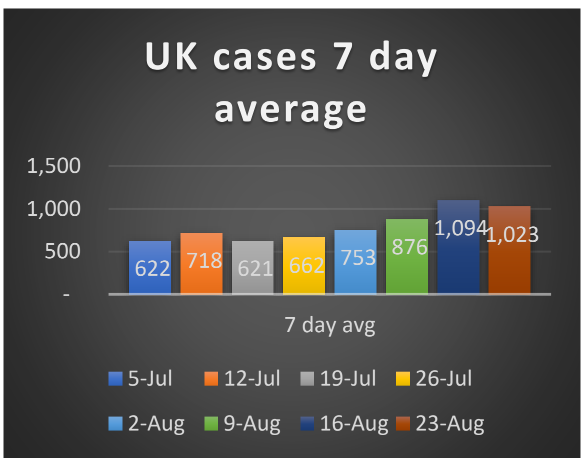
PCS Information Bulletin #31: COVID-19 Review

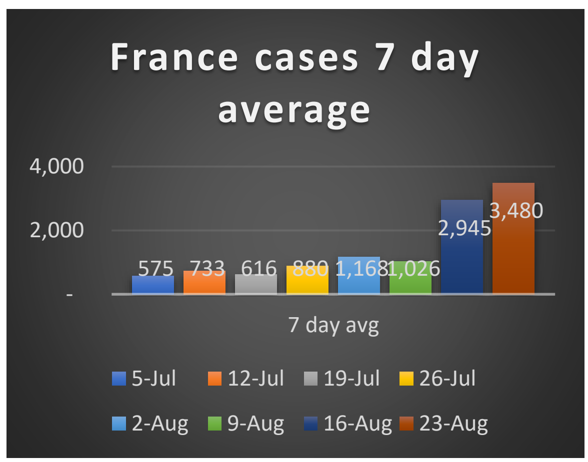
Wednesday, August 26, 2020

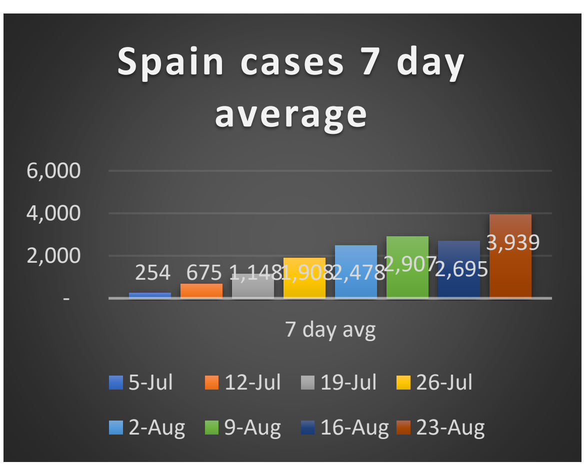
As always, please remember that **this report is for informational purposes only** and does not constitute the designation of a PCS event. We have decided to provide this report simply to help the market understand the COVID-19 situation and to provide access to some of the resources our team uses daily for intelligence on this event.

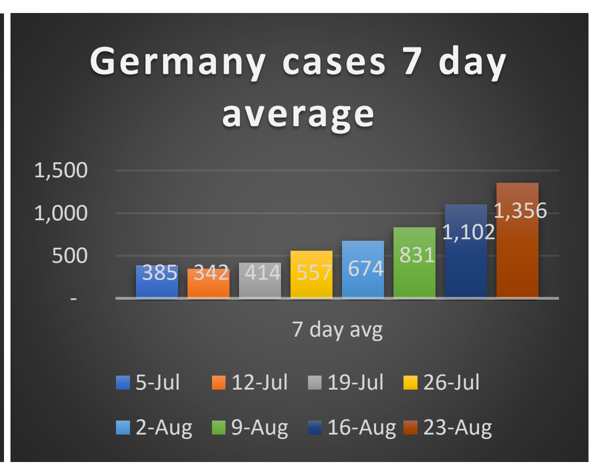
COVID-19 cases climb higher in European countries

