CBRE FLASH CALL

Global Capital Markets

MAY 20, 2020 CALL SUMMARY

As cities and states begin to reopen their economies, there is considerable speculation about how and when occupiers will bring their workforce back to the office and the short- and long-term implications for the office market. CBRE hosted a wide ranging discussion on this and other topics, featuring Mary Ann Tighe, CEO of CBRE's New York Tri-State Region, and CBRE economic and capital markets experts from around the world.

CALL PARTICIPANTS

- Patrick Arangio, Vice Chairman of National Loan & Portfolio Sale Advisory
- Chris Brett, Head of EMEA Capital Markets, London
- Emma Buckland, Global President, Property Management
- Melina Cordero, Managing Director, Retail Capital Markets, Americas
- Tom Jeanes, Associate Director, Asia Pacific Capital Markets, Korea
- Spencer Levy, Chairman of Americas Research and Senior Economic Advisor
- Chris Ludeman, Global President, Capital Markets
- Chris Pilgrim, Executive Director, Global Capital Markets, Southeast Asia
- Peter Schreppel, Managing Director, Head of International Investment, Germany
- Peter Senst, President, Canada Capital Markets, National Investment Team
- Brian Stoffers, Global President, Debt & Structured Finance
- Mary Ann Tighe, CEO, New York Tri-State Region

CALL SUMMARY

There is a great bit of uncertainty regarding the "shape" of the expected economic recovery. CBRE's view is a little more optimistic than the economist consensus. This optimism is, in part, driven by the current situation in Asia. Things are returning to normal much faster than anticipated. Shopping centers are reopening, and office leasing tours are coming back rapidly. While Asia is not a perfect parallel, CBRE does expect some lessons to carry over and prevent a second economic decline in the Fall.

However, commercial real estate will lag the broader economy with no expected rent growth in even the most bullish market segments through the end of 2021.

CBRE foresees a 1-2-3 tiered real estate recovery scenario:

- Year 1: Industrial and Multifamily
- Year 2: Office
- Year 3: Retail and Hospitality

THE OFFICE OF THE FUTURE

The celebrations of the forced work-from-home experiments—a natural reaction amidst a global crisis—may be premature. Companies' experience with deploying entire workforces remotely may be a better test of technology platforms than work-from-home business models. Over time, deploying workforces from home will face many stress tests, such as:

- How do you transmit company culture remotely?
- What does ad hoc collaboration look like in a remote work environment?
- How does mentorship work if your mentee is not present?
- How will compliance be monitored?
- Can sales productivity be maintained if sales are remote?
- How do you manage a hybrid operation—some employees at the office, some at home?
- How does geography impact remote work? For example, does anyone move to New York City to work from his or her apartment?
- Does working from home really balance life and work if work is never separated from home life?

Working from home is one in a long line of office experiments. Every one of them aims for competitive advantage and expense reduction—but competitive advantage beats cost cutting every time. Whether working from home can deliver competitive advantage is an open question. However, nothing good will come from putting employees in a situation where they feel diminished, disconnected or distracted.

INCOME DURABILITY

CBRE manages approximately 1 billion sq. ft. of properties in the U.S. and collects over $11 billion in annual rent. Rent collections have varied by sector.

- Industrial – 85% of pre-COVID rent payments with shortages concentrated in Arts & Entertainment and Construction. Dallas and Hawaii were the markets most negatively impacted.
- Office – 89% of pre-COVID rent payments. Size did not matter when it came to rent payment. Small tenants were just as likely to pay their rent as large tenants.
- Retail – 56% of pre-COVID rent payments, which may be higher than expected, but has been buoyed by grocery-anchored shopping centers.

As of May 18, rent payment in this month appears to match the pace achieved in April.

GLOBAL CAPITAL FLOWS

United Kingdom

- The pace of the pandemic in London is behind most of Europe, indicating that commercial real estate impacts are likely to be delayed as well.

- Leasing activity has remained active, particularly for larger transactions, as a lack of supply helps to keep tenants focused. Investment transaction activity has halted as pricing has become somewhat uncertain.
- For transactions that are occurring, discounts are steeper (10-25%) on the Value-Add side of the spectrum. Core investment discounts are less severe (0-5%).

