Metropolitan Markets

Impacts of Economic Shocks on Major Metropolitan Markets

How Could Coronavirus Affect the Commercial Real Estate Landscape

The rapid spread of COVID-19, and the public health measures taken to reduce its deadly impacts, have caused significant disruptions to global economic markets. Due to widespread business closures in America's largest urban markets, and uncertainty over the duration and recovery of the pandemic, commercial real estate markets will face challenges in the coming years.

While the modern global economy has seen its share of turbulent cycles, the speed and scope of COVID-19 make it unique. Though there is no perfect historical comparison for a worldwide pandemic of this magnitude, other periods of economic contraction can serve as examples of how real estate markets react to economic disruptions.

Modern Economic Shocks

Dot-Com Bubble (2001):

A stock market crash triggered by excessive speculation and overvaluation of internet-based companies. Adding to the uncertainty, September 11th occurred soon after the bubble "burst". While the heightened threat of terrorism impacted real estate markets differently, it served as an important cultural inflection point.

Global Financial Crisis (2008):

The worst financial crisis since The Great Depression resulted in a loss of $2 trillion in global economic growth and over 37 million new jobless claims in the U.S.

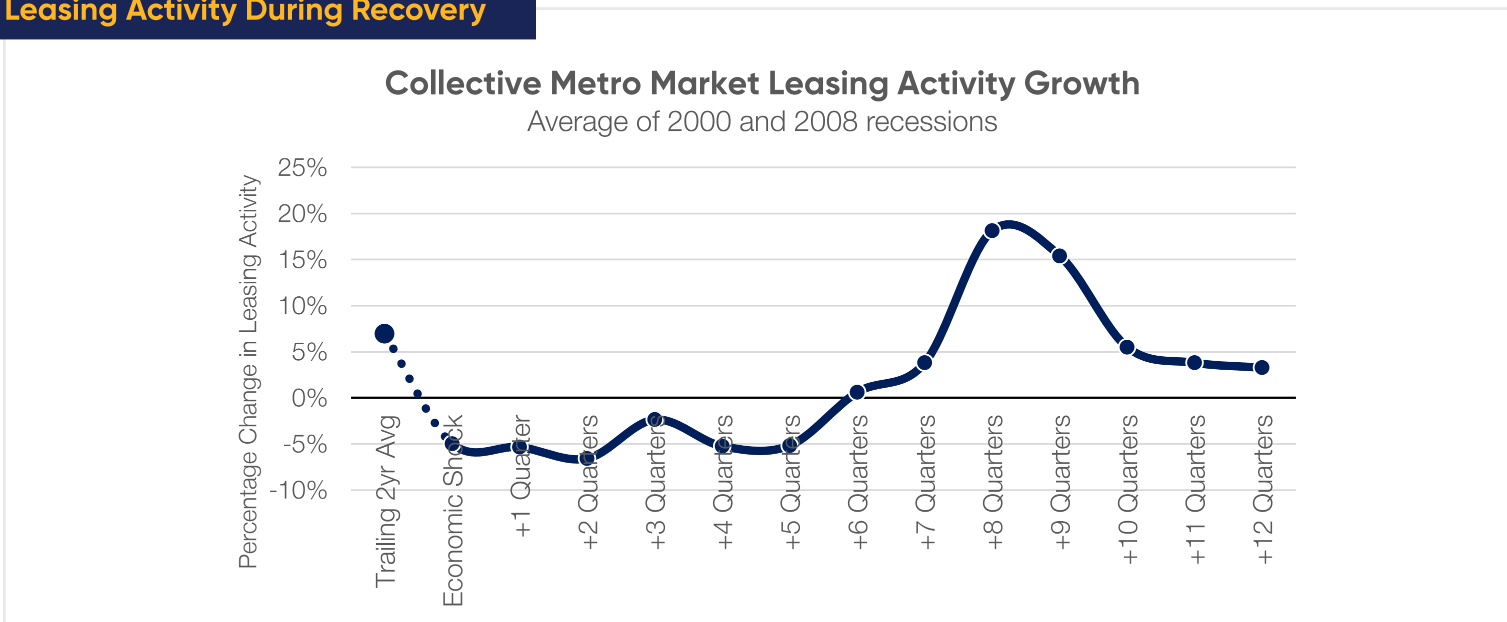
2001 | 2008

Real Estate

While COVID-19 will impact nearly all aspects of the economy, it poses a distinct threat to commercial real estate. Due to social distancing policies and "stay at home" mandates, many businesses were unable to occupy their real estate (offices, restaurants, stores, warehouses, etc.) to conduct normal commercial activities. Although economic conditions were healthy before COVID-19, prolonged disruptions to business activities will negatively impact revenue and the ability of firms to cover overhead expenses, such as real estate.