COVID-19 cases in Europe are rising steadily, increasing to about 26,000 cases per day. Two thirds of countries have reimposed some restrictions. France, for example, reported 4,711 new cases on August 20, 2020, its highest daily total since lockdown restrictions were eased in June. The seven-day case average has increased to 3,480 cases per day, compared to just 1,100 just two weeks prior. Germany, on August 20, 2020, reported about 1,700 new cases – its highest daily total since April. Germany's seven-day moving average almost doubled to 1,356 cases at the beginning of August (compared to only 674 at the end of July). On the same day, Spain reported, 3,715 cases, its highest since the easing of its lockdown in late June, with the seven-day moving average up to almost 4,000 cases. That's compared to 2,000 cases only one month ago at the end of July.









Eased restrictions and looser behavior by individuals have led to the resurgence of transmission in Europe. This time around, European leaders have largely avoided imposing widespread lockdowns, and they're instead relying on targeted restrictions – such as constraints on movement or activity in areas where transmission increases are most pronounced. Mask requirements and public health education campaigns have taken the place of civil orders to close or limit business activity.

The United Kingdom required people to quarantine for fourteen days if they were coming from some countries (like Spain, France, Greece and Austria) regardless of means of travel (air, auto, or rail).

In France, a growing number of cities has made mask-wearing mandatory in crowded streets and markets.

In Germany, Chancellor Angela Merkel has vowed to tackle the spread of the virus without closing national borders, despite the rising in cases because of vacationers returning from other countries. Challenges that could raise the number of cases in the fall include resuming school, tracking flu and strengthening economies from opening measures.

Decline and Fall of the Mall: A COVID-19 Casualty

I've always been fascinated by shopping malls – and not just because I grew up in American suburbia. After reading *Looking Backward* (https://en.wikipedia.org/wiki/Looking_Backward), I viewed these big chunks of consumerism differently. Author Edward Bellamy wrote of the covered downtown shopping districts that would exist 113 years in the future (he wrote the novel in 1887 and published it the following January), protected from the elements day and night all year long. Oddly, the consumerism that would ultimately be enabled by this climate-controlled public square otherwise conflicted with the socialist utopia he advanced. And it's that unintended consequence – the mall – that's at risk today.

In fact, since 2000, which is when Bellamy set his novel, the mall has seen its importance in American society decline. Malls have struggled to find their identity over the past decade. And in a world where online has put pressure on brick-and-mortar retailers to adapt, malls have been hit disproportionately hard. Even before the COVDI-19 pandemic, there was a "reinvent or die" ethos surrounding the mall concept. Articles on "ghost malls" abounded (such as https://www.businessinsider.com/american-retail-apocalypse-in-photos-2018-1 and https://www.theatlantic.com/video/index/602371/dead-malls/). Closures were common, while others limped along as retailers faded away.

It wasn't completely grim. Some malls were able to hold some ground, particularly where their location and stores aligned well. Affluent suburban neighborhoods showed some ability to support upscale and luxury formats (https://www.washingtonpost.com/business/2019/11/22/malls-are-dying-only-these-ones-have-figured-out-secrets-success-internet-age/). There may have been some strain on the model, but the core concept showed the ability to endure.

Where reinvention proved necessary, some interesting attempts came to market, and they showed potential (at least until the pandemic). Repurposing malls into lifestyle centers seemed particularly interesting. Taking advantage of the confluence of healthy lifestyles, socially responsible grocery, and apparel for both, an emerging solution seemed to bring to malls stores previously alien to them. Athletic apparel and "athleisure" stores fit well with gyms and mass market but socially conscious grocery (such as Trader Joe's and Whole Foods). Put together, the format catered to time-constrained customers who could put together their trips to the gym with other regular shopping needs. Add coffee, and the idea starts to look appealing.

