PANDEMIC

A PERIOD IN TIME AND THE PATH FORWARD

RESEARCH SPOTLIGHT | MARCH 2020

Newmark Knight Frank

THE HUMAN TOLL OF COVID-19 AND THE SPREAD OF THE CORONAVIRUS IS **THE WORLD’S GREATEST CONCERN TODAY.**

As we at Newmark Knight Frank isolate ourselves physically and care for our families, we remain committed to providing our clients not only with the latest market information but also with actionable intelligence to help support your business activities during and after this crisis.

As of late March, here is a data-driven assessment of the U.S. commercial real estate market and potential action steps for investors and tenants of the major property types to consider.

CAPITAL MARKETS

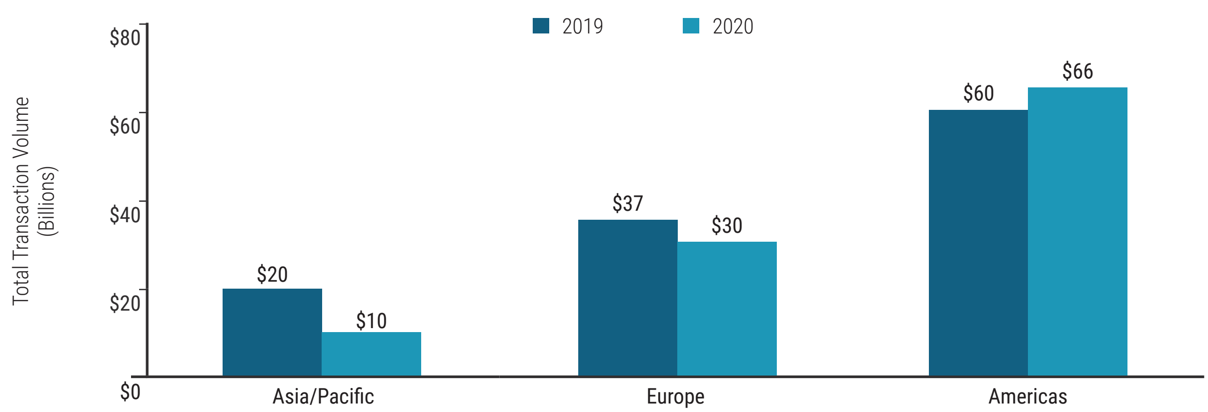
Because it often takes months to close a deal, it will be a while before the slowdown in domestic sales market activity can be fully evaluated. However, because the coronavirus became a public health concern in Asia and Europe several weeks before it did in the U.S., we hope to draw lessons from the pace of transactions in those markets.

Commercial real estate sales activity across all property types declined 50% in the Asia Pacific region during the first eight weeks of 2020—as the virus was spreading rapidly—compared with the same period in 2019, according to data from Real Capital Analytics. The decline in Europe for the comparable period was 18%. In the Americas—where the coronavirus was not fully recognized as a major threat until late February—transaction volume was up 10% during the first eight weeks of 2020 (see adjacent graph). This suggests that a decline in U.S. volume will be recognized in second quarter data.

The debt market's low yields still represent an opportunity for investors, even as some lenders pull back. Well-capitalized investors are in a strong position to buy. In times of dislocation and uncertainty, U.S. commercial real estate historically serves as a safe haven and outperforms other major markets, while real estate outperforms other asset classes—particularly notable given the recent stock market volatility. For now, sales transactions that were near closing continue to move forward, but deals in the early stages are on pause. Existing stabilized properties with good tenancy likely will be less impacted than properties with significant vacancy. There will be imbedded added risk in the discount rate and underwriting projections in the near term.