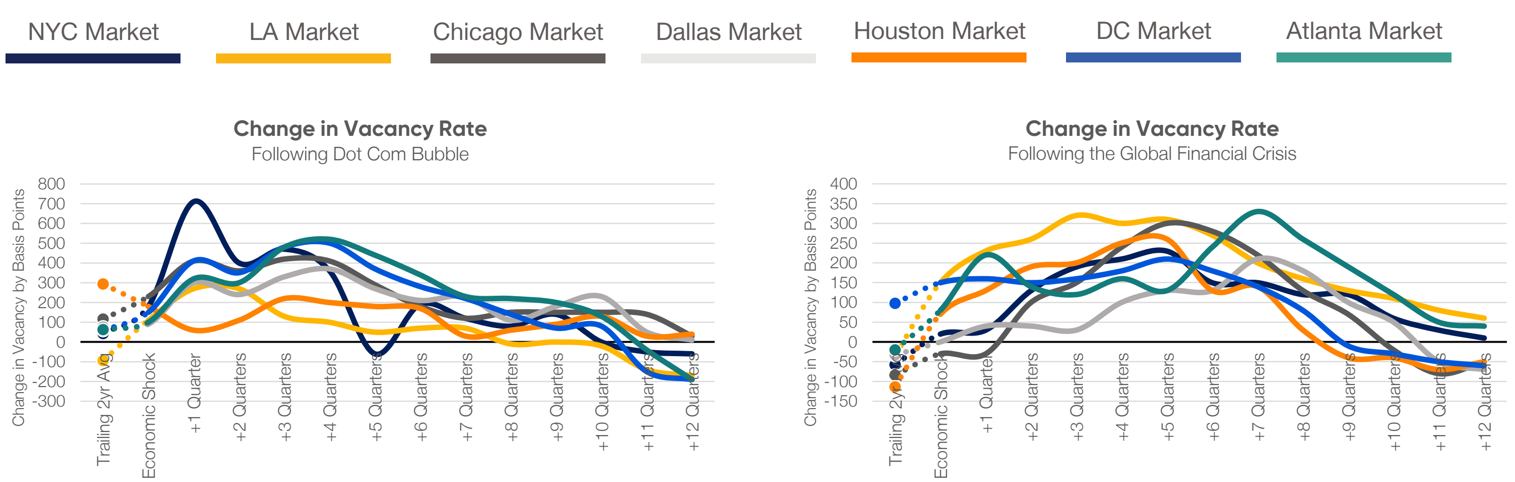
Real estate activities tend to slow following adverse economic shocks as businesses limit expenses and delay major real estate initiatives. Demand for office space generally falls, and uncertainty can cause landlords to cede negotiating power to compete for limited tenant demand.

