The CARES Act and Federal Reserve Policy:
A Response to COVID-19

The Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law on March 27. It provides economic support for American businesses and individuals affected by the COVID-19 pandemic. The provisions of the $2 trillion spending measure are wide-ranging and involve relief for tenants and owners of commercial real estate. Following is a summary of the law’s implications for stakeholders across the major commercial real estate property types.

IMPLICATIONS FOR THE MAJOR COMMERCIAL REAL ESTATE PROPERTY TYPES

Multifamily

- Of all the major property types, the CARES Act likely will have the greatest direct impact on multifamily, both in terms of tenant relief for various age and income levels, and for asset owner relief in the form of tax credits and suspension of loan payments.
- Aid for tenants will come in the form of $260 billion in additional unemployment benefits and insurance, which will help renters who were recently laid off or furloughed from their jobs remain in their units and pay their rent.
- Suspending payments through September for the federal government’s student loan program will support renters, who tend to be younger and indebted by student loans.
- Tenants who have had a significant loss of income will also be able to apply for Housing Choice Vouchers ($1.25 billion is earmarked), which will help them pay their rent in market-rate housing.
- For asset owners, the legislation will allow for certain forbearance periods for multifamily owners who have GSE loans (Fannie Mae and Freddie Mac). However, as a condition to this forbearance, multifamily owners cannot charge late fees and/or evict tenants.
- For multifamily developers who currently have PBS projects, $1 billion has been earmarked to provide additional funds to help maintain and run operations of these properties.
- Though not included in the CARES Act, municipalities across the country have indicated that they too will enforce limits on rent increases and evictions, which could impact certain asset owners more acutely than others.
- The legislation is geared specifically toward standard multifamily assets, and the impact on both student and seniors housing remains vague. Student housing may face headwinds with a sizable international enrollment decline in the fall, which will also negatively impact university system revenue. Seniors housing may have to adapt to new ways of protecting the older age cohort, as the COVID-19 crisis represents a greater threat to that demographic. There is a lack of support for lease-up or other value add situations as well.

Office

- Office tenants at all levels, from large Fortune 500 companies to small businesses, stand to benefit from a combination of CARES Act relief and accommodative Federal Reserve policy, while considerable attention is being paid to supporting small businesses through the worst of the crisis.
- In addition to benefits for employees who have been furloughed, the legislation will create a $500 billion fund to make loans and loan guarantees to—or investments in—businesses. While the implementation of this process remains vague, the funding is expected to provide short-term relief and liquidity to businesses that need it most, including many office-using companies.
- Small businesses are expected to receive $350 billion, which is contingent on the loan funds being used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments. Crucially, lease payments are included in the provision, which will ultimately benefit office asset owners, who are less likely to have to endure missed payments or tenant defaults.
- Sector-specific stimulus, such as the $25 billion earmarked for grants to airlines and $4 billion to cargo carriers, will help major office markets such as Dallas and Atlanta, where airlines have a large presence and represent a material share of office occupancy.
- Further sector stimulus will be provided to “businesses critical to maintaining national security,” which likely includes companies in the aerospace and defense industry, such as Boeing, but also companies in the biotechnology and pharmaceutical spaces who are on the front lines of the COVID-19 crisis.
- Critically, the Federal Reserve will now be the backstop to the largest office-using employers in the country, as long as they have investment-grade credit, and will be the lender of last resort if those companies are unable to sell corporate bonds on the open market.
- Office as a product type remains on sound footing, despite the increase in telework arrangements. Even before the COVID-19 crisis, many technology and financial services companies allowed flexible work arrangements but continued major office expansions, often including more flex and amenity spaces rather than pure office buildouts.
- Other components of office real estate stand to benefit, such as life sciences lab space. While clusters across the United States were developing in urban areas before the COVID-19 crisis, established markets, such as Cambridge, San Diego and the Research Triangle in North Carolina will likely continue to expand as pharmaceutical and biotech companies become even more critical components of the post-COVID economy.

- Data center properties have represented a growth opportunity for investors during the current cycle, even before the COVID-19 crisis, and likely will continue to benefit from the increased demand for data services across all segments of the economy and population—particularly if more employers expand their telework policies.

