Valbridge PROPERTY ADVISORS

COVID-19

In This Issue

- COVID-19

Valbridge Property Advisors | Baltimore Washington Metro
serving the Baltimore and Washington, D.C. Metropolitan markets from our central location:

11100 Dovedale Court
Marriottsville, MD 21104
(443) 333-5522

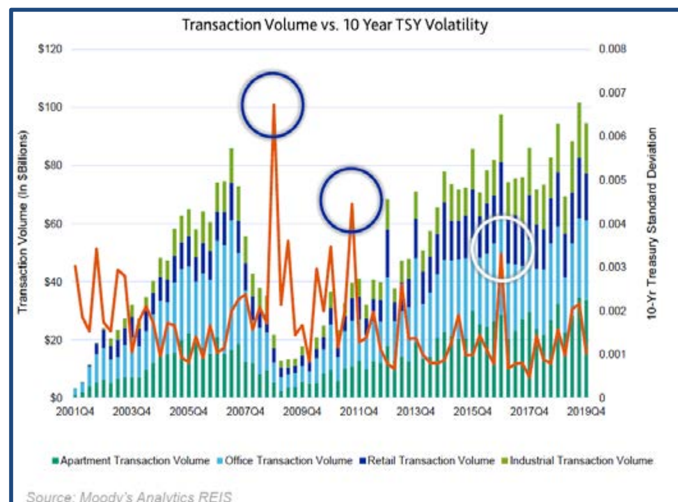
Prepared by:
David H. Brooks, CRE, MAI
(443) 333-5525
dbrooks@valbridge.com

ADAPTING TO THE WORLD OF COVID-19

Market Analysis Economic Impact – Financial markets are seeing dramatic impacts due to the novel coronavirus pandemic, and while the pandemic continues to be fought, no metric will be reliable to predict with certainty what value impacts will be. However, using trusted analytics resources we can better understand the ways in which past economic shocks have progressed which will help us better assess true risk associated with a particular Commercial Real Estate (CRE) asset.

Economic Impact – Real GDP is expected to decline 21% peak to trough between 4Q19 and 2Q20. In late July, unemployment was 11% and has since dropped below 10%; it is expected to continue dropping, albeit slowly, as more companies begin to normalize operations and restrictions are gradually lifted. Impacts and values have not been consistent across sectors, asset classes, and markets. Study and analysis on micro levels is critical.

CRE Transaction Volume – CRE markets report drops in transaction volumes due to travel restrictions, quarantines, and "stay at home" orders. The chart below illustrates the relationship between CRE transaction volume and volatility in the 10 year Treasury Note. Transactional volume may drop anywhere between 20 and 40% during periods of extreme volatility, such as in the 2008 recession. Moody's recorded a 47% drop in transaction activity by dollar volume in 1Q20, which corresponds with the Treasury Note volatility experience in the same quarter. We anticipate increasing CRE volume in 3Q and 4Q20 as market participants get used to the "new normal" and CRE pricing settles to some sort of equilibrium. Interest rates are also expected to remain low for the foreseeable future.



Comparing to Early 1990s and 2007/08 – The NCREIF found a 25% decline in values across 40,000 individual office, retail, multi-family, and hotel properties in the early 1990s, and a 27% decline in 2007/08. The recovery was fast in 2007/08, which can be attributed to better and more available valuation data and a desire by investment managers to get properties in their funds marked to market quickly. The strong federal response in 2020 has been well received and has kept many markets solvent, keeping the values from declining as sharply. But this is dependent on continued support for unemployment and the lifting of eviction moratoria (for multi-family), which has yet to be determined for the rest of the year.

Senior Managing Director:
David H. Brooks, CRE, MAI
(443) 333-5525
dbrooks@valbridge.com

Managing Director:
Michael Haller, MAI
(443) 333-5524
mhaller@valbridge.com

Managing Director:
Ed Steere, AICP
(443) 333-5521
esteere@valbridge.com

Senior Appraiser:
Kelly Hoffert
(443) 333-5528
khoffert@valbridge.com

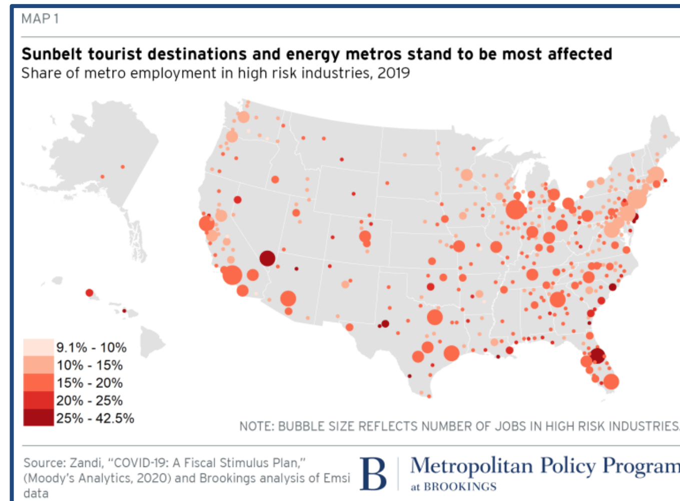
Senior Appraiser:
Ilene Sheer, MAI
(410) 802-0371
isheer@valbridge.com