One notable challenge to the capital markets—and the economy more broadly—is the high level of corporate debt, which was approximately $10 trillion in November 2019, or 47% of the U.S. economy. However, the Fed's apparent willingness to buy up to $1 trillion of short-term corporate debt and its commitment to ensuring liquidity in the financial markets ease those concerns in the near term and may help reduce layoffs. In the longer term, the financial implications of the COVID-19 crisis could more closely resemble those from other non-financial disruptions, such as the terrorist attacks of 9/11 or weather-related events such as Superstorm Sandy in the New York area, than they do the financial crisis of 2008. However, this is still a fluid situation. The human toll of all of these events, including the COVID-19 pandemic, is significant. However, many dire market-shaping predictions did not come to pass after previous catastrophic events, such as a refusal to lease high floors or invest in gateway markets. Also of note, given the increasing emphasis on social responsibility, we expect a high percentage of lenders to show leniency toward borrowers and tenants who are directly affected by coronavirus infection.

CAPITAL MARKETS TRANSACTION VOLUME
MAJOR GLOBAL MARKETS | JANUARY-FEBRUARY 2019 VS. 2020



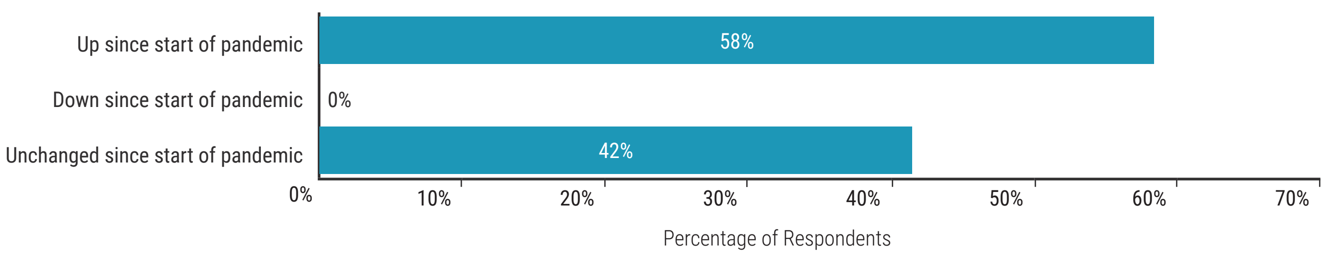
Note: All major property types excluding development sites; data is preliminary
Source: Data from Real Capital Analytics, graphic by NKF Research; March 2020

CAPITAL MARKETS (CONTINUED)

Volume may slow not only because of the significant reduction in asset tours, but also because of the cancellation of conferences that spark transactions between investors. In the meantime, an informal NKF survey in the Seattle market indicated that 50% of potential buyers were open to virtual tours of assets under consideration—a creative option to further deal flow during a challenging time. Virtual tours may be best suited to industrial assets, where fixtures and finishes are not as important a component of value as in office and multifamily properties.

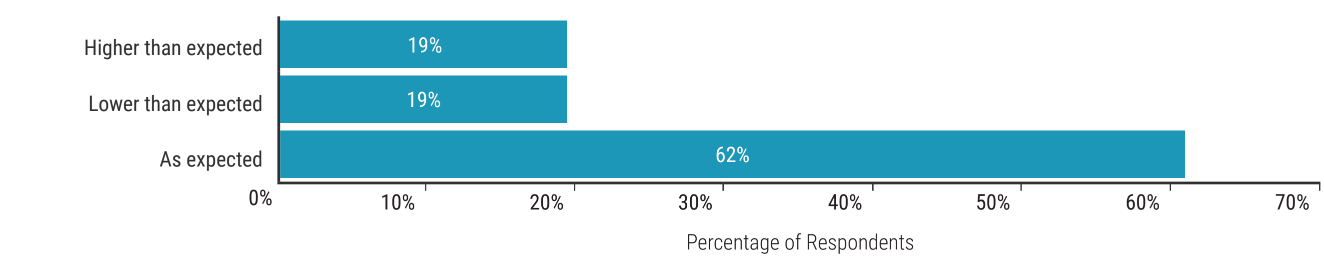
Action steps: Investors with long-term horizons may wish to focus on gateway markets, as they remain a strong option for their educated workforce, the quality of their assets, and their appeal to industries with strong, long-term growth projections, including technology. However, values are likely to decline in denser markets as long as the coronavirus remains a significant threat, due to the physical proximity of the workforce. For opportunistic investors with deep capital reserves, this could be a chance to buy strong assets at a discounted price. For investors with shorter time horizons, secondary markets that have been less affected by the virus (to the extent there are any) may have greater appeal. Another potential target market for office investment is single-tenant net lease, which may benefit from a renewed emphasis by tenants on controlling their environment. Large funds have been prioritizing the multifamily asset class for its stable nature, so opportunities to buy in off-market deals could be particularly valuable. Sellers—especially those in need of cash—are receptive to such deals but still expect high prices due to the low interest rate environment, and buyers are still offering expected prices (see the adjacent graphs). The multifamily sector remains a relatively safe harbor as layoffs or reductions in pay push some potential home buyers back into the rental market, although the taking of roommates could offset some of that demand. Notably, a moratorium on evictions, which some cities are implementing to protect those who lose their jobs, is likely to keep rent rolls low for the next few months.

