COVID-19

MARKET RESPONSE FAQs

Updated April 13, 2020

ECONOMIC IMPACT

Q: What is the probability the U.S. and the Global Economy will go into recession?

A: Very high. In fact, most forecasters believe we are already in one. Economic growth forecasts are being revised downward and are changing rapidly as new information emerges. The latest forecasts from Oxford Economics (released April 8th, 2020) show that the global economy and many major economies, including the U.S., will be in a recession in the first half of 2020. Moody's Analytics is also forecasting a global recession in the first half of 2020. Moreover, the latest economic data on jobless claims, payroll employment, consumer and business confidence, Purchasing Managers' Indexes, and other high-frequency data confirm a sharp slowdown in economic activity.

Q: What is the definition of an economic recession?

A: In most countries, it is defined as two consecutive quarters of economic decline (i.e. back to back quarters of declines in real GDP); this is called a technical recession usually. In the U.S., the National Bureau of Economic Research (NBER) is responsible for determining when a recession begins and when it ends. Specifically, it is the NBER's Business Cycle Dating Committee that maintains a chronology of U.S. business cycles. The Committee does not have a fixed definition of a recession but rather examines and compares the behavior of various economic indicators (GDP, employment, industrial production, real income and real sales) to determine when a cycle has peaked and troughed. The recession is the period between the peak and the trough.

Q: How many jobs will be lost?

A: There has already been a major shakeout in the globe's labor markets. The number of people applying for unemployment benefits (or some version of that) is setting records all over the world (Canada, France, the U.K. the U.S. – to name a few). It is unclear (indeed unknowable) how many jobs will ultimately be lost but the number is tracking to be greater than the total number of jobs lost during the Great Financial Crisis. However, many of these job losses may prove to be temporary as the economy is widely expected to enter recovery in the second half of 2020. One important thing to keep in mind is that not all people who are technically defined as "unemployed" qualify for unemployment benefits and not all people who qualify for unemployment benefits are defined as "unemployed."

Q: What industries will suffer the largest number of layoffs?

A: We expect large, medium and small businesses to be impacted across the board. The majority of the job losses are expected to occur in retail, leisure/hospitality, transportation, manufacturing and construction. Some of these declines will be offset by gains in warehouse employment as eCommerce demand surges.

Q: What are the implications of lower oil?

A: Mixed. Falling oil prices certainly creates economic pain in oil-producing nations and cities. Moreover, some of the volatility in the stock market this year has been connected to the decline in oil prices – not just COVID-19 - but unrelated oil market dynamics specifically. The reason for that is the fall in oil raised concerns that the weakness in the energy sector may spill over to the financial sector (e.g. banks provide loans to many oil companies and the stock market was pricing in the risk that oil businesses may go bankrupt which would negatively impact the banking sector and then, in turn, other downstream sectors like drilling equipment manufacturers). On the plus side, lower oil prices put money back in consumers' pockets as they pay less for gasoline at the pump and for heating oil. According to Moody's Analytics, every penny decline in gas prices allows consumers to redirect $1.1 billion in spending over the course of a year. Currently, with social distancing being practiced in much of the world, people are not driving as much, so these positive impacts are likely to be limited. But low oil/gas prices are likely to act as a strong tailwind for U.S. consumers as we get further along in the recovery and people begin traveling more.

Q: When will the U.S. recession end and the recovery begin?

A: In short, no one knows. The timing depends on many factors such as the rate of flattening the pandemic curve, policy responsiveness, the return of confidence, etc. That said, most forecasters are assuming infections in the U.S. peak at the end of April/May, and infections abate by June/July. This is reasonably consistent with the timing displayed in China and South Korea. Given that assumption, many forecasters assume the recovery will begin in the third quarter of 2020 and will accelerate from there. Of course, it remains unclear whether containment and testing will be as successful. Moreover, epidemiologists warn that there could be several waves of this. Some have also hinted at possible seasonality – meaning this could go away and come back each year. On the plus side, there is the possibility

ECONOMIC IMPACT (continued)

of medical breakthroughs or treatments as well as the use of other mitigation tools in future outbreaks (other than widespread lockdowns) that would speed up the economic recovery. Again, there are too many unknowns.

Q: Will this be a U-shaped recovery or a V-shaped?

