

# GETTING THROUGH THE GLOBAL HEALTH CRISIS **TOGETHER**

## COMMERCIAL REAL ESTATE MARKET: **FACTS, MYTHS AND NAVIGATING FORWARD**

Thursday, April 2, 2020

# A Path Through Unprecedented Human and Economic Conditions – Current Reality

- ❖ **Global Mission: Mitigating, Defeating a Pandemic.**
- ❖ **Markets Struggling to Assess Depth/Length of Economic Impact From Near-Shut Down of Consumption and Commerce.**
- ❖ **Headline Numbers Difficult to Process - Unprecedented Measures Engaged to Achieve a “V” or “U” Shape Recovery – More Likely Coming.**
- ❖ **Exogenous Shock of Forced Economic Pullback Hitting Otherwise Sound Real Estate Fundamentals, Capital Markets.**
  - **Transaction Market Conditions Wide Ranging: Many Transactions Moving Forward, Many Lenders Active While Others Delayed or Stalled for Now.**
- ❖ **Ability to Manage Healthcare Outcome will Determine Length and Severity of Economic Downturn.**

# Getting Through the Global Health Crisis **Together**

## HOST:



**Hessam Nadji**  
*President and Chief  
Executive Officer*

## PANELISTS:



**Scott M. Holmes**  
*National Director,  
Retail*



**Alan L. Pontius**  
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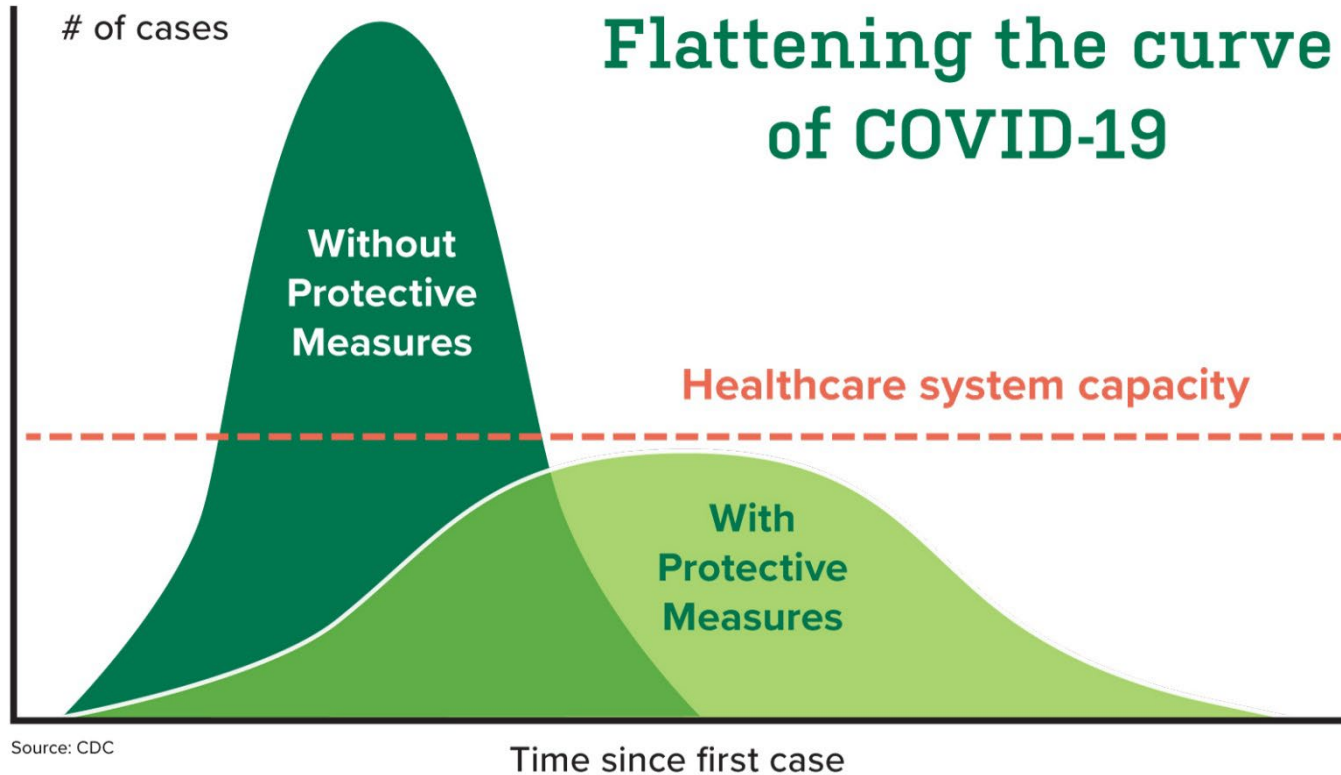


**John S. Sebree**  
*National Director,  
Multifamily*



**John Chang**  
*National Director,  
Research Services*

