The Daily Transcript
www.sdtranscript.com
Tuesday, November 10, 2020

Retail, other asset classes find ways to weather crisis

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Photo courtesy of Capstone Advisors

Capstone Advisors owns the 14,194-square-foot office property at 1545 Faraday Avenue in Carlsbad. The building's other tenant is Grant Construction.

Photo courtesy of Capstone Advisors

Capstone Advisors' president Alex Zikakis

Most retailers have been hit hard by the pandemic, but the president and founder of Capstone Advisors said the story is a very uneven one.

Some tenants, by the nature of their business, have had a very hard time due to the restrictions imposed to help stop the spread of the coronavirus.

"Examples are gyms and personal fitness studios, nail salons, and large format indoor restaurants," said Alex Zikakis, who responded to a series of email questions about the state of retail and other asset classes.

"Then there are tenants that have been impacted by changing work patterns, such as dry cleaners, that have had a dramatic drop in business due to the increased number of people no longer working in offices or going to social events."

Grocery stores and liquor stores have done very well as people have eaten at home more often, and like groceries, a drug store is also a required service. Other retailers who have weathered the storm fairly well include restaurants, where a substantial portion of their business takes place as 'to-go' service or a drive through, Zikakis said. The Capstone Advisors executive said with long distance travel for the most part out of the question, boats, RVs, bicycles, camping gear, fishing gear, and – here in San Diego – surfboard sales have all increased significantly.

"Other sectors that have done surprisingly well are the pet supply and the veterinarian industries as people have adopted dogs and cats at record numbers," he added. With many not paying rent, landlords have had to try and forge new relationships with their lenders. It may not be doable, however, according to Zikakis. During periods of uncertainty, he said it makes sense that lenders are going to be very focused on reducing their exposure and will naturally only want to lend to their best borrowers that have proven their strength. "It is a very difficult time to get financing due to continued tenant health concerns, especially if you are looking to establish a new lender relationship," Zikakis said. "Many property types have been negatively impacted due to COVID. Retail and hotels are the two most common property types that people mention, but office buildings ownership has become challenging as companies struggle with what will be the 'new normal' for employees that are now working remotely."

He added that multifamily continues to experience difficulty, especially expensive units in high density locations. As for how Capstone Advisors has managed to keep on leasing through the pandemic, Zikakis said it helps to have a diverse portfolio that includes retail, industrial and office properties. "Fortunately, our office assets were fully leased before COVID hit, and we have had minimal lease rollover," he said. "Our industrial assets have had strong demand as more and more companies refocus their logistics and supply chains." Zikakis said even though most of our commercial assets are shopping centers, our centers are mostly 'basic needs'-type centers with tenants that are the fabric to their customers' shopping 'needs,' not 'wants.' Like most landlords, Capstone has had to be creative and flexible with rent structures.

The firm has given tenants in impacted businesses lower starting rental rates to get through another year of COVID-induced difficulties before stepping the rent back up to a normal, market rent. Zikakis said what he finds surprising to many is just how important brick-and-mortar retail remains. "I think the biggest surprise for many people is how the pandemic has really brought home the importance of well-located, highly functional physical retail," he said. "During the early weeks of the pandemic, it was very tough to get delivery windows for many items that we had gotten used to buying online."

Zikakis said the large scale retail bankruptcies that happened during the COVID crisis likely would have happened anyway. By contrast, he said Walmart and Target offered daily needs items, facilitated with online delivery, online ordering for curbside pickup, "and good, old fashioned in-store shopping options." As for how the pandemic will help fuel entrepreneurial growth next year, Zikakis said not only have a large number of companies taken the plunge, many companies, particularly in the life science arena, are being spawned as a result of the pandemic. Other examples are companies that assist people who are now working at home, and other firms may have unique hygiene solutions (beer distilleries are making hand sanitizer these days). Capstone buys both relatively stable, 'coreplus' assets as well as well-located, value-add assets that can be improved by significantly upgrading the physical property and tenant mix. Capstone's focus has evolved over time.

"While we used to be very actively involved in the home building industry (we've invested in billions of dollars of home building and land development projects during our history), we are now primarily focused on income producing multi-tenant commercial assets," Zikakis said. "That said, we have a large land portfolio that we've built over the years and are looking for compelling land opportunities that will be ready to be developed in a three to 10-year period." Capstone Advisors has always been an active buyer of assets during periods of distress, and there will certainly be a number of distressed assets coming to market.

"We will be focused primarily on retail and industrial properties but will also entertain acquisitions of out of favor asset classes," Zikakis said. "We have never owned hotels, but that asset class is very interesting now and might be an area of opportunity for us. We might even move back into niche homebuilding opportunities in unique resort and lifestyle markets."

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