

## The Current Reality: Charting a Path Through Unprecedented Human and Economic Conditions

- The escalating human cost of the public health crisis has created fear and uncertainty, while consumption and commerce have become increasingly constricted. Financial markets are struggling to assess the depth and length of the resulting economic impact.
- Government response has been swift and supports the prospect of a more rapid recovery following the current shocks to the economy. The ability to manage the outcome of the public health crisis will determine the length and severity of the economic downturn. When normal behavior resumes, pent-up demand is likely to support a fast return to economic growth.

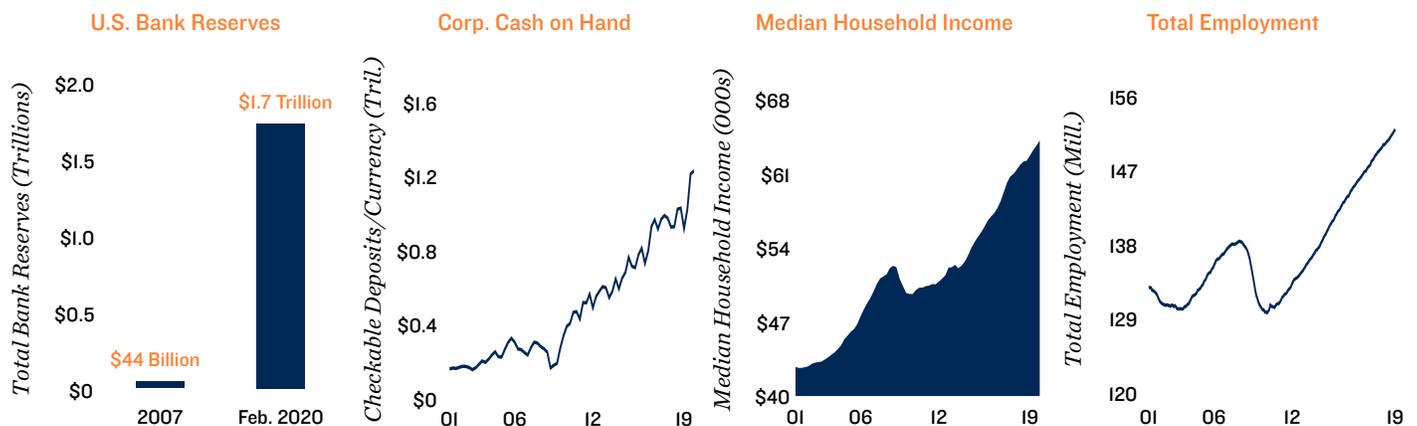
## Lessons Learned From the Global Financial Crisis

- The Great Recession was born from a cracked financial system in 2007, including overleveraging and massive speculation, that led to a major downturn. The federal response was slow and insufficient because it did not have a playbook. Early stimulus efforts went to shore up the commercial banking system and not to consumers to encourage spending.
- Today's challenges are quite different. The financial system is healthy. Banks are well capitalized, and household and corporate balance sheets are strong. While the unprecedented public health crisis will have immediate and severe economic costs, the public policy response has been informed by the past and been swift and substantial. Proactive measures taken by the Fed and Congress, including a recent stimulus package, will help limit the economic damage and support a faster recovery.