Leasing Activity During Recovery



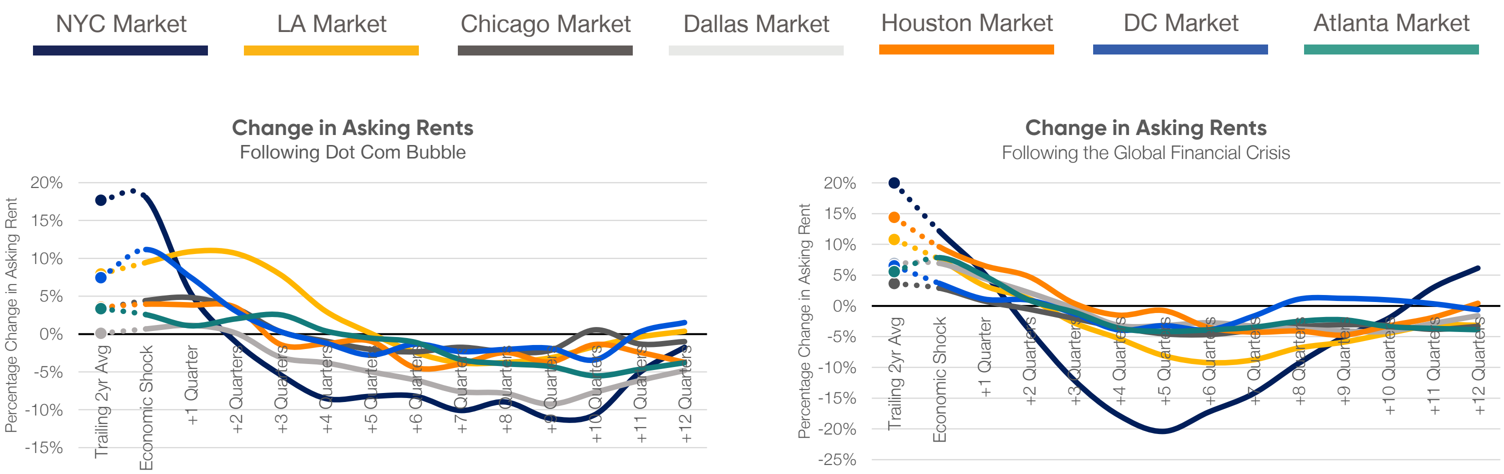
In the months immediately following the two recessionary periods of the 2000s, all sampled metropolitan markets saw a reduction in leasing velocity. Slow leasing tends to lead to above-average occupancy losses, thereby applying upward pressure on vacancy. While the magnitude of vacancy increases will differ from market-to-market, recovery trends among America's largest commercial markets were relatively consistent during past recessions. In the recovery of the Dot Com Bubble and the Global Financial Crisis, vacancy expansion reached its apex 4-5 quarters after the onset of the recession. If previous recessions are an indicator of COVID-19, it could be expected that vacancy growth will accelerate for the next 12-18 months. A combination of factors will drive occupancy loss through 2020, including office closures due to financial hardship, semi-permanent shifts to a remote workforce, and tenant "rightsizing" to lower overhead real estate expenses.

Vacancy Rates During Recovery



Falling rents are additionally symptomatic of a softening office market. Following both the Dot Com Bubble and the Global Financial Crisis, asking rent growth in America's largest markets began to decrease. For most markets, rents began contracting 9-12 months after the shock and "bottomed out" at annualized contraction of -3% to -5%. Historically, rents are slow to rebound during periods of economic recovery. Several market indicators, such as vacancy and overall economic growth indexes, must show sustained improvement for rents to begin appreciating.