Korea

- The Bank of Korea's cutting of interest rates has had minimal impact on loan pricing due to the addition of a "risk premium" by lenders.
- Transaction volumes and cap rates in Korea have been largely unaffected thus far.
- Korean investors looking to invest elsewhere have been accumulating capital due to an inability to invest internationally in the short-term.
- Amid global uncertainty, investors are looking to capitalize on under-valued core and logistics assets.

Singapore and Malaysia

- Both Singapore and Malaysia are active investors through government-sponsored entities. While Singapore is established as an institutional owner, Malaysia's presence is not as mature.
- The pandemic is not expected to alter investment strategies, merely delay them. Both Singaporean and Malaysian capital is expected to be deployed internationally on core investment strategies in the coming years.
- Whereas Malaysian capital is likely to seek out individual assets, Singaporean funds require scale, indicating a greater interest in portfolio transactions.

Germany

- Germany is considered highly successful in its management of the virus, as a result public sentiment is higher, and some semblance of normal activity is returning. From an investment standpoint, this suggests that Germany should be viewed as a relative safe haven, although losses in the economy will be significant.
- The investment market was incredibly active to start the year, but the pandemic has prompted a significant temporary slowdown due to the inability to price assets. Sellers are holding for now.
- Because leasing activity, particularly for larger transactions, is largely continuing unabated, vacancy impacts to the largest office markets are expected to be minimal.
- German investors are accumulating capital and have a strong positive view of the U.S. as a potential investment option.

Canada

- Business activity in the face of COVID-19 is limited across all major markets. Opportunities exists, but they remain on hold, waiting for launch. Investment activity should elevate significantly in the third quarter.

- Expectations of pricing changes are minimal and long-term confidence is evidenced by the increase in land transactions with significant properties trading hands in the last 30 days in Vancouver, Montreal and Toronto.
- Canadian investors are actively looking for new opportunities in the U.S., particularly as the pandemic ends, as they seek a first-mover advantage.

RETAIL MARKET DYNAMICS

- The retail recovery is going to vary significantly by geography, retail category and asset type. Local governments largely control the reopening process, but consumer perception of safety varies widely by income group, geography and age.
- Landlords are demonstrating more flexibility when it comes to non-payment of rent for local retailers but taking a harder line with national credit tenants. Rent re-negotiations are occurring in three phases:
    1. Initial triage of closure (deferment, focus on NNN, or small percent of rent)
    2. Ramp-up period (modified rent - percent, reduced base, etc.)
    3. Final phase (renegotiated, longer-term rent)
- E-commerce is spiking across most retail categories, but it is unsustainable for retail operators as home delivery and last-mile costs are difficult to implement at scale for traditional brick-and-mortar retailers.
- The current situation is an acceleration of the trend that has been occurring over the last decade. Consumers will return to the store and retailers will expand. Capital markets opportunities will materialize as well.

DEBT MARKET UPDATE

- The last 60 days have been challenging, but debt markets are starting to thaw due to federal government fiscal and monetary response.
- Lenders are now more conservative in their terms including lower loan-to-value requirements.
- Loan spreads are narrowing. Multifamily and logistics are being viewed the most favorable. Multifamily could get worse if rent payment data takes a turn for the worse. Grocery-anchored retail is doing relatively well. Concerns about the future of office is hurting current offerings. Securing loans for lodging is incredibly difficult, especially for convention hotels.
- Floor rates are being used by some lenders and securing loans for deep value-add plays and construction are getting increasingly difficult. Not impossible though, as we recently closed a construction loan for a $972M project in New York City, albeit 100% pre-leased.
- Things are looking better, but coming out of this economy, debt markets will operate more conservatively.

LOAN SALES

- Given the current situation, almost every lender is carefully reviewing their assets. Loan review activity with private equity funds, mortgage REITs, CMBS originators and balance sheet lenders has increased dramatically as stakeholders consider their options with respect to their financial holdings.
- The events of the last 12 weeks have had a marked influence across the different product types. Roughly 65% of what we have underwritten thus far has been retail and hospitality. The balance has been office and multifamily, with very few industrial reviews.
- A common thread in those reviews is that the poor-performing properties prior to the pandemic are the ones least favorably positioned now, regardless of property type.
- The overwhelming majority of loans continue to perform, but loan sales are expected to increase.
- For non-performing loans, we are seeing a thoughtful approach to negotiations by most parties, with tenants, landlords and lenders all working collaboratively to solve issues. It is likely that both the government stimulus and the fact that the pandemic is a humanitarian crisis has had a lot to do with this.