A: First, some quick definitions. A "U-shaped" recovery describes the type of economic recession and recovery where the economy declines, remains soft for a while and then gradually rises back over time, charts a U-shape. A "V-shaped" recovery is when the economy suffers a sharp but brief period of economic decline, followed by a strong "snap-back" recovery, charting a V-shape. Economically, policymakers are aiming for a V-shape recovery (strong second rebound in 2020H2), but a U-shape is looking increasingly likely. Certainly, there are plenty of other shapes this could take (L-shape, W-shape, etc). The trajectory of the recovery ultimately comes down to the path of the virus itself and when confidence is restored. We are watching the trajectory in Asia Pacific very carefully to inform us on the possible path forward in the U.S. and other countries.

Q: Is economic activity snapping back in China?

A: No, but it is rebounding. The bulk of the economic data that we are tracking in China (coal consumption, traffic congestion, subway ridership, etc.) is all showing significant improvement. The experience in China is suggesting that when social distancing restrictions are lifted, there is a noticeable bounce (not a V-shape, more U-ish so far).

Q: Given all the policy stimulus should we concerned about spiking inflation/interest rates?

A: There will likely be unintended consequences from the aggressive policy efforts being made, but a sudden spike in interest rates and inflation is low on our list of concerns. As we learned from the GFC (a recovery period that featured tremendous monetary easing) other factors were holding inflation and interest rates low, such as the low velocity of money, the eCommerce-effect, demographic factors and others. If inflation does begin to rise in a disorderly fashion, central banks do have tools. 1) Entice banks to move a portion of their reserves to long-term deposits (lock money up). 2) Reverse Repos—the central bank lends securities like Treasuries to the counterparties, draining money out of the financial system for a certain period, forcing up interest rates. Currently, 10-year sovereign yields are down sharply from the start of the year, negative in many places. No, not high on our list of concerns.

Q: What indicators are you watching to help identify the inflection point?

A: Containment of the pandemic is the only firm foundation for a recovery in the economy and, by extension, real estate leasing and capital markets activity. Accordingly, we are looking for the progress of different countries and, ultimately, different markets in reaching the containment phase where new case numbers have stabilized. We are also carefully watching the pace of economic normalization in geographies further along in fighting the pandemic as well as whether they experience renewed outbreaks that force the rollback of normalization. In terms of economics, we are paying great attention to unemployment and bankruptcy claims and the state of the credit markets generally. Well-functioning credit markets are a precondition for any significant activity in real estate equity investment. We are also keeping a close eye consumer confidence which correlates well with consumer spending and may help signal when conditions are beginning to turn for the better.

PROPERTY IMPACT

Q: How is COVID-19 impacting the office sector's leasing fundamentals?

A: The brief surge in remote working should not, on its own, cause office vacancy rates to rise significantly right away. It is important to note that 91% of all office leases are 2 years in length or longer; thus, even though many office buildings are sitting empty now, they are still leased. That said, clearly there is significant disruption occurring in every sector of the economy including the office sector. For example, touring physical space has become extremely difficult, if not impossible. Moreover, many occupiers and landlords have gone into a "wait and see" model. As a result, we expect absorption, both gross and net,

PROPERTY IMPACT (continued)

to slow substantially world-wide and turn negative in many markets. In terms of vacancy and rents, both are strongly correlated with the unemployment rate. If job losses caused by COVID-19 go from temporary to permanently destroyed, then the rise in the unemployment rate will be longer-lasting, causing vacancy to rise over the coming quarters. The unemployment rate will be a key metric to watch going forward, not just the immediate spike, which is now expected, but also the trajectory of the improvement during the recovery.

Q: What will be the impact on coworking?

A: Mixed. Congregating, sharing space, dense space – social distancing currently works against the "close sharing" environment. Moreover, today's version of coworking has not been tested by an economic recession. However, flexible space may be a good way for occupiers to navigate near-term uncertainty, gathering together and figuring out what their business looks like before signing longer-term leases. Swing space, flexible lease terms, no upfront capital costs – those aspects will be appealing during this period of uncertainty. Additionally, there may be some near-term demand from "essential industries" that have short-term expanded space needs in response to the health crisis.

Q: Have any construction/builders pulled off jobs?

A: At this point, yes some have. Construction projects are moving at a slower pace and some have stopped. Projects already in motion are continuing forward but some proposed buildings are in a holding pattern. In addition, some states have halted all but essential construction projects. With the labor force encouraged to socially distance unless necessary, materials coming in from overseas delayed, and uncertainty in the market, it makes more sense for developers to take a "wait and see" approach to construction for now.

Q: What will be the impact on the industrial-logistics sector?