# Solution to A Public Health Crisis Requiring Economic Shut-Down





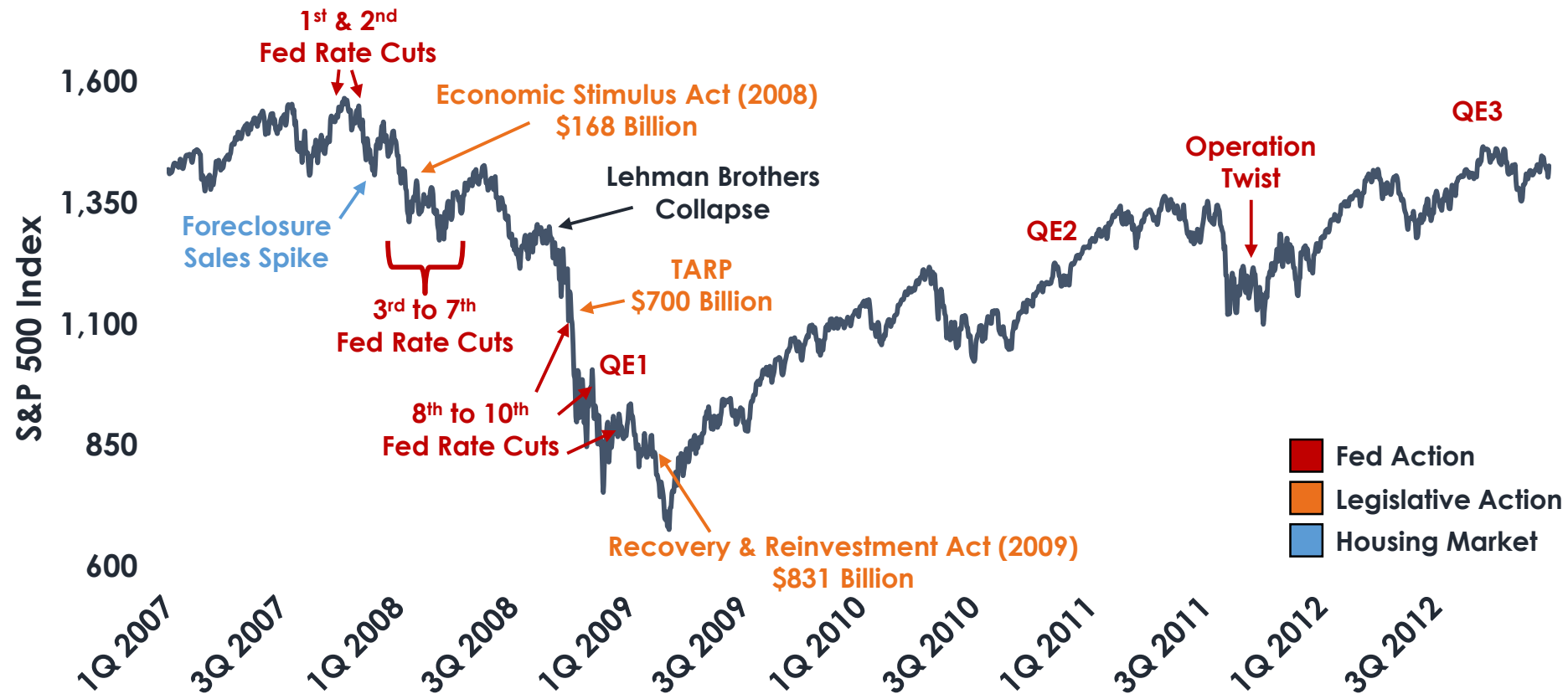
**DO PAST METRICS AND  
EXPERIENCES MATTER DURING A  
CRISIS UNLIKE ANY OTHER?**

*HISTORY SUGGESTS THEY DO,  
ULTIMATELY*

# Historical, Post-War, Significant Shocks to U.S. Economy and Recoveries

Economic Shock	Duration (Months)	S&P 500	GDP	Jobs	Unemployment Rate	Total Retail Sales
1973 OPEC Oil Crisis	16	-41.4%	-3.1%	-2.8%	4.6% - 9.0% (440bps)	-2.6%
<b>Following 12 Months:</b>		<b>+32.0%</b>	<b>+6.2%</b>	<b>+3.7%</b>	<b>9.0% - 7.4% (-160bps)</b>	<b>+5.1%</b>
Iranian Revolution/ Energy Crisis	16	-19.4%	-2.5%	-3.1%	7.2% - 10.8% (360bps)	-2.6%
<b>Following 12 Months:</b>		<b>+51.8%</b>	<b>+7.9%</b>	<b>+3.9%</b>	<b>10.8% - 8.5% (-230bps)</b>	<b>+6.5%</b>
Iraq Invades Kuwait/ Oil Price Shock	8	-15.8%	-1.4%	-1.5%	5.2% - 7.8% (260bps)	-3.3%
<b>Following 12 Months:</b>		<b>+21.9%</b>	<b>+2.9%</b>	<b>+0.4%</b>	<b>7.8% - 7.0% (-80bps)</b>	<b>+5.6%</b>
Dot-Com Bust/ Sept. 11 <sup>th</sup> Attacks	8	-46.3%	+0.4%	-2.0%	3.9% - 6.3% (240bps)	-1.0%
<b>Following 12 Months:</b>		<b>+22.2%</b>	<b>+2.1%</b>	<b>+1.4%</b>	<b>6.3% - 5.6% (-70bps)</b>	<b>+4.5%</b>
Global Financial Crisis/ Great Recession	18	-52.6%	-4.0%	-6.3%	4.4% - 10.0% (560bps)	-13.0%
<b>Following 12 Months:</b>		<b>+50.3%</b>	<b>+2.8%</b>	<b>+1.0%</b>	<b>10.0% - 9.4% (-60bps)</b>	<b>+7.5%</b>

