COVID-19: *Possible effects* on the Real Estate sector in Mauritius – An Insight by Kesaven Moothoosamy, Executive Director, Perigeum Capital Ltd

The global environment appears to have come to an almost standstill as communities are facing up to the reality of the novel Coronavirus Disease 2019 (COVID-19). As the world dives deeper into an analysis of the potential impact of this crisis, the short-term impact on economic growth, business activity and individuals is being felt while expectations hinge towards a probable rebound in the global economy in the end of H2 2020.

In fact, having been declared a pandemic by the World Health Organization (WHO) in early March, the COVID-19 outbreak has greatly affected the physical and economic health of the world. The COVID- 19 emerged as the "black swan" in the already turbulent economic environment where there were already many signals of an impending global recession. Economists worldwide recently declared that the coronavirus has indeed triggered a global recession leading to a faster collapse than anticipated. The debate is on how deep it will be and how long it will last. While in China, life is gradually getting back to normal and the outbreak has slowed down after nearly 3 months since the first case was detected, it is yet to be seen when the situation will improve in the other countries.

Following the declaration of 7 cases of COVID-19 in Mauritius between Wednesday 18th and Thursday 19th March and the subsequent decision of the Prime Minister to embark onto a lockdown strategy as from Friday 20th March, people have landed into a spiral of fear, pessimism, panic and this situation has given rise to various interpretations of the situation. Given that we are heavily dependent on exporting our services in the financial sector and tourism industry as well as on imports from overseas in relation to food or non-food stuffs, we have started to experience the knock-on effects on the Mauritian economy.

While the contagion on the tourism industry in Mauritius is tangible, this is only the tip of the iceberg. Other sectors, less spoken about like the Mauritian real estate sector could start feeling the infection. There are various debates on how the global economy will recover post COVID-19 and on whether it will be a U-shaped or L-shaped recovery curve. However, irrespective of the shape of the recovery curve, it is not expected to improve anytime soon and the sequel of COVID-19 could last for some time in vulnerable countries like Mauritius due to their dependence on foreign infected countries.

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Hospitality properties

The ban on travelling around the world has a direct influence on the Mauritian hospitality sector which was already experiencing a sluggish growth in 2019. Further to the Government initiative providing for any foreign national having resided in or with a history of travel to and from, any member state in the EU, UK, Ireland, Switzerland, Norway and Reunion Islands within the last 14 days, to be denied entry in Mauritius, the Government has now announced a ban on arrival of all passengers.

Many hotels in Mauritius are hooked onto tourists' arrival from these countries and the occupancy level of hotels has dropped to alarming levels and they are expected to continue experiencing further sharp drops, more so with the recent lockdown measure. Although it is temporary, we are not sure until how long the Mauritian entry restrictions will be prolonged and we need to wait until summer in the northern hemisphere to witness a slowdown.

As per stakeholders in the Mauritian market, foreigners are revisiting their holidays plans as a result of which, hotels and operators have not registered bookings for Easter and a deterioration of this situation is to be expected following the declaration of cases of COVID-19 in Mauritius, the travel ban and the recent lockdown. The corporate curtailing of travels, cancelations of conferences and similar large events are also hurting hotels' turnover.

The contamination anxiety will still prevail for some time and at this point, we cannot ascertain for how long this will last. The low or zero occupancy level of the hotels has a direct impact on the turnover of the hotel operators and can lead to a cash-strapped situation. The hotels in Mauritius have been extending several discounts over the past months to attract Mauritian citizens to effect bookings but the prevailing panic-infused environment has greatly undermined the appeal of these offers to Mauritian citizens.

When the prevailing climate directly impacts the health and wellbeing of families, it is highly doubtful whether a 30% or 40% discount in the hotel rates will attract customers. Empty or low occupancy in the hotels imply that they can either continue operating just to cover their fixed cost by giving discount to Mauritian citizens or close down temporarily, thereby leading to a ripple effect on the hospitality real estate sector. In fact, several Mauritian hotels have already reduced the number of hotels in operation.

Most of the big hotel groups in Mauritius have adopted an asset light strategy and have a structure whereby the hotel operators or management (OpCo) and the property holding company (PropCo) are separate. The walls of the hotels are owned by real estate investment companies or Real Estate Investment Trusts (REITs) under long term leases and the hotel operators are expected to make rental payments which could be in local currencies or hard currencies like EUR or USD.

The REITs on the back of the rental cash inflows have raised money from investors as well as taken loans from banks to finance the acquisition of hotel properties. The hotel operators have an obligation to pay the rents to the property owners irrespective of whether sales can be generated or not.

The debate is whether in these difficult and unforeseen circumstances, the hotel operators will be able to fulfil their obligations.

Even if the strategy for hotels would be to attract Mauritian residents to go to the hotels, given the low occupancy and the reduction in rates required to attract the local tourists, the hotel operators may not have enough dry powder to navigate in this circumstances. The knock-on effect will be on the property funds who may not be generating cash required to fulfil their commitment given to investors and at the same time will affect the bank covenants on loans like interest cover and debt service cover ratios.

If the situation persists, the value of the hotel properties will be impacted and this may also have a spillover effect on the Loan-to-Value (LTV) covenants imposed by banks. Landlords that are highly geared may find themselves in a defaulting position if banks do not provide them with repayment holidays and temporary relaxation on the covenants.