Senior Appraiser:
Ronald Godsey
(443) 333-5534
rgodsey@valbridge.com

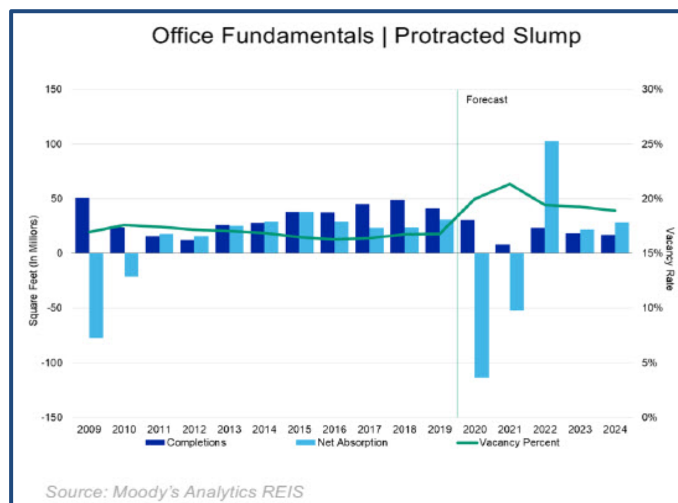
Senior Appraiser:
Simon Luttman
(443) 333-5532
sjluttman@valbridge.com

Senior Appraiser:
Robert Robidoux MAI, SRA
(301) 712-6807
rrobidoux@valbridge.com

Employment in High Risk Industries, by Metro Area – The following map shows the effect on those locations most dependent on tourist traffic and tourist employment:



Office Sector – As seen in the chart below, the negative net absorption in 2020 and 2021 corresponds to an increase in vacancy rate. Moody's expects a significant rebound in net absorption in 2022 and a slight drop-off in the vacancy rate (from 21% to 19%). While we belive that the vacany rate will indeed drop a bit, higher office vacancy rates are most likely to continue as companies have been learning how to succesfully work remotely, thus reducing the need for *as much* office space. This is indicated by Moody's flat vacancy forecast of 19% versus a pre-COVID rate of 17%.



Data Sources
❖Moody's Analytics REIS
❖CoStar Group, Inc.
❖STR, Inc.

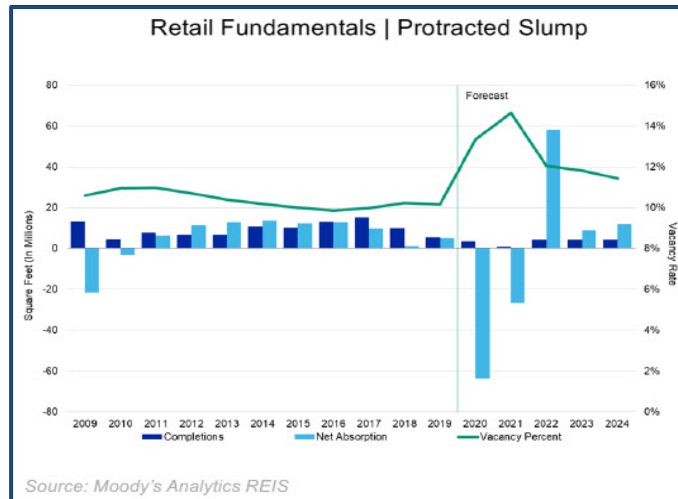
Some figures are interpolated and estimated due to variances between the reports.

Valbridge Property Advisors is based in Naples, FL and is the largest independent commercial property valuation and advisory services firm in North America.

