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Profimex Market Research Update – April 22, 2020

As we continue to work with our partners and stay up to date on the current COVID-19 crisis, we are noticing that many companies are beginning to invoke a little used legal provision called force majeure to get out of legal obligations. This is not limited to any particular company, we are seeing this occur across industries and countries. From large to small businesses, and from California developers to global energy firms.

Commercial real estate must do more than merely adapt to coronavirus

Over the past month, the world has dramatically changed for everyone. Stay at home orders and office closures have forced people to rethink their spending habits and focus on essential goods and services. Mckinsey writes that physical distancing has directly changed the way people inhabit and interact with physical space, and the knock-on effects of the virus outbreak have made the demand for many types of space go down, perhaps for the first time in modern memory. This has created an unprecedented crisis for the real estate industry.

Real estate managers, in general, have responded appropriately with a sense of urgency and in ensuring the safety of their employees and consumers. The best managers will take a long-term perspective in how this crisis will fundamentally change the real estate landscape.

While real estate investors have been able to off strong risk adjusted returns and steady cash flow over the last several years, the current realty has shifted this completely. Issues ranging from receiving permits for construction and managing employee health risk have emerged. Additionally, operators are facing potential lower operating income across portfolios.

The market seems to have pivoted mostly on the inherent degree of physical proximity among an asset class's users—even more so than on its lease length. Assets that have greater human density seem to have been the hardest hit: healthcare facilities, regional malls, lodging, and student housing have sold off considerably. By contrast, self-storage facilities, industrial facilities, and data centers have faced less-significant declines.

Look ahead, long-term implications of the current downturn may be in how we interact in the office space. The multiyear trend toward densification and open-plan layouts may reverse sharply. Additionally, demand for senior living may dampen as some baby boomers may choose to postpone moving to nursing homes.

With regards to retail spending, as consumer are being forced to spend greater time online the shift to online buying (ecommerce) may accelerate.

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Some CRE Lenders Are Feeling the Squeeze on Liquidity

With the total commercial and multifamily mortgage debt standing at $3.67 trillion, there have been early signs of trouble for highly levered lenders who rely on short-term repurchase (repo) warehouse lines of credit with mark-to-market provisions to finance loans. Particularly, there has been a surge in margin calls sent to lenders. This has caused some lenders to have discount loan portfolio sales, as a result of mark to market pricing on some of the loans.

Most of the early markdowns were centered around hotel loans. “In some cases, there have been margin calls, and every bank is dealing with it a little bit differently with some banks that are being a little more aggressive,” says Joseph Iacono, CEO and managing partner at Crescit Capital Strategies, an alternative lending firm that specializes in commercial real estate debt origination and investment.

The Federal Reserve has recently implemented a revitalized Term Asset-Backed Securities Loan Facility (TALF 2.0) program to support CMBS, as well as additional stimulus relief for the economy seems to have settled down some of that forced selling to cover margin calls.

That being said, the forced sales are creating buying opportunities for investors who are well capitalized. There are already funds being raised to grab these distressed debt opportunities, however, the challenge will be in assessing these large pools of loans.

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U.S. Industrial Market Flash: Industrial Development Slows Due to COVID-19-Related Delays

CBRE Research has found that 16 of the top 20 markets for under-construction space—accounting for 70% of total under-construction inventory nationally—have workers active and on site, with most of these projects deemed "essential."

Below is a table showing how construction activity has changed in the industrial sector.

Figure - Under-Construction Activity During Shelter in Place - Top 20 Markets (As of 4/10/20)

Market	Under Construction (SF) Year End 2019	Construction continuing?	Construction deemed essential?
Dallas/Ft. Worth	23,470,378	Yes	Yes
Atlanta	22,073,050	Yes	Yes
Inland Empire	19,059,846	Yes	Yes
Houston	17,683,614	Yes	Yes
Chicago	14,909,298	Yes	Yes
Pennsylvania/I-78/81 Corridor*	**12,389,605**	**No**	**No**
Phoenix	11,891,726	Yes	Yes
Indianapolis	10,921,885	Yes	Yes
Columbus	9,731,735	Yes	Yes
Memphis	9,093,831	Yes	Yes
Oakland**	**8,418,445**	**No**	**No**
Greenville	7,359,075	Yes	Yes
Las Vegas	7,237,189	Yes	Yes
Salt Lake City	7,234,359	Yes	No
Savannah	6,835,785	Yes	No
Denver	6,592,116	Yes	Yes
New Jersey Central***	**6,571,387**	**No**	**No**
Los Angeles County	6,453,217	Yes	Yes
Kansas City	6,435,976	Yes	Yes
Philadelphia*	**6,165,969**	**No**	**No**

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