NKF SURVEY: UNITED STATES MULTIFAMILY SALES MARKET (MARCH 2020)
HOW WOULD YOU CLASSIFY CLIENT RECEPTIVITY TO OFF-MARKET OFFERS?



Note: Survey of NKF multifamily capital markets professionals, based on their client feedback
Source: NKF Research; March 2020

NKF SURVEY: UNITED STATES MULTIFAMILY SALES MARKET (MARCH 2020)
ON DEALS WITH A RECENT OFFER, WERE OFFER PRICES...



Note: Survey of NKF multifamily capital markets professionals, based on their client feedback
Source: NKF Research; March 2020

OFFICE LEASING AND PROPERTY MANAGEMENT

The office leasing market is likely to suffer in the short-term due to COVID-19 as layoffs diminish tenants' overall need for space and in many cases set aside expansion plans they may have had. In addition, tenants who remain in the market for additional space will have a difficult time touring properties. In the longer term, the coronavirus crisis may reshape or accelerate some narratives about the office environment, with four potential changes most prominent at this time:

1. Office workers' pushback against the open office environment is likely to accelerate, as illness is more easily transmitted in an open environment. Many employers already had recognized that in a competition to attract and retain top talent, squeezing workers into increasingly tight spaces was not a sustainable strategy. Now, an emphasis on social distancing and good health practices—continuing in some fashion even after the crisis has passed—may help reverse the densification trend, with less shared space and fewer workers per leased square foot.

2. While successful remote work situations may reduce demand from some tenants who had not previously tried it, the current situation is also a reminder that isolation is unappealing and remote work is less productive for some occupiers.

3. Disruption in the coworking sector is likely to be exacerbated by COVID-19, given the clustered nature of many coworking environments and the short-term approach to members' space commitments, which present a threat to coworking providers' balance sheets. SoftBank's efforts to unwind part of its bailout agreement for WeWork underscore these concerns.

4. The property management landscape is focused more than ever on sanitation and disinfection of assets, both inside and outside tenant suites. Enhanced cleaning of common areas may occur at the asset owner's discretion and be passed through to tenants via operating expense charges. However, enhanced cleaning in a tenant's suite likely would be at the tenant's discretion and sole expense. Ultimately, there will probably be increased costs to tenants as a result of the proactive and reactive cleaning measures being taken.

Action steps: Office lease deals are generally moving forward if the tenant has an inflexible move date. However, if the requirement is not driven by a near-term lease expiration, the deal is likely either on hold or progressing slowly. Asset owners eager to boost occupancy may find that those tenants are willing to engage at the right price, and that outreach now can fill a void in the market. Notably, larger tenants in smaller buildings may be more inclined to consider full-building leases with better control of their environment, including public spaces, garages, and food service facilities. In the short-term, asset owners and tenants may wish to review their lease obligations, including penalties for non-compliance. Longer term, once offices reopen, a space re-evaluation and updated workplace strategy would benefit many tenants.

