CBRE FLASH CALL

COVID-19 IMPACT ON COMMERCIAL REAL ESTATE

MARCH 18 CALL SUMMARY

Thanks to the 15,000 of our clients and colleagues who dialed into the March 18 Flash Call on COVID-19 Impacts to Commercial Real Estate. CBRE specialists, along with an equity market analyst from Citi, examined the impacts on the macro economy, specific real estate asset classes, capital markets, publicly-traded securities as well as key operational issues.

Listen to the Recording
Visit CBRE's Global COVID-19 Resource Center

Macroeconomy

CBRE has downgraded our outlook for the Global and U.S. economy. We expect a recession in the global economy – with a sharp downturn in Q2 in the U.S. (-6%) and the start of a bounce back in Q3. It is increasingly unlikely that the U.S. will escape a technical recession with U.S. GDP growth expected to be 0.4% for the year.

- The trajectory of the economy's decline and recovery will resemble a Nike swoosh (not a "V" or "U").
- The rate of infections in the U.S. will likely peak between May and August – probably closer to May if the pattern observed in China prevails.
- China has already begun to recover and may surprise on the upside in Q2.

Public REIT Activity

Since the market peak in mid-February – the broad market is down about 28%, 10-year is down 105bps to 70bps, and REITs are down about 32% - about mid-pack compared with other sectors.

- REIT balance sheets are in the best position they have ever been with Net Debt to EBITDA of ~5/5.5x, Debt to GAV of ~30-35% and limited near term maturities. REIT dividends are more secure today than they were before the Global Financial Crisis (GFC).
- The best performing sectors have been tied to the digital economy – with Data Centers and the Towers – the clear outperformers – Data Centers down 6% while Towers down 10%.
- Self-Storage is also doing better than the rest – down only 20% – limited human interaction – and low cost for a household.

- Lodging owners down almost 60% and the lodging managers down 40%.

- Malls are down 50% and shopping centers are down 45% – and similar to lodging – was on a rough patch heading into this with widespread bankruptcies and closures – that likely only accelerate from here.

Equity Capital Markets Commercial Real Estate Conditions

Due to the rapidly changing landscape, most of the disruption to the real estate capital markets has happened in the last 10 days.

TRANSACTION VOLUME

- The last 10 days saw a meaningful fall off in transaction volume (<u>supply)</u> as measured by deals coming to market and <u>demand</u> (as measured by confidentiality agreements signed).

- That said, <u>most transactions in market are proceeding</u> fueled in part by a lot of 1031 Like-Kind Exchange buyers looking for opportunities, particularly in multifamily.

VALUE

CBRE surveyed our capital markets professionals on Tuesday, March 17, to learn what changes they are seeing from clients:

- Over 50% have seen sellers delay bringing assets to market
- Over 70% expect more of this disruption in the next 30 days
- Size of bidding pools is contracting: 65% getting smaller; 80% expect to shrink further
- 50% of buyers trying to "re-price" deals that are under contract (asking for a price reduction)
- Two-thirds of buyers have asked for 5% price reduction

  Note: We studied events in 2013 and 2017 (which were spikes in interest rates) and while at times of distress there is a huge spike in "asks" for re-pricing, the reality is that in both instances less than 10% of transactions repriced and the average repricing was less than 3%.

Working with CBRE's Econometric Advisors, we looked at "peak to trough" for rents and values following the events of 9/11 and the GFC:

- **Rents:** Took about two years for rents to go from peak to trough in each instance and then about 6 years to get back to base line.

- **Value:** Recovered much more quickly in all asset types, including retail, as cap rate compression due to falling inflation/interest rates made up for the slow recovery of rents.

Fundamentals

HOTELS

- To no surprise, massive fall off in demand at "any price."

- Prior to outbreak, we had forecasted U.S. hotels to have a 0.1% decline in RevPAR (revenue per available room).

- Our revised outlook as of last week estimated full year RevPAR decline to -37% for the year.

- Deepest impact will be in Q2 where RevPAR declines could reach more than 60%.

INDUSTRIAL

- Short-term leasing activity will decline as occupiers take a wait-and-see approach and there are challenges with site inspections for capital markets activity.

- But given strong overall demand, rents are likely to remain relatively stable.

- Longer-term industrial is likely to benefit:

    - More secure supply chains with more inventory increasing demand for industrial space
    - More e-commerce as people are buying more at home
    - Continued strength in last mile and cold storage (where there is limited supply)

OFFICE

- Greatest impact in markets impacted by oil & gas and travel & leisure in the short term but most industries are hitting at least a short-term "pause" button.

RETAIL

- Mixed bag with great weakness where you would expect (enclosed malls, restaurants & gyms), but surprising strength in in-line with grocery and pharmaceutical anchors leading the way.

MULTIFAMILY

- Overall, structural shifts in demand remain favorable for the sector, though we are going to see some short-term softness in luxury demand due to delayed moves and Class B and C, due in particular to greater stress on incomes for lower income workers.

- Senior housing is facing immediate stress and there is some concern of a longer-term demand shift to marginally benefit single-family rental housing.

SUMMARY

No surprises in short term market conditions:

- Smaller bidding pools
- Smaller # of deals
- Attempts at repricing are increasing, though few have actually happened yet
- Fundamentals weakening in those areas most impacted by closures, notably hotels and retail

HOW LONG WILL THIS LAST?

We believe due to massive fiscal and monetary stimulus, the fact that this is not a banking/financial crisis and the apparently fast bounce back of China, that there is <u>real reason for optimism</u> that we will bounce back much sooner than any of the 9/11 or GFC comparable periods we have reviewed.