A: The globe's industrial-logistics sector was booming before this crisis – net new leasing activity, rents, construction activity and occupancy levels were at record highs. Given COVID-19's impact on global trade, we expect some near-term headwinds. Longer-term, COVID-19 is accelerating the shift to eCommerce out of necessity. That may induce some longer-lasting behaviors in consumers. We expect the industrial-logistics sector to come out of this crisis stronger than ever.

Q: What will be the impact on the multifamily sector?

A: Multifamily should be more resilient, but not immune as evidenced by the YoY drop in returns among multifamily REITs in the past couple of weeks. Certainly, strong demographics fueling the apartment sector coupled with a housing shortage in the aggregate support demand fundamentals, but multifamily does enter this crisis potentially overbuilt in the luxury unit segment. Most layoffs will likely disproportionately hit the rental market due to the immediate impact on hourly workers, which is anticipated to show up on rent rolls as early as April. Landlords in some cities and countries will need to work through "no eviction policies" and how to address back payment of rent.

Q: What will be the impact on the hotel sector?

A: The hotel sector is most obviously impacted right away, given the travel restrictions, work stoppage, and plunge in tourism. The most immediate questions are how many hotels default on their loans, how many shutter permanently and how many management companies go bankrupt. This depends on the length of the acute shutdown period, how long and to what extent hotel demand recovers and the speed and extent of government support to the industry. Thus far, there has been little stimulus specifically to the hospitality industry, although the sector is clearly included in broader stimulus efforts. These efforts should reduce immediate bankruptcy risk, though any near-term mortgage maturities will have difficulty refinancing and will require some kind of loan modification. The post-containment recovery will be measured since after domestic containment, the primary risk for an outbreak comes from international travel. The same is true domestically. Even if a permanent solution is found (e.g. a vaccine), it seems likely that both business and leisure travel will be lower than pre-crisis for some time, even if output recovers abruptly. Said differently, fundamentals will remain under pressure and consolidation.

Q: What will be the impact on retail sector?

A: This event is likely to accelerate a trend that was already in the making: the secular shift toward eCommerce, which continues now at a faster pace. Certain aspects of the retail sector will now be more severely challenged, and we will see more store closures as a result. There's currently plenty of negative press about the retail sector, so rather than pile on, here are a few positives. Consider this: prior to this event, brick and mortar stores accounted for ~85% of total retail sales, eCommerce just ~15%. So retail was still by far the

PROPERTY IMPACT (continued)

dominant way people shopped. Certain concepts are going to survive this and will thrive. In fact, the retail sector is always evolving due to quickly changing consumer tastes and preferences. If any sector knows how important it is to adapt, it is retail. When this is over, people will be chomping at the bit to go out and shop, eat, play and exercise. Experiential concepts will come storming back. Food halls may serve as a forum for restaurateurs getting back on their feet.

Q: What is the current state of the capital markets? Is anything trading?

A: Yes, some deals are getting done. But it is difficult, if not impossible, to price risk in the current environment. In response, we have seen both lenders and equity investors largely adopt a "wait and see" posture. Underwriting and leverage levels were quite conservative coming into this crisis, so investors have flexibility in managing their existing portfolios. From a property perspective, there is a tremendous emphasis on the quality of rent roll and logistics properties. Underneath this relative stasis, there is a tremendous amount of capital and an eagerness to seize any opportunities that arise. Said differently, there is potential for capital markets to run rather than crawl back.

Q: Should we expect a sharp decline in CRE values over the coming months?

A: It is impossible to say right now. Transaction activity is extremely muted, so there has been little price discovery in the private markets. Pricing is likely to move last, pricing is sticky, no one is in a rush to drop prices. We suspect we will see limited declines in core office, industrial and multifamily values in the near-term. More significant losses can be expected in the hotel and retail sectors, where the impact could be longer-lasting and more transformative.

Q: How is the office sector being impacted by the $2.2 Trillion CARES Act?

A: Landlords are being impacted by the decline in the economy – that's really the central issue. Many businesses are struggling to make money right now, through no fault of their own, but paying rent is already difficult for some and if this drags out, it will become difficult for many. So any policy that aims to get the economy back on its feet more rapidly, especially by protecting company cash flows, is generally good for the tenants and, therefore, for landlords. The CARES Act provides qualifying tenants with liquidity options, allows some of them to apply for aid or tax provisions and eases regulations on banks who work with affected business and commercial loans. On the consumer side, there are cash payments to households and expanding unemployment benefits – all of that should help. We are also encouraged by what we've seen so far, landlords and tenants are working on solutions together.

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