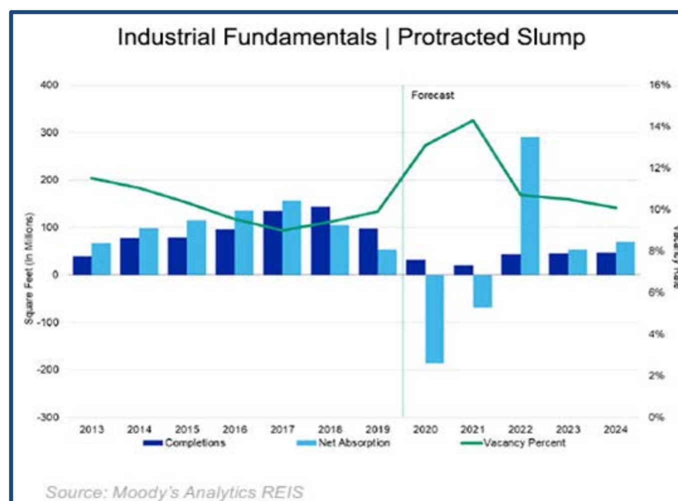
Valbridge has 200 MAIs, 78 office locations and 675+ staff across the nation. Each Valbridge office is led by an appraiser who holds the MAI designation of the Appraisal Institute.

Valbridge | Baltimore Washington Metro serves the Baltimore and Washington, D.C. markets from its central location in Marriottsville, MD. With four MAI's, five Certified General licensed appraisers, six motivated trainees, an economic consultant and a very capable support staff, VBWMetro is available for all types of real property valuation and evaluation assignments.

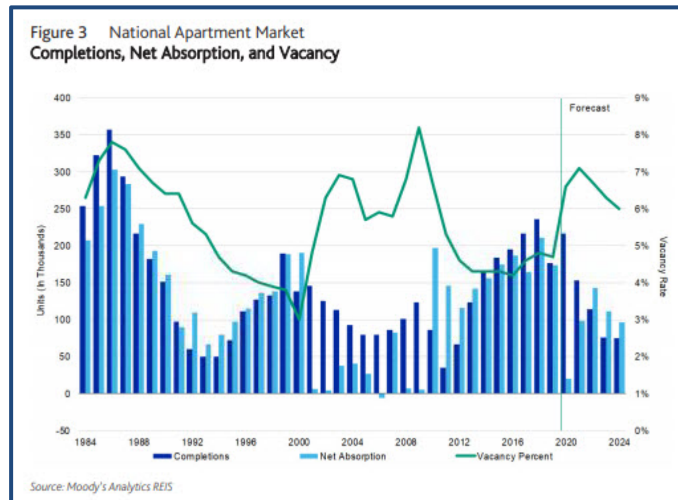
<u>Retail Sector</u> – Moody's shows forecasts a jump from the pre-COVID vacancy rate of just over 10% to almost 15% in 2021, then dropping to 12% in 2022, according to the following graph. It also shows a negative absorption of over 60 million sq. ft. in 2020 and another 25 million sq. ft. in 2021. Moody's suggests a positive absorption of almost 60 million sq. ft. in 2022, and while that seems rather optimistic, only time can tell.



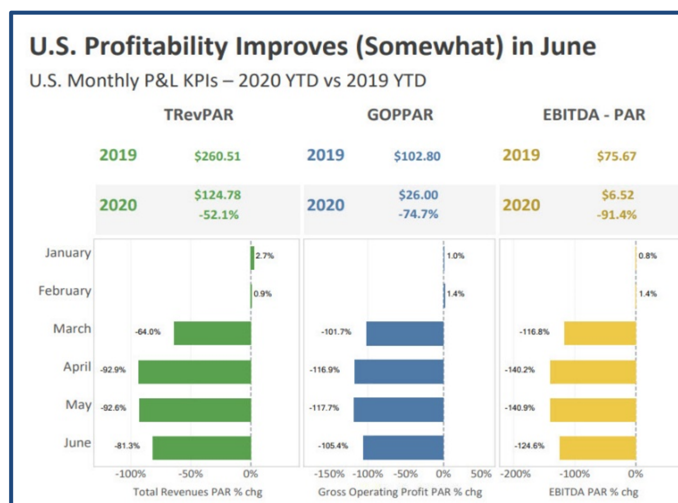
<u>Industrial Sector</u> – The industrial sector follows similar patterns as office and retail, though numbers and magnitudes vary somewhat. As industrial buildings are larger, Moody's forecasts a negative absorption of almost 200 million sq. ft. in 2020, with a negative 75 million sq. ft. the following year in 2021, then bouncing back with just under 300 million sq. ft. of positive absorption in 2022. Vacancy peaks slightly above 14%, then drops precipitously to around 10% by 2022. We believe these projections to be a bit more accurate than those for retail.