LESSONS FROM CHINA'S RECOVERY:

- Hotel demand: Took about 6 weeks for hotel room demand to stop falling and begin to rise (we are now about 3 weeks (or ½ way) into our crisis.
- Retail: 80% of the shopping centers are re-opened, including 85% of Starbucks.
- Industrial:
    - As of the first week of March, 81% of manufacturing companies that export goods from China have resumed doing business.
    - Of most importance to industrial, E-Commerce (shipping) – 4 weeks from almost complete shutdown back to almost total 100% recovery today.

Debt and Structured Finance (DSF) Analysis

While markets have been tumultuous the past 3 weeks, liquidity is still available, although changing.

AVAILABILITY:

- Depends on lender type: some have hit the "pause button" or have "stalled"
- GSE's, Banks, Life Co's generally amply supplied
- CMBS and Debt Funds feeling the squeeze

PROPERTY TYPES:

- Multifamily and Logistics still largely in favor
- Neutral appetite for Office
- Retail and Lodging very difficult
- Senior and Student Housing experiencing some stress

SUMMARY:

- Despite all the market volatility and disruption, debt capital is still available
- Despite much lower indexes and widening spreads, net rates to borrowers are at historic lows

Landlord-Tenant Implications

IMPORTANT REMINDERS TO OWNERS/LANDLORDS:

Most companies (your tenants) are in the real estate business because they have to be to run their business. Most did NOT choose to be in real estate like you may have.

Agility: It has become increasing apparent over the last few years – and certainly during times like this – that traditional real estate is NOT agile enough to align with the changes most companies experience regularly. Note: "Agile" in this case refers to the flexibility around the use, amount of space, location, length of lease term, etc.

Partnerships: We are ALL in this together: owners, tenants, insurance companies, the government. This moment is a great opportunity to build massive good will and long-term partnerships with your tenants. Have conversations with your tenants to understand how they are being impacted – and what you can do to help. Below are some key concerns:

IMPORTANT KEYS FOR ALL COMPANIES/TENANTS:

1. Health & Safety of their people
    - Many employees can work from home. Many cannot.
    - For those that cannot, things like deep cleaning/hygiene, critical supplies (like hand sanitizers), food options, suspected or confirmed cases at the site and how safely facilities can be re-opened…all become critical!

2. How to continue to operate their business while keeping their people safe varies by sector:

    - **Retail:**
        i. Some are thriving, like those providing critical products like food/grocery stores.
        ii. Most are at-risk as they are forced to close.

    - **Industrial:**
        i. Plants and distribution facilities have different dynamics (less crowds = safer environments), so much easier to keep these up and running … which results in Supply Chain being able to continue to function at a reasonably high level However, employers and employees still experience lots of angst given the lack of testing.

    - **Office:**
        i. Many professionals will have a very difficult time working from home. Bankers, traders, medical professionals and those working for public agencies or institutions (in office space).
        ii. Many professionals will be "fine" working from home. Lawyers, accountants, consultants, etc. who can function with a computer and a phone, but "working from home/working virtually" does not come easily to some (who have never done it, have kids at home or who heavily dependent on support resources from others who are no longer a cubicle or two away and accessing HR and Finance systems).

Property Management

Communication and Partnership with Your Tenants is Key.

- In times of uncertainty, communication with your tenants, lenders and other key stakeholders for your portfolios is even more important.
- When it comes to access to the building common areas or tenant suites, potential exposure to the COVID-19 virus by tenants or visitors and more specific questions around actual lease language, make sure you are communicating with your tenants early and often.

Remember that your tenant relationships are governed by a lease.

- We are not proposing that you are only going to stick to the letter of the law, but know that you have certain obligations designed to protect both you as the owner and your occupants. A well-drafted commercial lease will address mandatory hours of operations as well as cleaning procedures.

If we have notified of an infected (or suspected) person working in the building, what do we do for cleaning?

- Refer back to your lease so you know the specifications for both "standard" and "above-standard" or "enhanced" cleaning for common areas of the building.
- In the event you are notified by a tenant of a potential infection within your building, immediately engage with the tenant contact (per the lease) and ensure that any communication and engagement is in lock-step with the leadership/management of the Tenant.
- Where an 'above standard clean' is required inside one tenant's suite due to a suspected or confirmed case, all other tenant contacts are made fully aware within the building. It is then clearly communicated that it is up to them to decide what they feel is appropriate to provide enhanced cleaning inside their spaces.

Carefully consider taking the step to close a building.

- If the situation presents itself where you feel you need to close a building due to infection, execute this decision considering lease obligations and consulting with expert resources (like the CDC, local health authorities).

In the event you require additional guidance, one resource is a Certified Industrial Hygienist (CIH).

- This is a professional familiar with and well versed in pathogens in the workplace.

- If you are in a conversation and people are talking about cleaning protocols, frequency, mixtures of chemicals – defer all specific questions to experts in this area with a CIH being one option.

- We have one CIH at CBRE and she is essential to our internal team to drive our terminology and education around the profession.

Be attentive to supply chain interruption for essential building materials.

- Building construction schedules may be delayed as new supplies and equipment manufacturing are halted, delayed or become limited.

Increased Operating Expenses:

- Increased operating expenses (CAMs) will be incurred by properties that require increased cleaning of common areas as a proactive measure or because of having a person or persons with potential exposure to COVID-19 enter the building.

The power of partnership with your Property Manager.

- CBRE has a multi-disciplinary Property Management Business Continuity Planning Committee covering Health and Safety, Legal, Communications, Building Operations and Engineering, and Procurement amongst others working hourly to evolve our responses and educate our people.