## Implications of Monetary Policy and Recent Fiscal Stimulus on Commercial Real Estate

- The Fed has cut rates by 150 basis points since February and re-initiated quantitative easing, buying an open-ended amount of Treasuries and mortgage-backed securities, while also opening new funding and credit facilities. These actions help maintain business operations and prevent a funding freeze.
- Recent rate cuts have also pushed bond yields and mortgage rates to historical lows, creating a unique climate for investors by fostering wider spreads between yields and costs of capital.
- The recently enacted \$2.2 trillion fiscal stimulus package includes key support for small businesses and consumers that benefits the public, companies and commercial real estate. The \$349 billion Paycheck Protection Program (PPP) and emergency grants to the Economic Injury Disaster Loan Program (EIDL) will both help companies leasing retail, office and industrial real estate maintain payrolls. Forgivable PPP loans are equal to two month's payroll expense from 2019 plus 25 percent, capped at \$10 million, while EIDL loans are limited to \$2 million per borrower, but new grants essentially offer \$10,000 in immediate cash.
- Over \$600 billion has also been put toward expanded unemployment benefits and safety nets, as well as direct payments to individuals, which will help people pay rent and buy goods.
- Numerous tax adjustments include a temporary raise of the cap on the tax deduction for real estate depreciation for non-corporate taxpayers. The limit on deductible business interest moved from 30 percent of EBITDA to 50 percent. Non-REIT businesses can also apply a five-year carryback on net operating losses incurred from 2018 to 2020.

## Economy Well Positioned Prior to Shock



\* Sources: Marcus & Millichap Research Services; BEA; Federal Reserve Bank of St. Louis; Federal Reserve Board; U.S. Census Bureau



### Health Crisis Impacts All Property Types

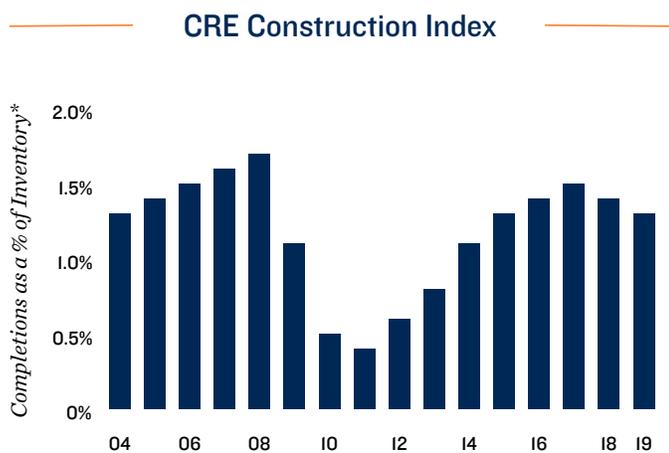
**Multifamily:** Owners, managers and tenants face many immediate challenges but are coming up with creative solutions. In several cases leasing offices remain open and key functions like maintenance are being performed. Some tenants may not be able to pay rent, but recent fiscal stimulus, including direct payments to individuals and loan forbearance on some federally guaranteed loans, will help both renters and investors of apartment properties meet financial obligations.

**Multi-Tenant Retail:** Segments that were performing the best through 2019 are now being hit the hardest, including entertainment venues and fitness concepts. Grocers and necessity-based retailers are faring better. Recent fiscal stimulus provides much needed support to tenants and consumers as current spending patterns are tied to the health crisis and are therefore temporary.

**Single-Tenant Retail:** Prominent lessors of single-tenant space, including grocery, drug and convenience stores, are facing fewer immediate hardships. Mass merchandisers and pharmacies are also reporting less downturn in demand. Local or regional tenants will face more hurdles than national chains, but recent federal actions provide much needed near-term support.