# Timeline of Global Financial Crisis – Solutions Deployed Reactively and Slowly Due to Lack of Playbook



# Economic Foundation Leading Up to the Pandemic Was Historically Strong

## Total Employment



## Job Openings vs. Unemployed

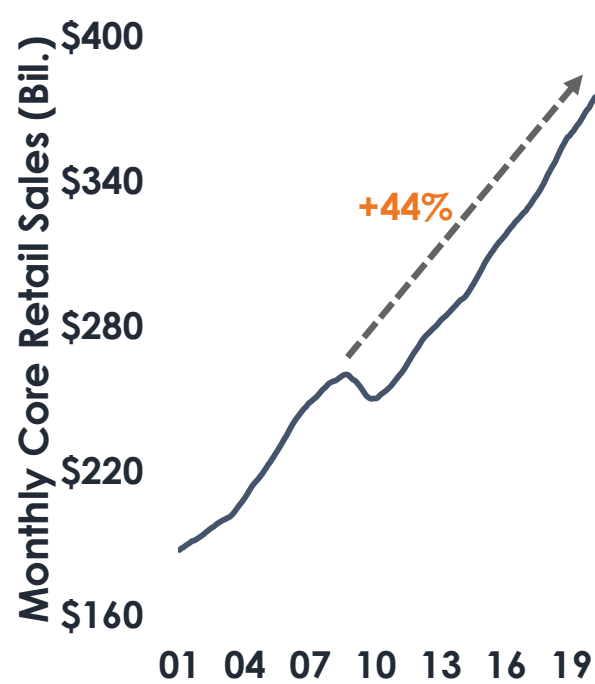


\* Employment and unemployment through February 2020; job openings through January  
Sources: Marcus & Millichap Research Services, BLS