INDUSTRIAL

The industrial market is in an unusual situation as the coronavirus pandemic takes hold. For years, e-commerce has served as a demand driver for distribution and warehouse space, which has elevated rents and asset pricing. With millions of American consumers spending many more hours at home, e-commerce has become a virtually indispensable resource. However, interruptions to the supply chain may curtail some of the market's advantages during this challenging time, when the priority is on delivering core goods. Logistics firms are an essential part of this process but may be challenged as some of their customers have difficulty affording their services.

Because of the size of many modern warehouses, they may find value in another way: as temporary homes for medical supplies or even as impromptu sites for patient treatment. Industrial space has particular value when outfitted for cold storage (refrigerated warehouse) uses; with the normal food supply chains subject to timing disruptions, every cubic foot of such facilities may be needed for emergency uses. Similarly, with so many more workers connecting from home, there may be additional strain on data centers.

Action steps: Underutilized industrial space—particularly if located near major population centers—may be in greater need than it was a few months ago. Modern warehouse facilities are likely to be in greater demand as well, to serve the needs of e-commerce; owners of such space may wish to market it. Notably, changes in the supply chain may result in increased demand for domestic warehouse and distribution space as some of those steps are brought closer to home. Logistics firms are likely to further evaluate the use of robotics in their activities, possibly leading to new leasing requirements for modern facilities as the industrial sector remains an economic driver in the period ahead.

RETAIL

With approximately 70% of GDP attributable to consumer spending—and consumers largely on the sidelines due to physical isolation and store closures—the economy likely will see contraction of at least 5.0% in the second quarter of 2020, and perhaps significantly more, according to Goldman Sachs. The range of possibilities remains wide at this point in the crisis. The question is how quickly the economy will rebound, and that is highly dependent on the containment of the virus; the consensus forecast from major banks is for U.S. economic growth of 2.5%-3.0% during the second half of 2020. To the extent a fiscal stimulus is primarily directed to individuals, that is likely to spur consumer spending, even if much of the spending is done online. Universal basic income may gain traction as a longer-term policy option if it proves successful at mitigating economic harm during this crisis.

Amazon has pledged to hire at least 100,000 workers to fulfill a projected increase in orders, including absorbing some workers who are laid off from brick-and-mortal establishments. Walmart is implementing a similar initiative of up to 150,000 new hires, and some grocers are hiring on a smaller scale. While health concerns in the warehouse environment may slow shipments—and Amazon and other electronic retailers face supply chain challenges—the movement of more retail sales online benefits those retailers who developed strong omnichannel operations before the crisis. Some restaurants and smaller retailers will not survive the crisis—notably, consumer spending at restaurants and bars represents almost 4% of GDP—but those who do will benefit from a strong desire by consumers to socialize, dine out, and shop once the pandemic is contained. The current crisis also renews emphasis on the importance of grocery stores and pharmacies; centers that are anchored by essential goods and services providers remain a strong investment going forward—although those stores should incorporate online or mobile ordering and delivery/pickup services where practical, if they had not done so already.

RETAIL (CONTINUED)

Action steps: Regarding the long-term outlook, investors may wish to evaluate their portfolios now to ensure appropriate weighting toward essential goods and services retailers like groceries and pharmacies. The accelerating movement toward using retail spaces for urgent care centers also is likely to gain further momentum. More immediately, investors might consider accommodating tenants on matters of existing lease obligations and offering temporary rent and parking abatements in order to keep them in their spaces. Also, many office asset owners consider their retail space to be an investment in their office space. There may be willingness, ability, and desire to save threatened retailers who provide services to workers, such as quick service restaurants.

