

Implications of Coronavirus for Global Real Estate Markets

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Concerns around the coronavirus continue to increase dramatically across the world, with most major countries now recording a sharp rise in the number of infections.

Measures to contain the spread of the virus – including travel restrictions, quarantine periods and shelter-in-place orders requiring many businesses to close – are causing significant economic disruption. In the near term, a global recession looks likely, and the question now is how deep and long-lasting it will be. With that question unanswerable for now, we expect financial market volatility to remain elevated.

We are currently in the initial phase associated with any major real estate market disruption – illiquidity. During this phase, a lack of liquidity caused by increasing fear grinds capital markets to a halt. Limited transactions result in sidelined investors waiting for price discovery. Buyers and sellers are less likely to transact, and real estate lenders – both bank and non-bank – are equally hindered by the lack of market transparency. However, longer term, when price discovery returns, lenders with healthy balance sheets will resume lending, which in turn should support real estate price recovery.

The second phase is the duration of the shock. The situation we face today is extraordinary. While each market cycle is different, the current economic climate may be especially harsh for millions of small businesses around the world, many of whom have been forced to close their doors. The duration of coronavirus shock will set the course for what the recovery looks like. The longer the shelter-in-place and travel restrictions persist, the more significant the damage to businesses, supply chains and the broader economy and thus the longer it will take to recover.

While our observations and actions will continue to evolve, we are sharing our current thinking on real estate market implications globally.

Prepared for a U.S. downturn

The coronavirus outbreak may induce a U.S. recession for which we have been preparing since 2015. The sectors likely to be impacted most-to-least are – hotels and hospitality, discretionary retail, offices, industrial, discretionary housing, necessity retail, storage and necessity housing. Housing, particularly necessity segments including affordable and senior housing, should benefit from the significant debt liquidity provided by government Agencies. However, even housing will be impacted by increasing unemployment. Markets with high exposure to the technology and financial services industries may experience the most significant short-term drops in rents and vacancy rises. However, over the long term, we still believe these markets offer the best income-growth potential, due to their demand drivers and supply constraints.

With limited near-term upside in real estate equity, private real estate debt is looking relatively more attractive. Pressure on small business lenders, such as banks, will create opportunity for investors in the private debt space to fill the funding void. Low interest rates spurred an initial flurry of refinance activity, as borrowers looked to recapitalize in lieu of selling, but that initial wave has now been replaced by uncertainty. The diversity of capital providers in the US will strengthen the liquidity and thus the real estate recovery.

When we enter a recovery period, well-capitalized equity funds will have an advantage over funds with weak balance sheets. We see a number of potential opportunities, including in all kinds of housing – particularly

suburban apartments, senior housing and manufactured housing. We are also looking at infill industrial opportunities, including cold storage, which are close to large U.S. population centers, as well as industrial across Mexico as manufacturers seek to diversify their U.S.-serving supply chains. Necessity retail is another appealing area, particularly as grocery delivery accelerates in the coming months. More generally, we will look to grow exposure to U.S. markets, particularly in the Southeast, with more diversified economic bases than the tech-dominated coastal markets.

Careful approach in Europe

In Europe, investors will need to be highly selective in transaction activities until the situation normalizes. For the time being, acquisitions are being put on hold, particularly in smaller markets and niche sectors, as well as higher up the risk spectrum, where we believe market volatility will be greatest. The sectors most affected are retail, hotels, offices, and senior and student living, with logistics and the traditional residential sector less vulnerable. Additionally, core assets in major markets offering bond-like income characteristics are set to fare relatively well in a risk-off environment.

Looking ahead, we see opportunities benefitting from favorable structural trends, including logistics assets serving supply chains in major population centers. In addition, assets offering secure income streams, notably in the for-rent residential sector where demand is expanding in major cities, also are attractive. There will also be selective opportunities for income-generating assets in low vacancy office markets.

The financing markets in Europe remain highly concentrated in the banking community, and this lack of diversity slowed the recovery coming out of the global financial crisis. While the markets are slightly less dependent on the banking community than in 2008, the European financing market is much less diversified than the United States. Banks remain the dominant force in providing liquidity for real estate in Europe. This lack of diversity will hamper the recovery, though to a lesser extent in the UK, where non-banks have created a noticeable market share.

Navigating uncertainty in Asia Pacific

It is clear the scale of the economic impact on Asia Pacific will be severe. Short-term growth outlook has deteriorated significantly and an economic recession in the region is a possible scenario. Nevertheless, the significant and seemingly effective measures taken by China, South Korea, Singapore and some other countries in the region to limit the spread of the virus may result in the Asia Pacific being one of the first regions to stabilize in the crisis.

While the hospitality and travel related sectors face significant headwinds, retail and office will also be impacted by increasing social distancing measures and slower economic growth. Logistics is likely to benefit from an increased shift to e-commerce as consumers stay at home.

Potential opportunities include sectors benefitting from structural drivers, such as logistics across Asian markets and the living sectors in Japan and Australia. In addition, private debt markets look attractive, as credit spreads widen, and banks are more constrained in real estate lending. We see an opportunity in the future recovery of high-quality CBD office assets in markets with limited supply and higher exposure to their domestic economies and intend to keep an eye on sub-markets offering potential benefits from infrastructure investments and fiscal spending.

The impact of the coronavirus on real estate debt and equity markets is being felt across the Americas, Europe, and Asia. While it is important to remain cautious – particularly in the hospitality, retail and office sectors most affected – it is crucial to always keep an eye on the long term and, where possible, capitalize on opportunities arising from shifting structural trends.

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