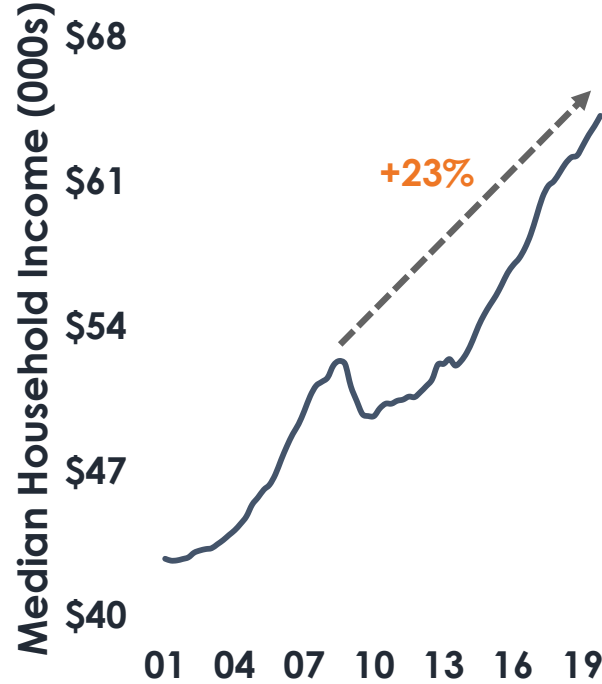


# Consumer in Fundamentally Sound Position Entering Global Health Crisis

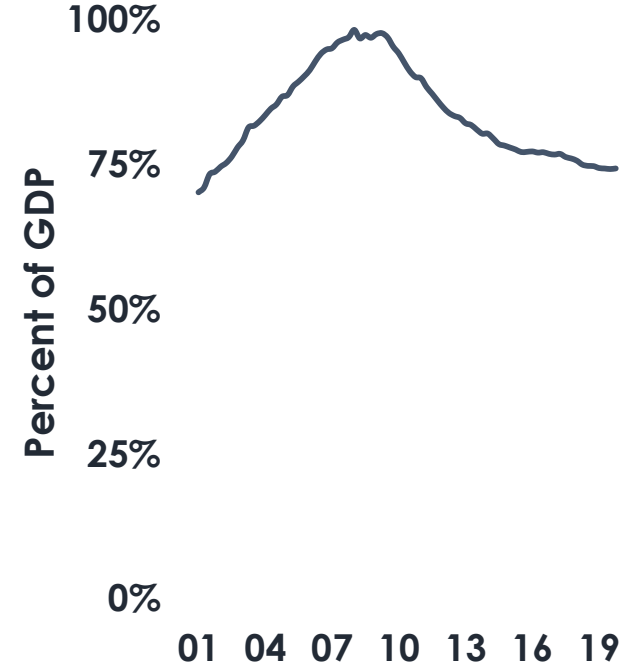
## Monthly Core Retail Sales



## Median Household Income

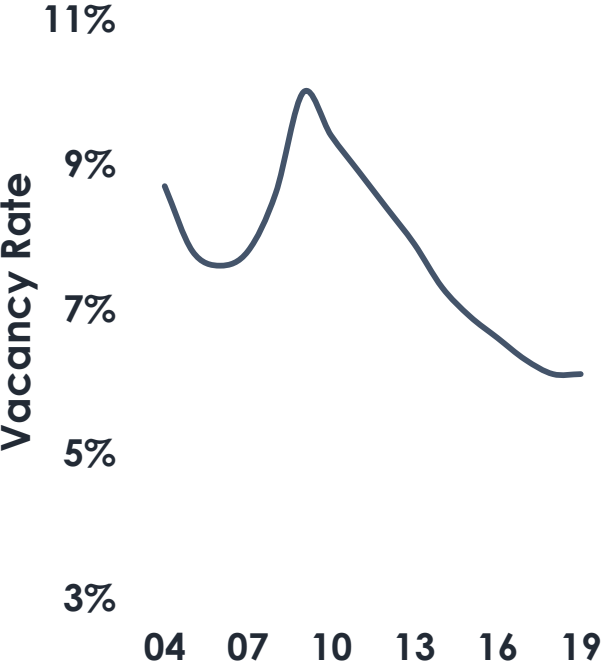


## Household Debt

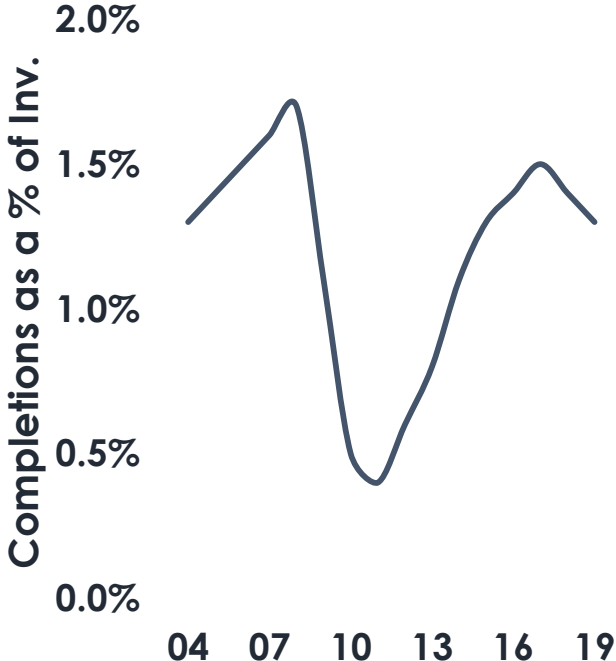


# Pre-Health Crisis Commercial Real Estate Foundation Solid/Best in History

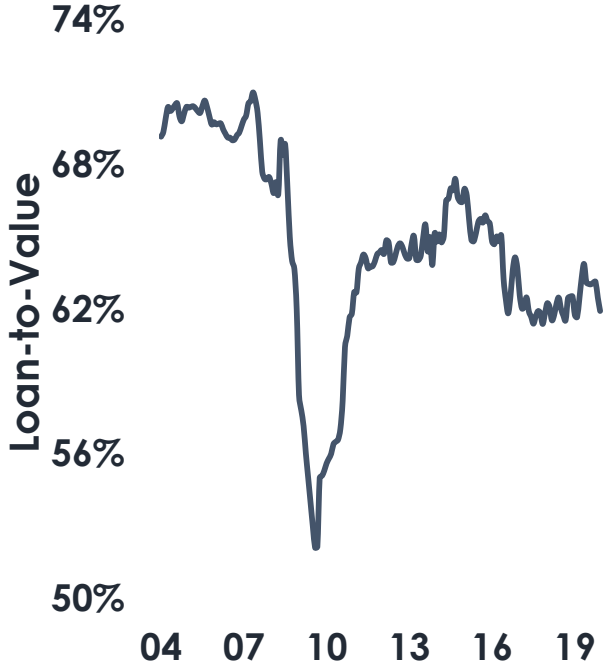
### CRE Vacancy Rate



### CRE Construction Index



### CRE Loan-to-Value



Commercial real estate includes apartment, retail, office and industrial; Loan-to-value for retail, office and industrial  
Sources: Marcus & Millichap Research Services, RealPage, Inc., CoStar Group, Inc., Real Capital Analytics



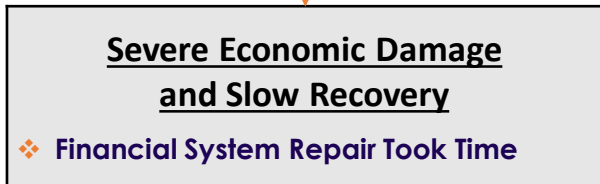
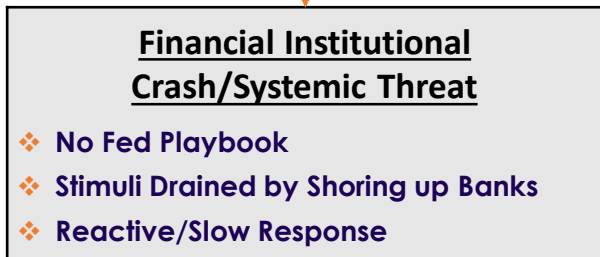
**Starting with the Best  
Fundamentals on Record**

**Facing an Unprecedented  
Economic Problem with  
Unprecedented Remedies**

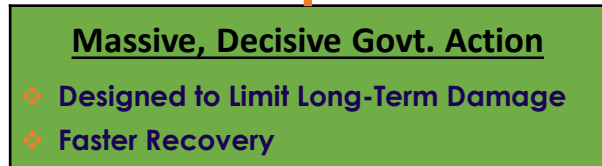
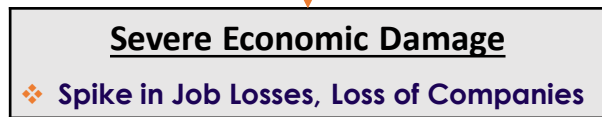
***Will It Work?***

# What Can The Most Severe Recent Shock and Action Tell Us- Why Does it Matter?

## Global Financial Crisis (2008-2009)



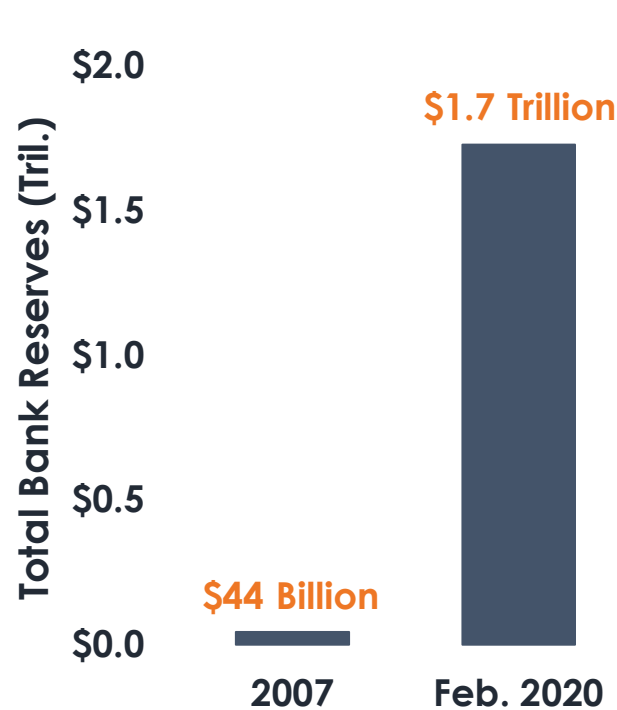
## Global Health Crisis (2020)