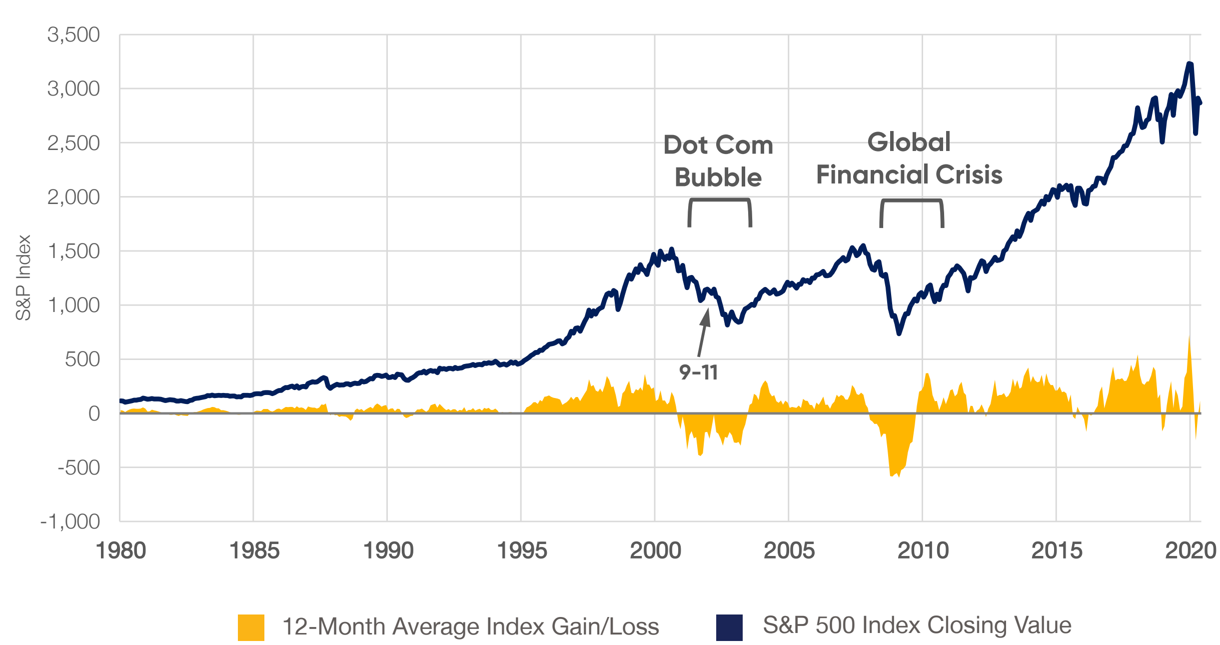
Asking Rents During Recovery



Economy

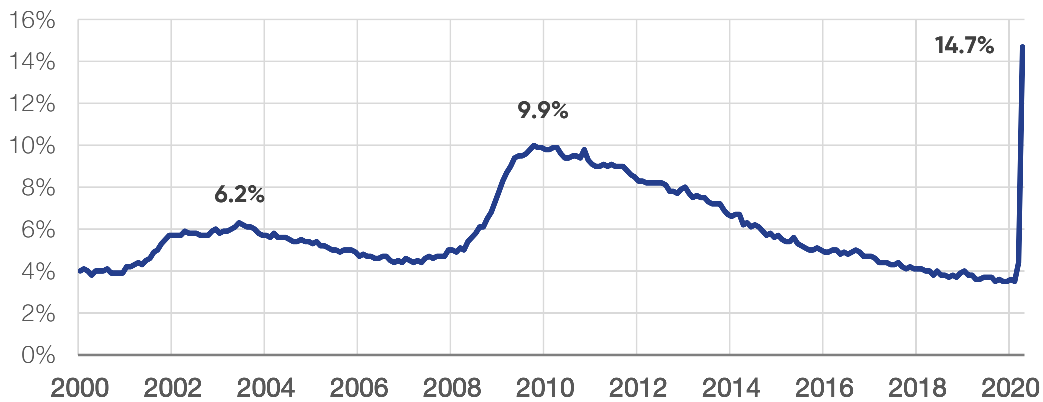
The emergence of COVID-19 as a global pandemic has been a massive shock to the global economy. Disruptions to supply chains, purchasing power, and consumer confidence have become significant concerns as the pandemic's duration is likely to be lengthy. While COVID-19 is not a direct financial crisis, its prolonged impact on global economic systems could result in a recessionary period. While it is understood that the stock market is not a sole indicator of the economy, it will likely be useful in measuring near-term consumer confidence and corporate health throughout the summer of 2020.

Recessionary Indicator: S&P 500



The local economy and labor force are critically important factors in driving the health of real estate market. Labor participation and unemployment will be key metrics used in measuring recovery in America's largest urban markets. Unemployment rates have skyrocketed across the county due to widespread lay-offs in retail, hospitality and food service sectors. Retail and service-based businesses play a critical role in activating urban streetscapes, town centers, and shopping malls. As financial hardships mount, permanent business closures will have a direct impact on the performance of local real estate.

National Unemployment Rate



Conclusion

The coronavirus pandemic will cause national economic growth to contract. Due to uncertainty regarding COVID's duration, the extent of the financial distress which companies may experience is unknown. Office tenants' operational and financial struggles will ultimately become a stress on landlords, resulting in softening market conditions, rent contraction, and vacancy growth. COVID-19's origins as a public health pandemic could delay recovery as local jurisdictions extend efforts to restrict public gatherings and avoid a "second wave" of infection. Markets will rebound in time, as they have following more severe historical economic shocks; however, the unprecedented nature and unknown duration of COVID-19 make it difficult to quantify a "return to normal."