While the government is providing financing facilities to the hotel operators to ease their cash flow, it is yet to be determined whether the cash available should be applied toward payment of employees' salaries and maintaining employments thus avoiding a social crisis or on prompt settlement of rents to the landlords.

Retail properties

The fear is prevalent and we may experience continued low footfall in malls excluding supermarkets or grocery stores, as seen by the recent rush to buy groceries and other essentials as a precautionary measure ahead of the citizen confinement strategy implemented in Mauritius as a result of the virus outbreak.

With the virus having reached our shores, it is unlikely for the social distancing measures established by some supermarkets to be successful. Avoiding crowded areas can be a helpful tool in mitigating the spread of the virus and if the population follows this advice, the immediate impact on the real estate retail asset class could be significant as people would avoid shopping centers and malls. While people still need food, clothes and other essentials, they may turn to online shopping which has started to gain momentum in Mauritius.

Amazon announced that it would hire 100,000 warehouse and delivery workers in the US, to deal with a surge in online orders, as many consumers have turned to the web to meet their needs during the coronavirus outbreak. There will be a significant number of Mauritians who would be tempted to try online shopping for the first time as a result of this pandemic. The significant reduction in footfall in malls and shopping centers will affect the retailers by an abrupt and significant drop in turnover. The situation could be a temporary one but the sequel could be lasting on their businesses.

The spillover effect on the real estate sector is that a reduction in sales from low footfall together with possible shortages of commodities might weaken shops' performance and will as a consequence, also impact the ability of tenants of malls and shopping centers to pay the monthly rentals to the landlords. Most tenants and especially those in the high-end apparel business deemed a non-essential good, in these tough times, may default on the rental payments to their landlord and this may put further pressure on the property owners to be in a cash-strapped position especially if they are highly geared.

The situation could be amplified with the looming recession where people would start tightening their belts. The food courts of malls which normally attract a lot of customers would be in difficulty as well. With the fear of poor hygiene that may be adopted by the food shops coupled with avoidance of crowded areas, this could further lower footfall and affect overall performance of the malls. On a slightly positive note, the supermarket/ grocery stores are still expected to drive traffic towards in the malls for essential commodities during the current lockdown.

The current situation calls for a need to do a tenants' analysis to understand the impact of this significant reduction in footfall on the tenants' turnover and on their ability to meet their current obligations. Some grocery supermarkets may be able to absorb the shock while other stores of non-essential goods may take a direct hit.

Property funds may need to give extended credit facilities to the tenants. Another possible scenario could be that the owners of shopping centers and malls, may be required to forgo some months' rentals in the hope of retaining the tenants and avoiding sudden closure of the shops which could have a ripple effect on the overall attractiveness of the mall.

On a similar vein, the mall owners may need to in turn negotiate repayment holidays with the banks in order not to affect their cash flow position, interest cover covenants and hence default on their loan. In the short term, this will have an effect on the valuation of malls and also affect their banks' LTV covenant.

In more extreme cases, the shops may decide to close instead of accumulating liabilities even if this means breaching the lease agreements. If China has taken about 3 months to tackle the situation and bring down the number of confirmed infected cases, one could reasonably assume that the other countries would take more than 3 months starting from now. Therefore, it seems that the situation could only get better by Q4, 2020 i.e. toward the year end, during the festive period.

Residential properties

The residential property market may benefit from the interest rate cut thus making the cost of financing for purchase of houses/villas/apartments lower. However, some buyers may adopt a wait-and-see approach and avoid huge spending in this uncertain environment. The risk of possible loss of employment in this forthcoming recession is unfortunately looming, as well as an expected reduction in income in the foreseeable future; the dual effect of these conditions is expected to directly affect this market.

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Commercial properties

Some office buildings that were occupied by businesses servicing the tourism industry will experience a more direct impact. The tenants in that situation may either absorb the cost, request for credit facilities or simply hand over the keys to the landlord.

This real estate asset class may not have the immediate impact but many businesses have adopted a work- from-home (WFH) policy in order to ensure continuity of the operations due to the COVID-19 outbreak in Mauritius. This process of telecommuting may encourage businesses to try new cultures and processes which could be adopted in the aftermath of the COVID-19 pandemic.

The impact on the commercial property sector in the country could be everlasting as businesses will re-think about their office space requirements with a WFH policy. If their staffs can telecommute easily and a Result-Only-Work-Environment (ROWE) is implemented, this could be a game changer. Co-working spaces or shared offices will also see lower traffic and a fall in demand in this current circumstances.

Property owners with short term leases could be under pressure and long term leases' tenants may negotiate new rates or reduce space requirements at the renewal. In the wake of a possible recession as a knock-on effect of the virus, the valuations of the office properties could be impacted as future cash inflows from the rentals of the office spaces could thus be challenged.

Closing remarks

The outbreak of the COVID-19 has only started in Mauritius and the multiplier and domino effects are yet to be seen. We hope Mauritius is able to contain the spread of the virus and it subsides quickly. One should expect the real estate industry to see major changes as a result of the COVID-19 which has forced people to re-think about the way we all live, work and play.

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