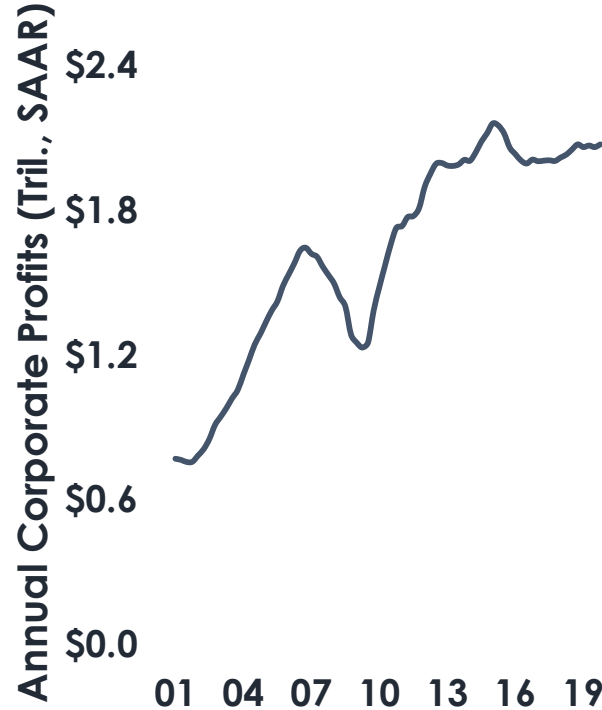
Could Threaten Financial System

# U.S. Financial and Corporate Foundation Solid Ahead of Pandemic, Especially Banks' Much Improved Capital Reserves

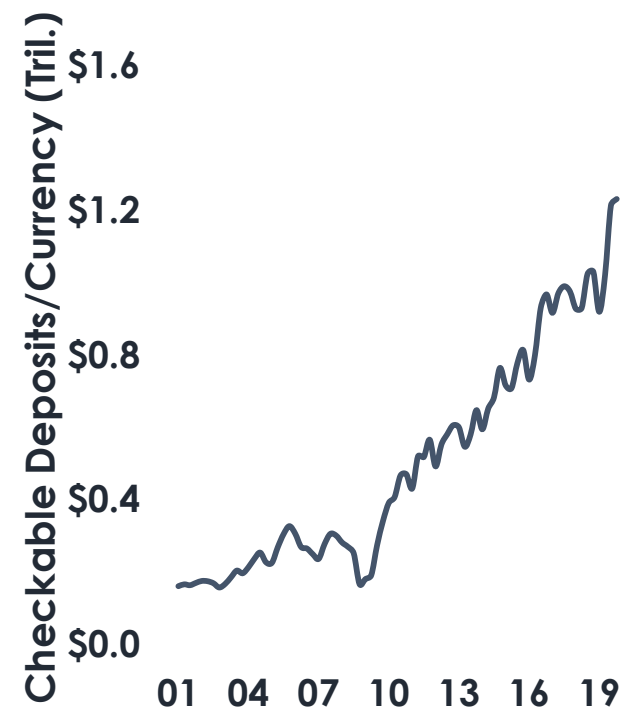
## U.S. Bank Reserves



## Corporate Profits\*



## Corporate Cash on Hand



\* Trailing 12-month average

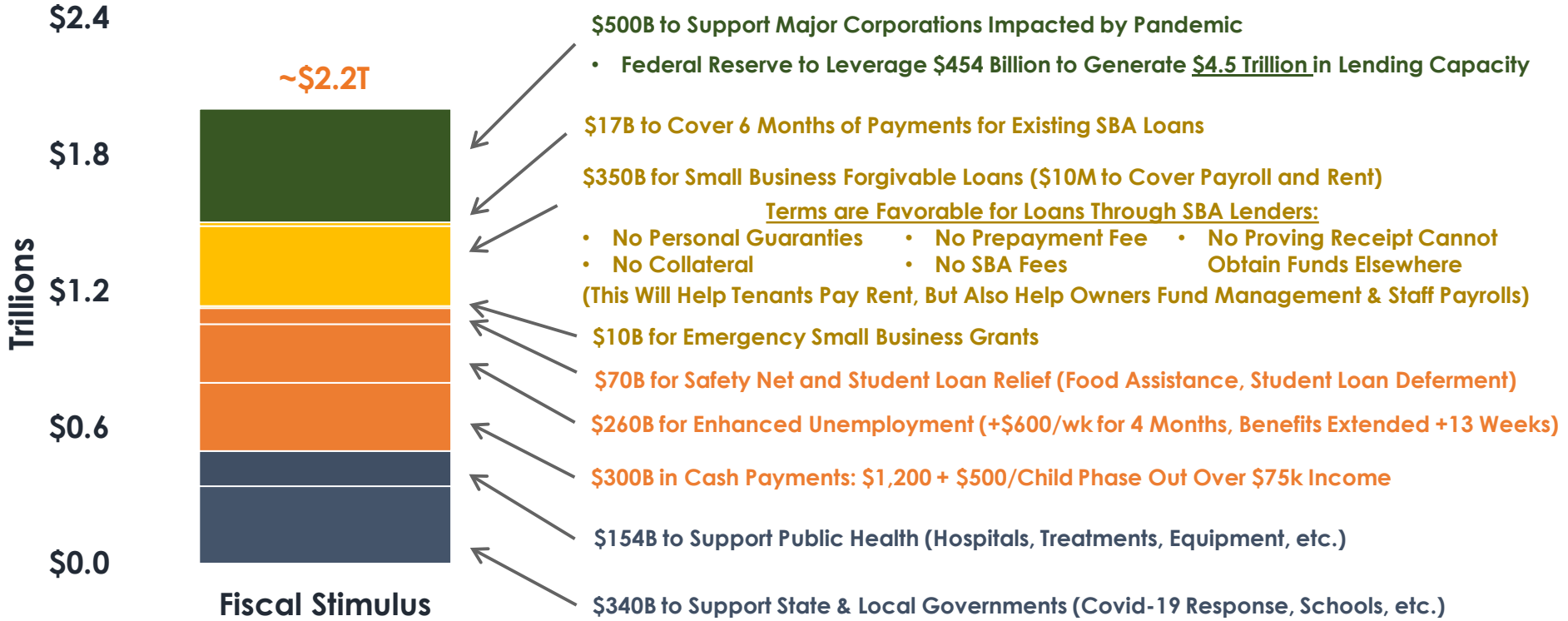
Sources: Marcus & Millichap Research Services, BEA, Federal Reserve Bank of St. Louis, Federal Reserve Board

