5%. The REIT's operations are in the United States, which is the market most exposed to disruption because of the rapid expansion of internet retailing.

Slate Retail's numbers at the end of 2019 indicated that it is vulnerable to the fallout from the coronavirus pandemic. It ended the year with an occupancy rate of 93% which was 1.2% lower than 2018. Slate Retail also has a levered balance sheet, evident from its high debt to gross book value of 60%. More worrying is that total debt was a whopping 15-times annual funds from operations (FFO)**,** indicting that Slate Retail is vulnerable to an economic downturn.

The REIT also recently reported that its planned US$106.5 million acquisition of seven grocery-anchored U.S. retail properties won't proceed. Then there is the growing inventory of U.S. retail real estate because of rising bankruptcies as well as store closures among brocks and mortar retailers. The impact that is having on rents and asset values is being magnified by waning demand for retail real estate.

For these reasons Slate Retail's earnings are under pressure. That means a distribution cut makes sense, particularly with the current harsh business environment making it prudent for Slate Retail to shore-up its balance sheet and protect cash flow.

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