As long as people are comfortable going out and gyms remain open.

Another high-profile attempt was the American Dream facility in New Jersey (https://www.bloomberg.com/news/articles/2020-06-09/american-dream-leaves-family-behind-mall-empire-mired-in-debt). Developed by the folks behind the massive Mall of America in Minnesota, American Dream sought to become a destination, mixing extremely high-end retail (which still hadn't opened before the pandemic hit) with theme park and lifestyle attractions, including a water park, skating rink, and indoor ski slope (the last of which saw one PCS team member watch another fall flat on his back after an ill-conceived and poorly executed snowboarding jump – GoPro video available to any interested). The mall was a big bet decades in the making, and again depended heavily on the ability to draw and retain crowds.

Doubt surrounding the future of the shopping mall concept impacts more than the REITs and managers who run them. For many retailers, malls meant access to customers – premised on the notion that you have all the customers in one place, rather than needing to draw each to your geographically dislocated establishment. Think about your last trip to the mall (I know, it's been a while), and reflect on the different retailers you walked by. For how many of them have you seen a standalone location? Not much, right? The streets of most cities and town are not littered with Brookstone stores.

Without the mall, these businesses would be forced into a massive strategic exercise to completely refashion their futures, from choosing store locations to engaging with customers via advertising. It would be hard for Forever 21 to live up to its name.

Some mall fixtures were under pressure already, and not just from online outlets. Department stores, once a staple of American weekends, lost ground to big box retailers across the country on the value end of the consumer spectrum and to upscale alternatives and standalone brands at the other extreme. What was left in the middle was squeezed by online. Without the mall, it only gets worse for them.

For mall operators, online does offer a glimmer of hope, although minimally. Some facilities may become fulfillment centers for Amazon or other large online retailers (https://www.cnbc.com/2020/08/09/amazon-wants-to-use-jc-penney-stores-as-fulfillment-centers---report.html), which at least creates some jobs and puts those cavernous retail husks to some use. However, the utility of the mall building doesn't do much for the retailers within it that would lose their contemporary agora. The outcome seemingly resembles the repurposing of Manhattan grocery stores into bank branches a dozen or so years ago. The walls find some use, but the rest doesn't.

Insurers may still have access to revenue from repurposed malls, although the drastic decline of retailers within them – hastened by COVID-19 – could constrain growth prospects for the portion of the global re/insurance community focused on consumer business.

So, the question becomes one of reinvention. The building may be reinvented as a distribution center, but the capabilities within it will need to come back, at least on a limited basis.

Our guess – and a guess is all it is – is that the brand equity associated with some mall-dwelling retailers will make them fodder for the global private equity sector, which will find ways to rehabilitate the stores lost to the decline of the mall, either online or with new in-person formats. When the dust settles, there should be a swing back to destination-driven retail, especially with folks reacting to what could be several years of limited social interaction as a result of COVID-19. It seems that prudent players will pick up assets during the pandemic and formulate plans for reconfiguration and relaunch when the tide turns, which would enable them to capitalize on what should be a prevailing sense of enthusiasm. It leaves little upside in the interim, but when you can spend the pandemic fretting or planning, the latter is far better.

Retail Reckoning

Then pandemic and U.S. riots this year have resulted in unprecedented pressure on the retail sector (some of which is discussed above). However, a few have found opportunities to succeed despite challenging economic conditions. According to a *Washington Post* report (https://www.washingtonpost.com/business/2020/08/19/retail-earnings-second-quarter-2020/?hpid=hp_business-1_retail1015pm%3Ahomepage%2Fstory-ans), several big box retailers have shown increases in both revenues and earnings, including: Walmart, Target, Home Depot, and Lowes. And rather than see sales limited to essential items, bigger ticket items (such as consumer electronics) are starting to move.

