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THE ONGOING STRUGGLE OF SMALLER MALLS

MOODY'S FOUND THAT SMALLER SHOPPING CENTERS FACED MORE ISSUES BEFORE COVID AND ARE NOW DEALING WITH SERVICERS RELUCTANT TO MODIFY.

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By Les Shaver

Smaller malls were struggling even before COVID hit.

But as the pandemic caused mandatory shutdowns, shoppers avoided indoor spaces. It should be no surprise then, that the percentage of all retail loans on Moody's Analytics watchlist or in special servicing has risen to 37%. Delinquencies and late payments are almost nearly 13%.

But some retailers and mall owners are struggling more than others. While the malls that came into 2020 on firm footing still have a future, malls that are no longer destinations are struggling. Moody's says 250 or so malls had occupancy troubles before the pandemic and are continuing to face challenges. Many of these properties were built nearly a half-century ago and are in lower- to mid-income submarkets.

By looking at malls in special servicing, Moody's found that smaller shopping centers faced more issues before COVID and will fight an uphill battle as servicers seem reluctant to modify.

Malls that were less than 250,000 square feet saw occupancy fall from 78% in 2019 to 75% in 2020, according to Moody's. Their debt service coverage ratios (DSCR) remained at 1.1 from 2019 to 2020.

"Generally, the smallest of these malls currently lacked a 'traditional' anchor, had low occupancy, and very thin coverage margins," according to Moody's.

By contrast, those malls between 250,000 and 750,000 square feet saw occupancy drop from 88% in 2019 to 78% in 2020. Their DSCRs fell from 1.6 to 1.4. Malls with more than 750,000 square feet saw occupancy fall from 85% to 82%, while DSCRs were flat at 1.7.

While Moody's points out that large, previously high-performance malls can face challenges, the non-"destination" smaller size mall will continue to be tested.

In some cases, distressed investors are waiting to buy these properties at a discount. "Because commercial real estate investment firms are having a difficult time acquiring industrial, manufactured housing, suburban office and apartments, and fully leased food store/drugstore shopping centers at acceptable cap rates, it is anticipated that an infusion of new private equity capital and institutional capital will be utilized to acquire malls and distressed shopping centers," Gary Glick, a partner at Cox, Castle & Nicholson, told GlobeSt.com in an earlier interview.

Once these properties change hands, there is also a lot of talk about converting them into distribution facilities**.**

"There is a contemplation of taking down a portion of a tired mall," Ryan Companies Southeast President Doug Dieck told GlobeSt.com in an earlier interview. "But that's very, very difficult to do."

But those aren't the only uses Dieck sees for retail. With people migrating and living longer, there may need to incorporate residential into these retail centers.

"Retooling the old Montgomery Ward's building that still may exist and turning that into a residential play that is directly adjacent to retail and those kinds of creative plays will continue," he says.