# The FED and Global Health Crisis : Unprecedented Measures Delivered in Weeks vs. Months during the Great Financial Crisis

1. After Three Years of Tightening Monetary Policy, the Fed Reversed Course in 2019 Issuing Three Rate Cuts.
2. March 3<sup>rd</sup> – Rate Cut by 50 bps.
3. March 13<sup>th</sup> – Rate Cut and Quantitative Easing (QE):
  - Fed Cut Rates by 100 bps, Taking Rate to 0%-0.25% Range Where it was for Recovery From Great Recession.
  - Fed Committed to \$700 Billion in Quantitative Easing, Buying Treasuries and Mortgage Backed Securities.
  - Reduced Reserve Requirement Ratios to 0.00%.
4. March 17<sup>th</sup> and 18<sup>th</sup> – Established Funding Facilities:
  - Commercial Paper Funding Facility (CPFF) – Provides a Liquidity Backstop to U.S. Issuers of Commercial Paper by Purchasing Commercial Paper Directly from Eligible Companies.
  - Primary Dealer Credit Facility (PDCF) – Offers Short Term Loans to 24 Large Financial Institutions.
  - Mutual Fund Liquidity Facility (MMLF) – Lends to Banks on Collateral They Purchase From Prime Money Markets.
5. March 23<sup>rd</sup> – Fed Committed to Maintaining Liquidity and Ensuring Businesses Can Access Credit:
  - Announced Open-Ended Purchase of Treasuries and MBS and Expanded Purchases to Include Agency CMBS.
  - Established Primary and Secondary Market Corporate Credit Facility (PMCCF and SMCCF) to Support the Corporate Bond Market and Provide Loans to Businesses. Initial Funds Set at \$100 Billion for Each Facility.
  - Created Term Asset-Backed Securities Loan Facility (TALF) for Student, Auto, Credit-Card & SBA Loans.

# Fiscal Stimulus: A Foundation to Mitigate the Shock

■ Public Health   ■ Individuals   ■ Small Businesses   ■ Large Corporations



# Additional Measures Benefiting Commercial Real Estate

- 1. Temporarily Lifts the \$500,000 Cap on Tax Deduction for Real Estate Depreciation for Non-Corporate Tax Payers.**
  - Gives Ability to Apply On-Paper Losses From Depreciation Over \$250K for Single Filers/\$500K for Couples.**
- 2. Increases the Limitation on Deductible Business Interest From 30% to 50% of Earnings for 2019 and 2020.**
- 3. Allows 5-year Carryback of Net Operating Losses for Non-REIT Businesses for 2018, 2019 and 2020.**
- 4. Allow 100% Bonus Depreciation for “Qualified Improvement Property” Fixing an Error From the 2017 Tax Cut Law.**



# Epidemic and Economic Expectations: A Baseline Scenario in Highly Uncertain Environment

## Epidemic

### Baseline Expectation

- 3M to 8M confirmed U.S. infections
- New infections peak in May
- 0.5% to 1.5% case fatality rate
- 10% hospitalization rate
- Infections abate by July
- 19% excess capacity of hospital beds
- 4% excess capacity of ICU beds
- 17% excess capacity of ventilators

## Economic

### Baseline Expectation

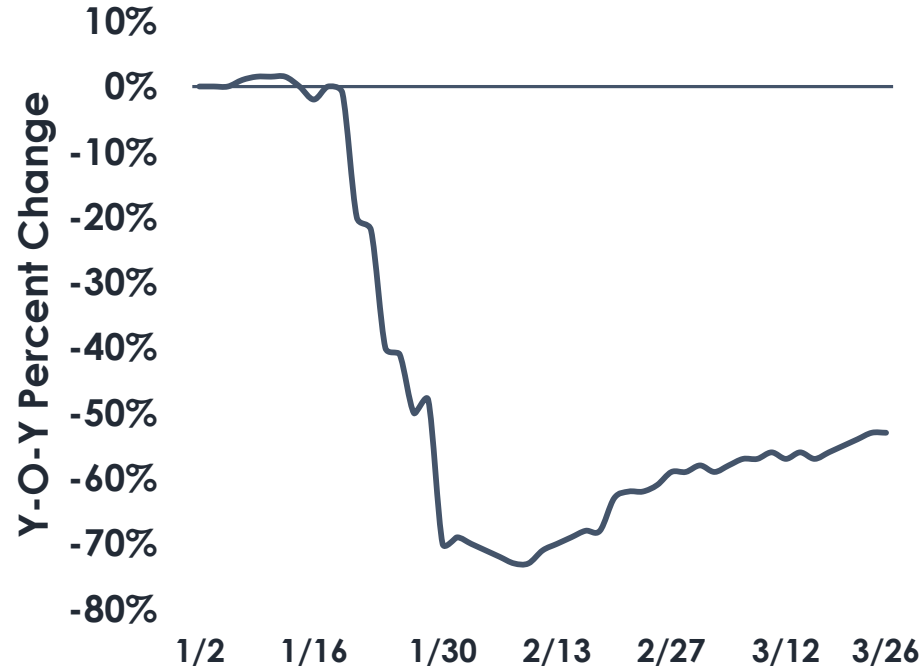
- Recession in 1Q and 2Q 2020
- Unemployment rate 9% in 2Q 2020 up from 3.5% pre-crisis
- -2.5% GDP in 1Q 2020 and -18.3% in 2Q
- Recovery starting in 3Q 2020
- Acceleration in 2021
- Return to full employment by 2023