Retail

- The CARES act will provide direct relief for consumers of retail goods, via direct payments of up to $1,200 per taxpayer, as well as provide $350 billion in loans for small businesses, of which many are retail-oriented local businesses. The retail sector will also benefit from relief to the unemployed and those in the middle- and lower-income brackets, who will continue to spend money on consumer staples.
- However, the overall impact on retailers has varied greatly during the COVID-19 crisis, with some tenants being hurt badly due to a lack of customers while tenants in grocery, pharmacy, and essential goods and services categories are benefiting as consumers prepare for long stays at home. Notably, several national and regional retailers have announced that they will not pay rent beginning as early as April 1.
- Retail tenants with large e-commerce footprints have best absorbed the economic impact from the current health crisis and stand to benefit from the relief provided to consumers by the CARES Act.
- Consumer discretionary retail, on the other hand, will be severely impacted: retailers such as restaurants, wellness/fitness centers or those located on urban high streets are seeing significantly reduced demand due to mandated closures and drastically reduced foot traffic. Some restaurants with robust delivery and takeout services will be able to maintain moderate levels of business.
- Dense retail contained within regional malls, shopping centers, and food halls will feel more acute pain, as consumers remain at home and continue to avoid large gatherings of people.
- Ultimately, asset owners and tenants will have to work collaboratively to find a path forward outside of the CARES Act. Local tenants are expected to need and receive more leeway than national tenants, who generally have longer term business plans and more cash. Relief sought by tenants from asset owners will vary but so far often includes the following:

    - Short-term rent relief: 30 to 90 days
    - Renegotiation of agreements to percentage rents with significant concessions
    - Free rent, especially if their space is currently being built
    - Long-term reduction in price/rent

Industrial

Logistics Subsector

- Retail and industrial have become more integrated in the current cycle through e-commerce, particularly for firms like Amazon and Walmart, and consequently industrial logistics stands to benefit from the continued demand for consumer staples that the CARES Act will enable.
- While e-commerce was already benefiting from rapidly increasing adoption in the current cycle, the COVID-19 crisis has introduced online delivery to even more of the U.S. population by necessity and will likely see strong retention of new users even after the crisis has abated.
- The largest users of warehouse and distribution warehouse space are already planning to expand their operations in major metropolitan areas that have been hardest hit by COVID-19, and are actively hiring workers to handle the increase in demand.
- Warehouse and logistics space has been the fastest growing segment of commercial real estate in the current cycle, with the largest firms such as Blackstone allocating an increasing amount of capital to the space, anticipating secular growth. This trend is likely to accelerate, as institutional investors will continue to seek well-located last-mile real estate just outside of major metropolitan areas.
- Companies with a significant e-commerce presence will reevaluate their supply chains after the current crisis and will likely factor future pandemic scenarios into their business plans.

Manufacturing Subsector

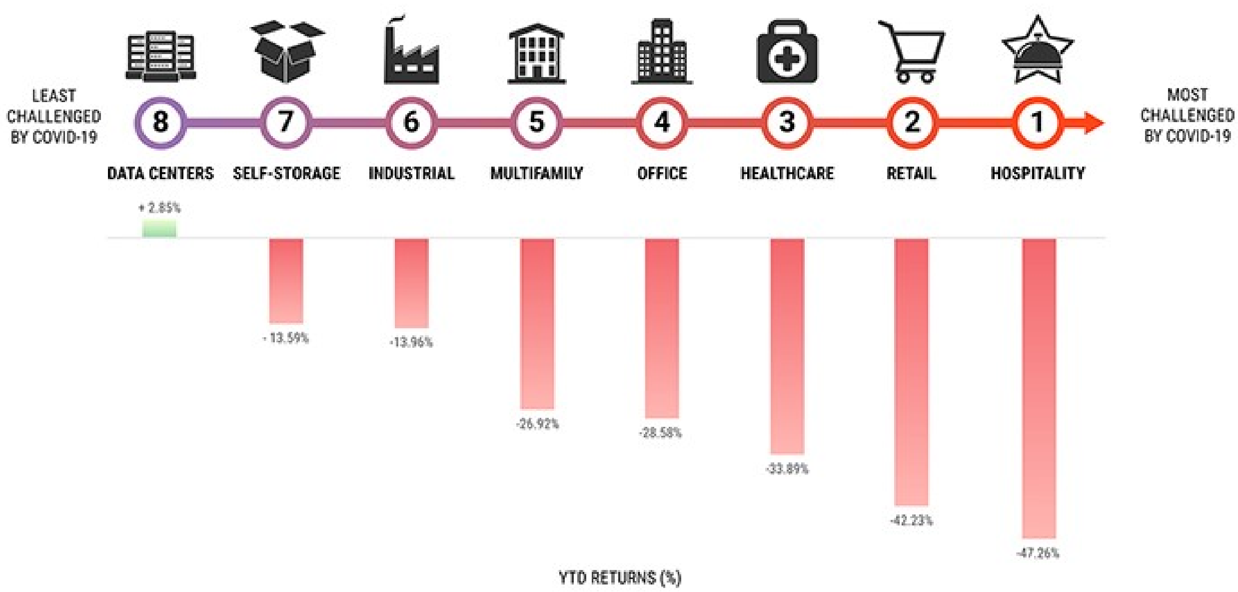
- The CARES act specifically provides $16 billion for the strategic national stockpile of pharmaceutical and medical supplies. While some of this supply will likely come from foreign sources, there has been renewed national interest in harnessing domestic production to produce the most essential medical supplies and drugs.
- The pandemic could lead to domestic expansion in the medical device sector, with the largest firms such as Abbott Laboratories, Medtronic and Thermo Fisher Scientific possibly expanding operations. Producers of masks and personal protective equipment (PPE), such as 3M and Prestige Ameritech, might also be encouraged to expand, providing a boost to manufacturing-oriented industrial real estate.