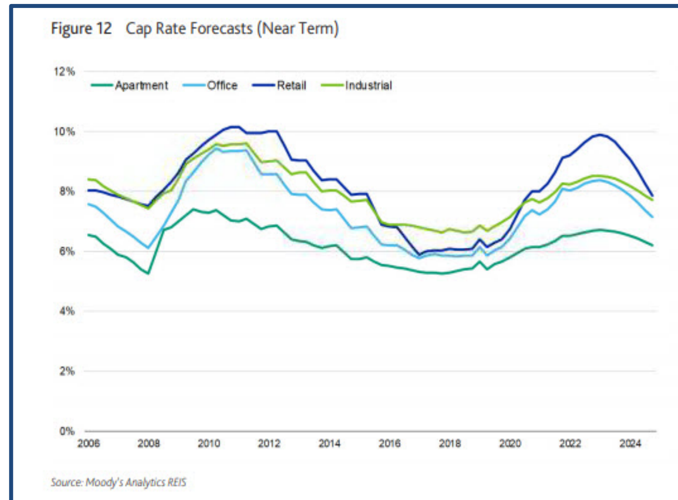
Multi-Family Sector – As of July 20, 91.3% of households paid full or partial rent. This of course is a result of the financial stimulus being paid out, but what happens when the stimulus runs out (and a new one is not introduced) before the vaccine comes out? We will most likely see the answer to this question in 3Q and 4Q20. The stimulus, along with a prohibition on evictions, has clearly lessened the impact of the recession on apartment vacancies as compared to the previous two recessions. Moody's forecasts a vacancy rate increase from a pre-COVID 4.5% to 7% in 2021, then gradually dropping to 6% by 2024. Markets that are oversupplied, or which have a history of rising vacancy or low to flat rent growth, are indications of areas that may be harder hit by the new crisis. Markets with volatility in rent growth are still vulnerable, even if vacancy was stable in the past 12 months.



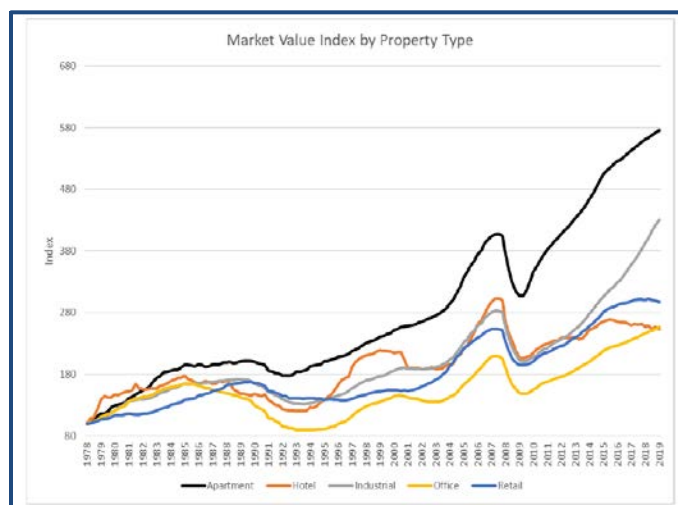
Hospitality Sector – Predictably, all indicators are down for the hospitality sector. As seen in the chart below, GOPPAR is down 105.4% YoY in June, occupancy is down 42.5% across all room types, and June ADR is at $92.15 - down 31.5%. Although June was an improvement over May and April, it will still be quite some time until we see a return to 2019 levels, perhaps by 2024.



Rates – Interest rates are expected to remain low for the foreseeable future. Though Moody's expects CAP rates to rise a bit, peaking in 2023 then trending back down, as seen in the following graph. It shows retail rates rising and dropping the fastest, which can most likely be explained by the Amazon Effect and that by 2024, the retail industry figures out hot to operate within its paradigm. Understand that CAP rates are essentially risk barometers; a lower CAP rate in 2024 for retail does not mean that the Amazon Effect has subsided, rather that the investment market has learned to live with it. Also notice that multifamily is the least affected.



Market Value by Property – The following chart shows historic values, including the effects of the previous recessions, which might give us a suggestion as to what values might look like in the following years. Notice the volatility in multi-family, from the steep rise and fall around 2007/08 to the meteoric rice thereafter, until now. With incredibly low current interest rates, apartment values remain at high levels, as they are frequently positively impacted by leverage. All of the property types eventually recovered from the 2007/08 recession, excluding hotels (orange line), which have yet to get back to their peak, and will certainly have even more trouble doing so post COVID.



© Copyright 2020 Valbridge Property Advisors | Baltimore Washington Metro. ALL information herein was obtained from third parties. The accuracy of the data is not verified, warrantied or guaranteed. For the exclusive use of Valbridge Property Advisors | Baltimore Washington Metro clients. Reproduction or distribution without consent is prohibited.