COVID-19 Impact on South Louisiana Commercial Real Estate

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The stock market prices assets daily; the spread of COVID-19 has already driven the market into bear territory, with March 12 suffering a 10% drop -the biggest since 1987. In real estate, we don't get instant pricing of assets; we appraisers are always looking in the rear-view mirror for data to prove our suppositions. But it isn't too soon to consider the likely impact on various asset classes.

The 10-year Treasury has been pushed to an all-time low. The Fed-funds rate will be 0% to 0.25%. Normally, this would be a big plus for real estate values, but instead we may see a frozen credit market, as we had in 2008, as banks stopped lending to each other across the globe. Fears intensify that the spreading virus will hurt corporate income and ability to repay loans.

Despite the flood of headlines, commercial real estate (CRE) remains in balance, with a positive investment climate. Past shocks such as SARS, swine flu, the Loma Prieta earthquake (1989), the Persian Gulf War and 9-11 attacks generated short-term volatility that stabilized in less than six months. We expect the same for COVID-19, assuming a tapering of new cases in the next 6 months.

In the short term, many businesses will be devastated. For real estate closely tied to business operation just a few weeks of disruption will turn Mom & Pops upside down. Lodgings that usually run 60-75% occupancy will suddenly drop near zero.

The same for bars and restaurants. Governor Edwards called for all bars, restaurants, theaters, casinos and malls to close in the state, or to operate as take-out and delivery only.

The following commentary is largely focused on real estate impacts, as opposed to business, stock market or social impacts.

Hospitality, as noted above, will surely see the biggest impact from the novel virus. Both business and tourist demand will surely be greatly impacted. Most impacted will be venues that have a significant conference component. On Wednesday, March 18th, the Hyatt Regency New Orleans reported just 60 guests - in the past they've hosted up to 3,000 at a time.

Favored asset classes will **be apartments and self-storage.** **Office** should show little impact; a tech company looking to lease, say 250K sf, can't suddenly turn off their plans.

Industrial: the flow of goods from Asia has already tapered. Sales declines will surely follow. For example, Apple issued guidance that iPhone production will be constrained. On the sales side, iPhone sales were down 60% in China in February. Nonetheless, we expect the impact on industrial real estate to be minimal.

Retail demand should remain stable over the medium to long term, but significantly impacted in the short term as shoppers and diners avoid public spaces.

In conclusion, CRE isn't like the stock market or oil market, where assets are repriced daily. And to the extent that some buyers may be expecting a big price cut but sellers refuse to budge, there will be no sale and thus no data point. Many small tenants will fail before the market returns to normalcy. Well-capitalized tenants will carry on as the economy returns to normal by the end of the year.

But, as Treasury Secretary Steven Mnuchin said on March 15, "I think we're in the second of nine innings…".