Hospitality/Lodging

- Hospitality workers are likely the largest beneficiary of the CARES Act, as many have been furloughed or let go as the COVID-19 crisis has severely reduced hospitality and leisure spending by individual consumers and businesses.
- Hotel operators will benefit from the Act’s retention stimulus, which will help them keep essential staff during the crisis while enabling them to reactivate furloughed employees once the threat of COVID-19 has passed.
- Prior to the CARES Act stimulus, modeling by Kalibri Labs estimated that a 50% or greater reduction in cashflow due to the COVID-19 crisis would result in nearly two million layoffs in the hospitality sector alone. For most hotels operating in the U.S., a mere 15% decline in revenue would be enough to push a hotel into negative cashflow territory. The CARES Act is expected to more than halve that layoff figure.
- Regardless, most of the U.S. lodging inventory, despite assistance from the government, will be offline in the weeks ahead. Capital assistance for lenders will be important to regenerate transaction demand and would therefore enhance asset value. Since valuations are generally forward-looking, the recovery of asset values will be quicker than lodging fundamentals (such as RevPAR).
- Typical demand drivers, including global travel buyers such as major consultancies, national corporate conferences, music festivals, and other cultural events will be absent until the current crisis has abated.

INITIAL MARKET RISK ASSESSMENT OF THE COVID-19 CRISIS

The COVID-19 crisis has placed varying levels of pressure on different segments of the commercial real estate market. Based on year-to-date REIT performance as of late March, the spectrum of pressure levied by the crisis is reflected in the diagram below.



FEDERAL RESERVE POLICY: IMPLICATIONS FOR COMMERCIAL REAL ESTATE

While the CARES Act provides direct payments or tax relief for millions of Americans, the Federal Reserve also has been active in order to enhance market liquidity. Following is a summary of the Fed’s recent actions and their implications for commercial real estate stakeholders across all major property types.

- Even before the CARES Act was passed in the Senate on March 25, the Federal Reserve Bank of New York put in place an unprecedented financial support policy, allowing investment grade companies to borrow unsecured from the Federal Reserve for up to four years.
- Traditionally this primary market credit facility arrangement has been reserved exclusively for banks but has now been loosened to include regular investment grade companies, who often finance via corporate bond issuances. This step will shore up liquidity in the corporate bond markets, which can dry up in recessionary environments and leave large companies with fewer financing options in a time when they need cash the most.

- The Fed will also engage in a secondary market credit facility, where it will buy investment grade corporate bonds on the open market, and even shares of corporate bond Exchange Traded Funds (ETFs).
- Additionally, for the first time since the financial crisis, the Fed will buy asset-backed securities (ABSs) backed by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA).
- These measures, in addition to quantitative easing, rate cuts and continuing purchases of treasury securities, are moves to signal that the Fed will remain an active participant in the market and will act quickly—and with innovation—to tackle the current crisis.

Newmark Knight Frank's professionals stand ready to advise our clients on how the CARES Act and the Fed's recent actions can support their business activities. We invite our clients to call on us for guidance.

Sources: *Bisnow*, Federal Reserve, Kalibri Labs, MarketWatch, NAHB, NAREIT, *The New York Times*, NKF Research, NREI, *The Washington Post*

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