# Encouraging Potential Developments in Addressing the Health Crisis

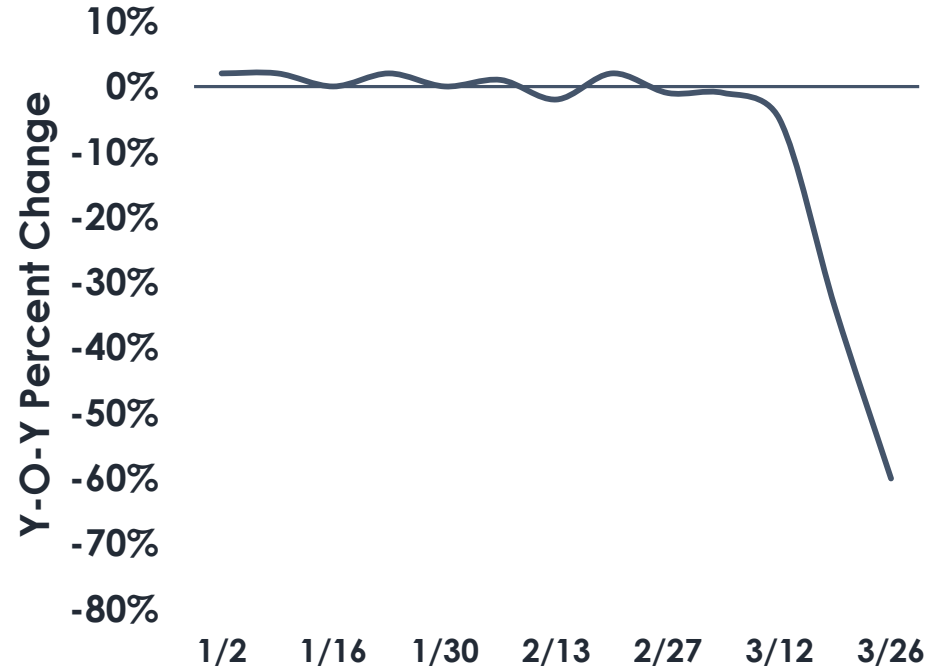
- ❖ **FDA Granted Emergency-Use Authorization to Rapid Response Tests That Can Provide Results in Under 15 Minutes – Production of 50,000 Tests Per Day.**
- ❖ **Italy Beginning to See Contagion Growth Rate Plateau – New Coronavirus Cases Levelled Off at a Two-Week Low.**
- ❖ **Ford and GE Joined General Motors in Production of Ventilators.**
- ❖ **Estimated Timetable for COVID-19 Vaccine Accelerated to 12 to 18 Months.**

# Comparative Consumer Activity Patterns During Health Crisis

## China



## United States



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# Heard From Our Clients: Current Impact of Health Crisis and Response

## Apartment

- ❖ Analyzing Rent Rolls to Project Rent Collections in April, May and Beyond
- ❖ Options and Consequences of Forbearance Agreements From Fannie/Freddie or Local Banks
- ❖ Working Through Operational Issues Including Leases, Showing Units, Maintenance, etc.

## Multi-Tenant Retail

- ❖ Outperforming Segments Have Been Hit Hardest (For Now) – Restaurants, Fitness, etc.
- ❖ Many Businesses Already Seeking Forbearance From Property Owners
- ❖ Grocery and Necessity Retailers Withstanding the Current Climate Best – Some Outperforming

## Office

- ❖ Work-From Home Raising Questions About Office Outlook
- ❖ Questions About Durability of Tenants Over Longer Term
- ❖ Fall-Off in Leasing Activity During “Shelter-in-Place”

## Industrial

- ❖ Lead Product Through 2019 Also Under Pressure
- ❖ Remote Working Solutions More Challenging
- ❖ eCommerce Sector Outperforming; Likely Boost in 2021

## Single-Tenant Retail

- ❖ Mass Merchandise and Grocery Performing Best
- ❖ Restaurants with Drive-Thru, Pharmacies Performing Well
- ❖ Some Tenants, Particularly Non-Credit at Risk

# Capital Markets and Transactional Environment

## Apartment

- ❖ Banks Still Making Loans; Prefer Existing Clients and Borrowers With Strong Balance Sheets
- ❖ Buyers are Making 2 or 3 Separate Loan Applications
- ❖ Fannie/Freddie Increasing Reserves on Deals Under Application

## Multi-Tenant Retail

- ❖ Lenders Far More Cautious but Active – CMBS Sidelined- Most Likely Temporarily, Banks Still Lending but More Conservatively
- ❖ Necessity-Based (Grocery, Drug) Still Trading; Most Discretionary-Based Retail Deals on Hold
- ❖ Private Equity Selectively Buying; REITs and Advisors Largely Out of the Market