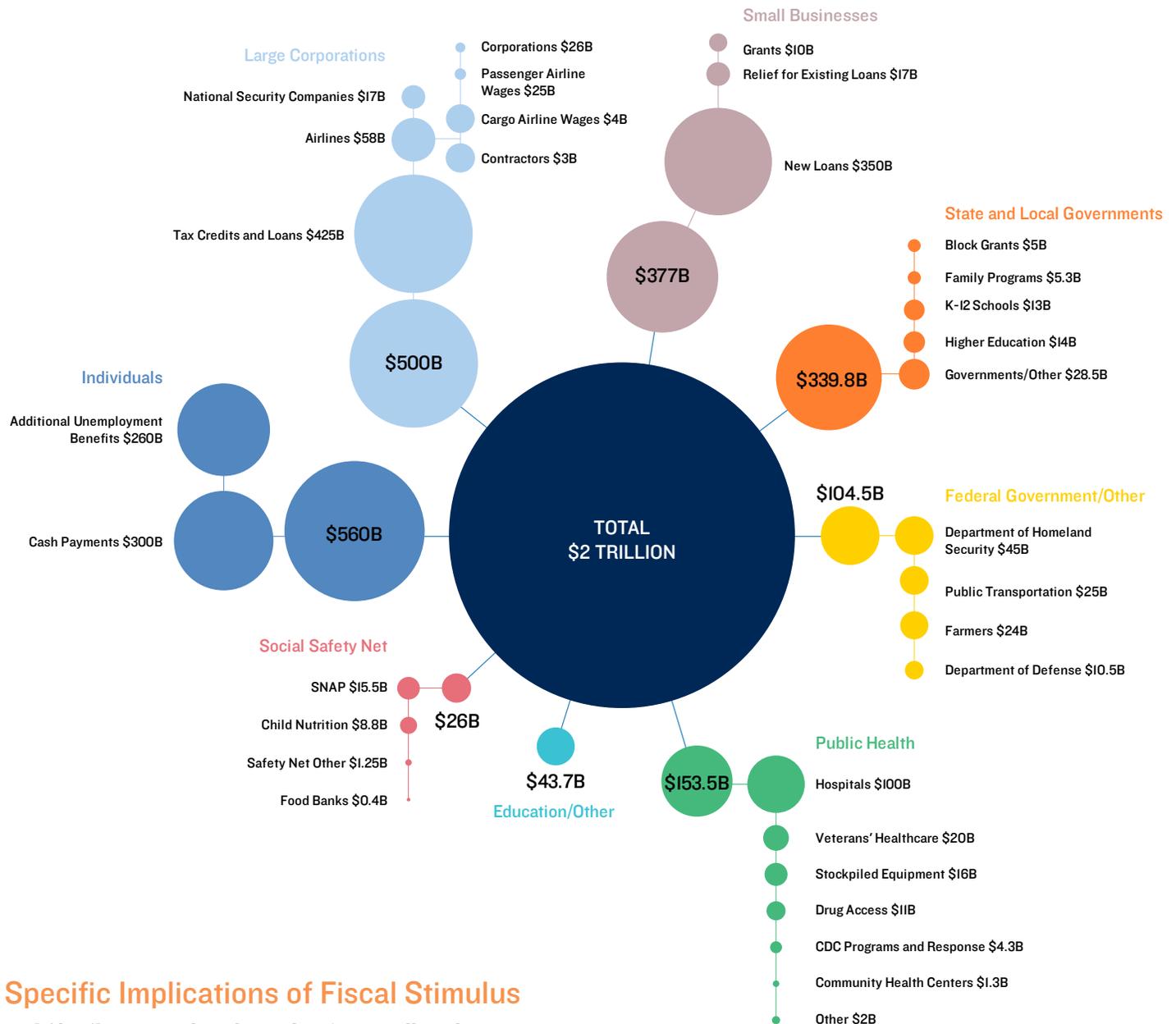
**Office:** The sudden and massive shift to working from home for many office-based roles has raised questions regarding the future demand for space. Despite current behavior dictated by “shelter-in-place” regulations, traditional space use is expected to return as people consider the costs of isolation. Owners and lessors are improving communication to understand immediate needs. While the long-term value proposition of offices remains compelling for tenants and investors, new leases may be difficult to place in the coming weeks.

**Industrial:** Perhaps the strongest performing property type through last year, industrial assets are now under pressure. Health concerns limit labor hours as remotely working is not an option in many fields. Consumer demand for some tenants’ services will also decline. Local businesses operating out of small bays are most at risk, while larger-scale distributors benefit from strong e-commerce performance.



\* Represents the multifamily, retail, office and industrial property types.

