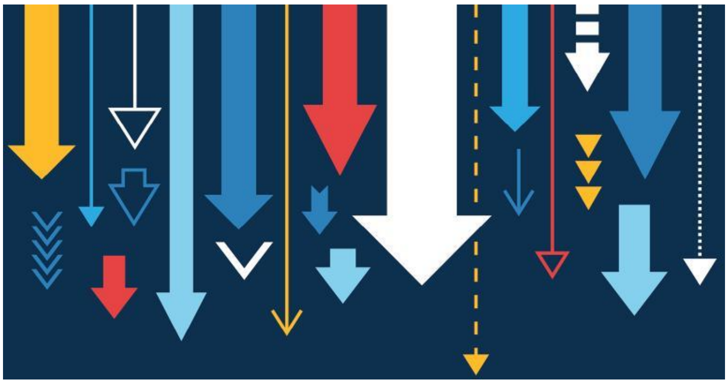
Profimex Market Research Update – May 24, 2020

How Much Further Could U.S. Retail Rents Drop?



As the economic crisis from Covid-19 continues to impact the US real estate market, effective retail rents are projected to continue to fall 11% in 2020. This would be nearly twice as large of a drop compared to the 2008 recession. Moody predicts that retail will be the hardest hit sector as a result of Covid-19. That is because traditional retail was already experience a disruption from the rise of e-commerce, and Covid-19 only accelerated this process. "Store closures have made it difficult for retail tenants to pay rent, which has negatively impacted landlords. It is not yet clear how effective government support will be in this sector," said Victor Calanog, head of commercial real estate economics at Moody's Analytics. "From store closures, hits to incomes and values, to the ambiguity surrounding who pays for rent relief, the future is bleak for retail properties," wrote Calanog, in a report titled "Retail Armageddon: COVID-19 and the Future of Retail Rental Markets."

Additionally, CBRE forecasts an average rent decline of 8.5 percent for neighborhood centers, community centers and strip centers through the remainder of 2020. That's compared with a 5.0 percent drop in rents during the Great Recession, says Jing Ren, an economist with CBRE Econometric Advisors. He continues to explain that many retailers are seeking rent relief as a result of their difficulty paying rent. Many landlords are working with their tenants to retain tenants and are offering deferrals for lease extensions.

Furthermore, research firm CoStar Group is forecasting annual retail rents across the board will decline by 13.0 percent in 2020. The impact will likely be the worst in the general retail category (down by 13.3 percent) and the most "mitigated" in the grocery-anchored shopping center category (down by 12.6 percent).

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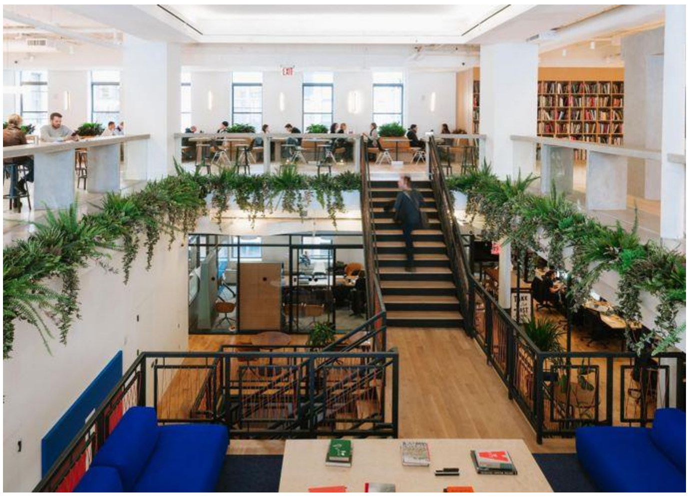
WeWork, Once Valued At $47B, Is Now Worth Less Than $3B, SoftBank Says

As Softbank recent reported earnings, people were able to read into Softbank's financials to better understand the valuation of the investments in the Vision Fund. As of Q1 2020, WeWork has been valued at about $2.7 billion, which is down from its $47 billion valuation last year. Softbank reported about a 13 billion loss on its investment in WeWork. At less than 10% of its peak value, WeWork still has tens of billions of dollars in lease obligations that it has on its books not yet fulfilled.

Though the company has begun negotiating rent relief with its landlords, WeWork's outstanding liabilities are far higher than its current worth. The pandemic has only put more financial strain on the company. WeWork missed some rent payments in April, paid 80% of its rent in May and hired major debt brokerages to help renegotiate its leases. That being said, the company has been aggressive in its own rent collection policy by requiring customers who live in states and cities with stay at home orders to pay rent.



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Commercial Real Estate's Havens Suddenly Not So Safe

A growing number of office and apartment owners are falling behind on their mortgage payments; signaling that the economic shutdown is harming stabler property types and raising the prospect of widespread industry damage. This mainly due to a combination of drastically less leases being signed today and office tenants saying that they would like to take less space. At the same time, the economic and business collapse is leaving many people unable or unwilling to pay rent for their apartments.

In the beginning the office sector and apartment sector seemed like safer bets relative to other real estate asset classes. But the severity of the economic downturn hasn't spared any type of real estate this spring, and a number of properties are already troubled. In Brooklyn, the owner of the 500,000-square-foot Whale Building is negotiating to hand over the building to its mortgage lender, TPG RE Finance Trust Inc., the firm said during an earnings call last week.

In April and May, 354 apartment and office properties started missing payments on $7.1 billion in mortgages, according to data from Trepp LLC, which only includes loans packaged into mortgage bonds. That is up from around $4.2 billion in February and March. Additionally, the risk of rising mortgage defaults may hit particularly hard for smaller landlords who typically hold less in reserves. In the office sector, currently, most tenants are paying rents; however, as rent comes due many may be thinking of shrinking their footprints.

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