## Office

- ❖ Liquidity in Stability/Credit vs. Value-Add
- ❖ Tenant Roster Strength and Term Essential
- ❖ Debt Underwriting – Asset and Borrower

## Industrial

- ❖ Long-Term Outlook Driving Continued Buyer Interest
- ❖ Tenant Roster a Major Influence on Debt/Equity
- ❖ 1031 - Single or Few Tenant Assets in Greater Demand

## Single-Tenant Retail

- ❖ Restaurants, Fitness and Entertainment Hardest Hit
- ❖ QSR with Drive-Thru, Grocery and Drug Still Transacting
- ❖ Private Buyers and 1031 Most Active; Others Waiting

# Key Stimulus Provisions

## Apartment

- ❖ Expanded and Increased Unemployment Crucial Lifeline for Many Renters
- ❖ \$1,200+ Cash Payments will be Important Support for Tenants
- ❖ Forgivable Small Business Loans Instrumental in Retaining Staff/Maintaining Operations

## Retail

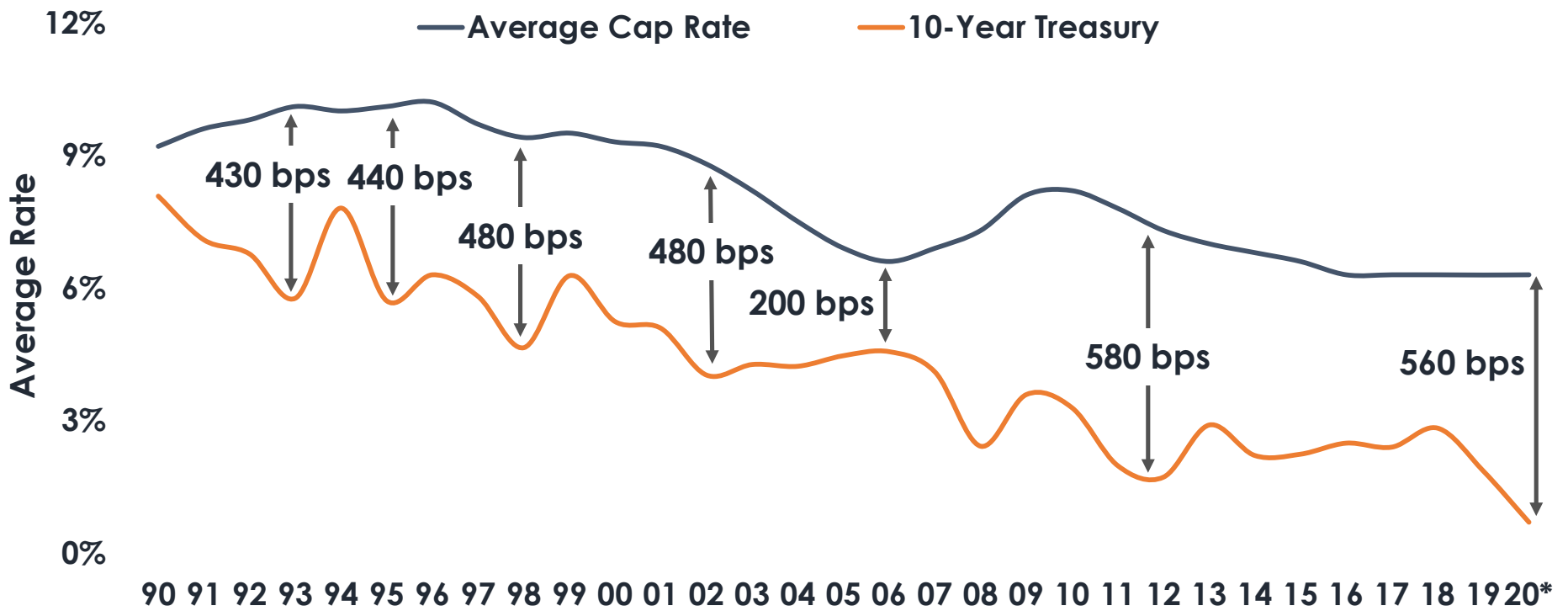
- ❖ Paycheck Protection Provisions Cover Rents as Well as Payroll for Small Business
- ❖ ICSC Reports That 70% of Shop Tenants in Shopping Centers are Small Businesses
- ❖ Necessity Retailers Will Benefit Most From Direct Household Stimulus Payments

## Office/Industrial

- ❖ Important Backstop to Support Companies. Loans to Help Cover Operating Expenses
- ❖ Small Company (<500 Employees) Forgivable Loans up to \$10M to Cover Payroll, Rent, etc.



# Commercial Real Estate Yield Spread to Interest Rates Second Highest Since 1990 - Indicates Investment Strength



\* Through March 31  
Includes apartment, retail, office, and industrial sales \$1 million and greater  
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Real Capital Analytics, Federal Reserve

# Real Estate Investment Strategy Considerations

- 1. What Tenants are Unlikely to Make a Come-Back?**
- 2. How Deep Could the Operational Gap Get in the Short-Term?**
- 3. What Happens When the Health Crisis Passes and Massive Pent-Up Demand is Released Into the Marketplace?**
- 4. Will the Two-Year Recovery Period After the Health Crisis Likely See Far Less New Construction than Otherwise Would Have Occurred?**
- 5. What are Some Permanent Societal, Space Consumption Changes that are Likely by Property Type – Some Good, Some Bad?**
- 6. What is the Best Way to Balance Short-Term Risk with Long-Term Opportunity?**

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