Sources: Marcus & Millichap Research Services; RealPage, Inc.; CoStar Group; Real Capital Analytics



### Specific Implications of Fiscal Stimulus

**Multifamily:** Tenant-based rental assistance allows borrowers to potentially obtain loan forbearance with federally backed mortgages at the cost of foregoing late fees and evictions for the 90-day forbearance period. Management companies with fewer than 500 employees can also apply for a loan under the PPP or EIDL to meet payroll and related costs. PPP loans will be forgiven if 75 percent of the funds go toward payroll expenses and the company restores its workforce and salary levels by June 30. Greater unemployment benefits and direct payments to individuals, which can extend up to \$1,200 per person plus \$500 per child under 17 years of age, will help many tenants cover expenses.

**Multi- and Single-Tenant Retail:** Expanded unemployment benefits and direct payments to consumers will benefit all retail operations by supporting discretionary spending during the recovery. Retailers with fewer than 500 employees can also apply for a PPP

loan to meet short-term costs, in addition to smaller amounts from the EIDL. By helping tenants meet their rent obligations, these programs will help keep vacancies lower than they otherwise would have been because of the health crisis. Correcting an error from 2017 tax reform, qualified improvement properties (QIP) now gain 100 percent bonus depreciation on internal improvement costs.

**Office/Industrial:** The PPP and EIDL programs also apply to small and medium-size office and industrial tenants and will partially offset downward pressure being exerted on vacancies. QIP office assets are also subject to the same depreciation stipulations explained above.

## Trends in Transactions and Capital Markets

**Multifamily:** Transaction activity continues but logistical challenges, such as site visits and appraisals, hinder execution. Banks are still providing capital but are carefully considering borrowers’ balance sheets and the likelihood and value of a potential longer-term relationship.

**Multi-Tenant Retail:** Private investors, often completing 1031 exchanges, continue to drive sales velocity. Banks and insurance companies are active lenders but cautious. Necessity-based tenants and nationally recognized chains are favored. CMBS financing is limited for now but is likely to return in the near future.

**Single-Tenant Retail:** Long-term leases and more resilient consumer demand for frequent tenants of the property type bolster interest by investors and lenders. Capital liquidity remains tied to the credit quality of the tenant and sponsor.

**Office:** The credit history of the tenant and duration of lease will be driving factors in supporting investor interest and capital liquidity in the near future. Value-add opportunities will be more rare as investors carefully balance long-term strategic goals with immediate business operations.

**Industrial:** The long-term outlook for the sector is driving buyer interest. Sequestered consumers are demanding products be delivered to them, emphasizing the importance of maintaining current supply chains. The current health crisis will nevertheless impact the financial health of certain tenants, which may impact the investor demand for smaller properties.

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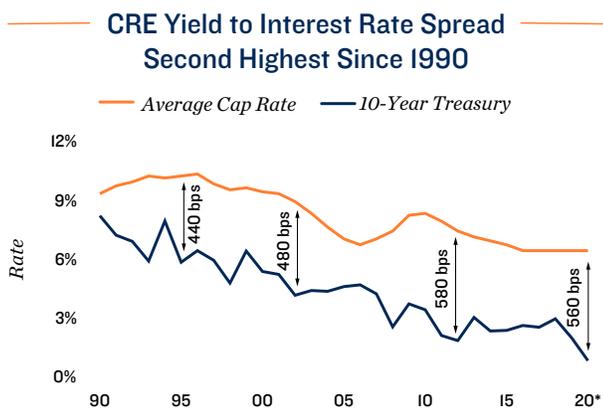
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Price: \$1,500



\*Through March 31

Includes multifamily, retail, office and industrial sales \$1 million and greater

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Sources: Marcus & Millichap Research Services; BEA; BLS; CoStar Group; Federal Reserve; Real Capital Analytics; RealPage, Inc.; U.S. Census Bureau; U.S. Small Business Administration

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### Webcast Details

On Thursday, April 2, Hessam Nadji hosted a webcast, titled *Getting Through the Global Health Crisis Together*, which is now available for replay at the following location:

[www.marcusmillichap.com/research/coronavirus-update](http://www.marcusmillichap.com/research/coronavirus-update)