HOSPITALITY

The hospitality industry has been hurt badly by the coronavirus outbreak, with air travel severely disrupted, cruise lines shut down, and the hotel industry reeling. For the week of March 8-14—the most recent data available at this writing and the first week during which the COVID-19 crisis significantly altered Americans' behavior—U.S. hotels experienced a 24.4% decline in occupancy rate, a 10.7% decline in average daily rate (ADR), and a 32.5% decline in revenue per available room (RevPAR), as shown in the adjacent graph.

The world's largest hotel chain, Marriott, announced on March 17 that it was placing tens of thousands of employees on furlough until travel restrictions and social distancing measures have subsided, which would allow its occupancy rate to rise.

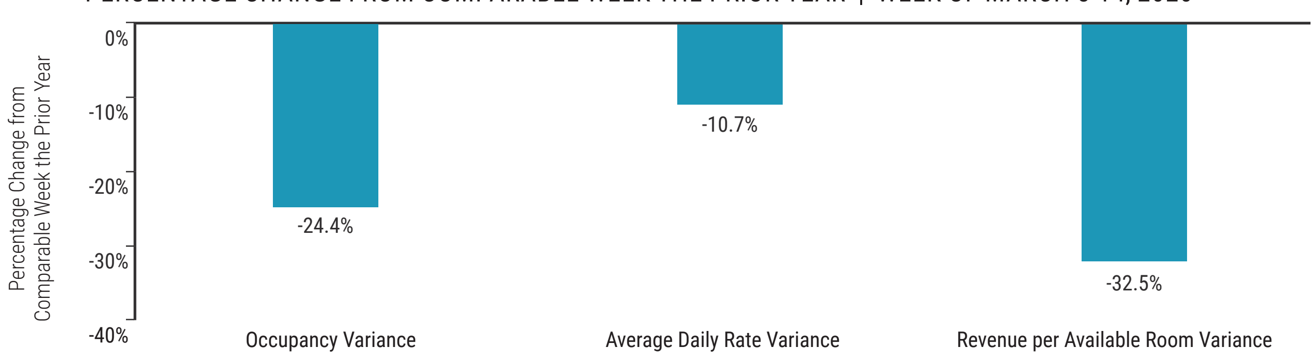
Given the severe impact of the pandemic on the hospitality industry, it is possible there will be a federal bailout for this sector, which might allow hotel chains to survive a prolonged downturn and allow more workers to remain employed.

Much like some industrial assets, hotels may be able to serve a temporary but valuable purpose: as a location for medical treatment of coronavirus patients or as temporary storage space for medical supplies.

Action steps: Cities closely associated with tourism and conventions—including Chicago, Las Vegas, Miami, New York, and Orlando—may see assets hit especially hard, with the spring convention season already a lost cause. Investors may find that asset pricing falls to attractive levels in these markets, with significant upside available as conventioneers may be particularly eager to return to these locales once the crisis has passed. Longer term, hoteliers may choose to incorporate more antiseptic textiles into their designs to slow the spread of infectious diseases; office asset owners may do the same. Also, a silver lining for the hospitality sector is that downtime offers a rare opportunity to renovate, although cash and financing may be hard to come by.

HOTEL MARKET METRICS: UNITED STATES

PERCENTAGE CHANGE FROM COMPARABLE WEEK THE PRIOR YEAR | WEEK OF MARCH 8-14, 2020



Source: STR, NKF Research; March 2020

LOOKING **FORWARD**

Newmark Knight Frank will continue to report on evolving market conditions throughout the COVID-19 crisis, emphasizing market data and actionable intelligence, including from proprietary NKF surveys. Please call on our professionals for guidance—we stand ready to help you remain prepared as this crisis evolves.

We extend our compassion to those who are suffering, and we wish you and your families good health.

Sources: Barron's, *Bisnow*, Federal Reserve, Goldman Sachs, JPMorgan Chase, MarketWatch, Meister Seelig & Fein LLP, Moody's Analytics REIS, NKF Research, Real Capital Analytics, STR, *USA Today*, U.S. Commerce Department, *The Wall Street Journal, The Washington Post*

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