There are many reasons for some big box retailers to find opportunities to increase revenue. In addition to the fact that consumers are likely beginning to find their feet after lockdowns and other constraints on non-home activity, big box retailers may offer price points that make consumers feel more comfortable spending during a period of economic threat. There may be a sense that some people still employed are likely to stay that way ("if my company didn't lay me off by now, they aren't going to" or "I understand how my business works, and we can operate on a remote basis"), which makes them feel more comfortable parting with their cash.

One thought, though, that hasn't appeared in any of the reports we've reviewed, is that big box retailers address a lot of shopping needs in one place. In addition to value pricing, it obviates the need to visit more than one store, which reduces potential exposure to COVID-19. Home improvement stores (Loews and Home Depot) may not fit this model, but they may dovetail with a stay-at-home lifestyle, with purchases to support home improvement efforts or gardening.

Additionally, the extremes may squeeze the middle in the retail sector. Lower prices and value-driven retailers may attract those more at risk by prevailing economic conditions, while luxury alternatives can satisfy the needs of those who feel more secure in the current environment.

Take it outside … until you can't

Use of outdoor space has given restaurants and retailers more flexibility in how they deal with social distancing and local regulations that may prohibit indoor service. The expansion of the restaurant or store floor out onto the sidewalk or street provides for more turnover, potentially larger sales per interaction (either basket or table, depending on the business), and a way to stay alive during the pandemic. Unfortunately, this strategy comes with an expiration date in some of the most populated markets in the developed world.

When it gets cold – or rainy, or snowy – it's harder to engage with customers outside. Folks don't usually want to eat out in the cold. Blankets, portable heaters, umbrellas and awnings, and other tools can help restaurants fight nature for a bit, but in many cities, eventually, winter wins. Retailers may also see some targeted opportunities for outside shopping, but there are limits to the effectiveness of that strategy. There's nothing more charming than a northern European Christmas market. The roaring fires in Berlin's Alexanderplatz bring fond memories, but what may be charming for a night or two doesn't bring a long-term solution. Retailers ultimately benefit from putting a roof over customers' heads – as Bellamy clearly figured out (if you skipped to get here, go back to the top to see who Bellamy is).

Through the next few months – and a bit longer in warmer places – consumer-focused businesses will be able to take advantage of gentler weather to expand their engagement and fight the coronavirus-induced economic malaise. In addition to amping up sales as much as they can, it's also a good idea for these companies to come up with ideas to get them through the winter. After all, nobody wants to tromp through the snow for months on end, even if there is plenty of glühwein involved.

COVID-19 & Litigation

There has been significant state insurance regulatory activity related to COVID-19 pandemic. State insurance regulatory authorities have issued emergency notices and bulletins, rules and regulations, containing both directives and guidance, as well as requesting information related to the COVID-19 outbreak. These regulatory behaviors vary from state to state. Some refer only to specific lines of insurance while some are generally directed at all regulated insurance companies. These regulatory actions have changed business operations, consumer activity, and economic forecasts.

Although the effects of the COVID-19 pandemic are still unfolding across the insurance industry, the impact of COVID-19 on business operations, consumer activity, and economic forecasts have made it clear that the legal filings made to date are only an early indication of what is to come. Even before the COVID-19 pandemic made its way across America, class action lawsuits had been on the rise. Now, COVID-19 has caused that trend to pick up even more steam.

Insurance coverage litigation regarding business interruption coverage has continued to drive much of the growth in COVID-19 related litigation. Federal courts are individually coordinating with state and local health officials to obtain local information about the coronavirus (COVID-19), and some have issued orders relating to court business, operating status, and public and employee safety. Below is a list of links to all federal court websites, as well as links to court orders and other information posted to the courts' websites regarding the COVID-19 pandemic and court business.

The information is updated most days by 1 p.m. EDT, but the situation in local courts may change rapidly. We cannot ensure the latest information is posted below. We strongly suggest you visit a court's website to confirm you have the latest information.

https://www.uscourts.gov/about-federal-courts/court-website-links/court-orders-and-updates-during-covid19-pandemic