Q1 2020: North America Commercial Property Monitor

Covid-19 takes its toll on the real estate market

The Q1 2020 RICS-AFIRE North America Commercial Property Monitor results fairly predictably show the spread of the pandemic exerting a significant impact on the real estate market with the key metrics capturing sentiment amongst occupiers and investors moving into negative territory in both the US and Canada (chart 1). Significantly, concerns regarding the outlook for the economy are visible both in the sharp drop in the tenant demand indicators and as well as in expectations regarding the outlook for rents (chart 2).

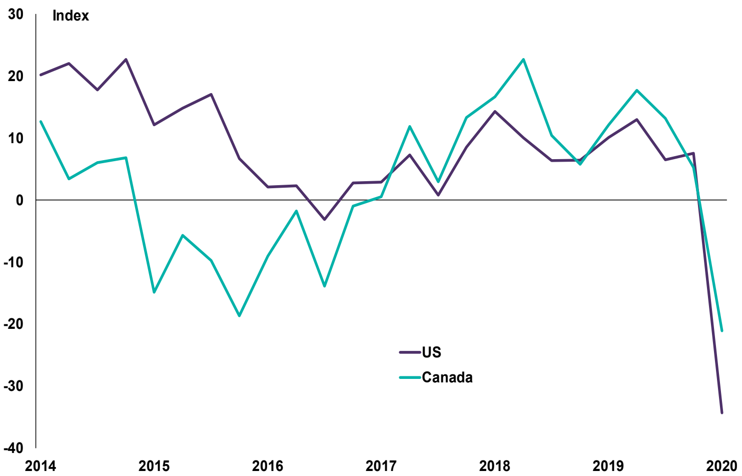
Comments from respondents to the survey underline the uncertainty about the likely extent to the impact of the virus but note amongst other things that some ‘occupiers are already asking for rent reductions’ and that ‘while the results may be similar to the 2008 financial recession, the effects will create drastic long term changes in the office and retail markets’.

This latter point is clearly visible in the results for twelve month expectations (charts 3 and 4). For the US, the headline number suggests capital values could decline by in excess of 5% over this time horizon (against expectations for a modest increase previously). Significantly the only sectors bucking the negative trend for now, according to the feedback received for the survey, are prime industrial and multifamily. The decline in retail is now projected to be particularly severe, particularly in the secondary space. The results for Canada tell a broadly similar story albeit with slightly less adverse numbers.

The downbeat trend is also reflected in perceptions regarding where markets now stand in the property cycle. For the US (chart 5), the proportion of contributors seeing viewing real estate in a downturn has jumped to three quarters from just one in six previously. For Canada (chart 6), the respective number is just over a half. Credit conditions are predictably viewed as deteriorating although the survey suggests that this is more marked in the US (chart 7).

Reflecting this, international investors appear to have responded to the current environment by turning a little more defensive. A large majority of AFIRE respondents to the survey suggested that they expected to deploy capital disproportionately towards the US over the next year (chart 9).

Chart 1: US and Canada Sentiment Indices*



* These indices are unweighted averages of the OSI and ISI foe each country

Chart 2: Twelve Month Rent Expectations

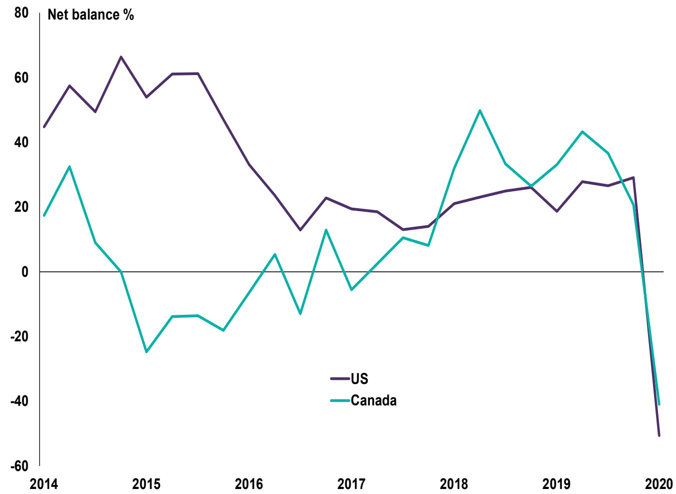


Chart 3: US Twelve Month Expectations

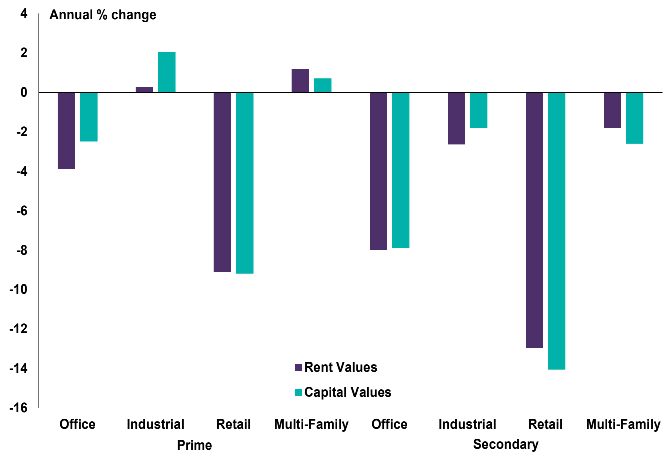


Chart 4: Canada Twelve Month Expectations

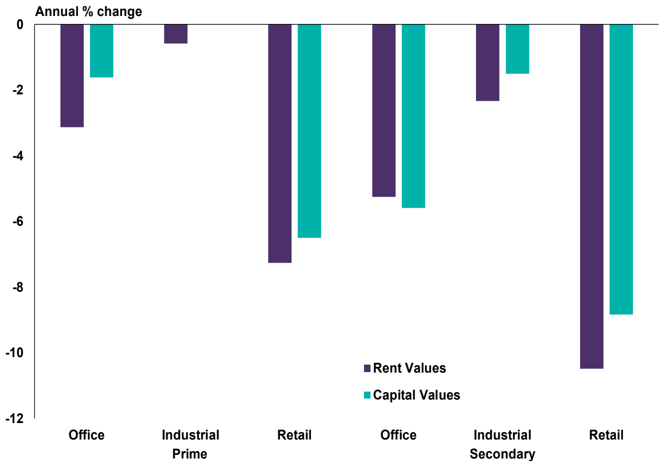


Chart 5: US Perception Regarding Cycle

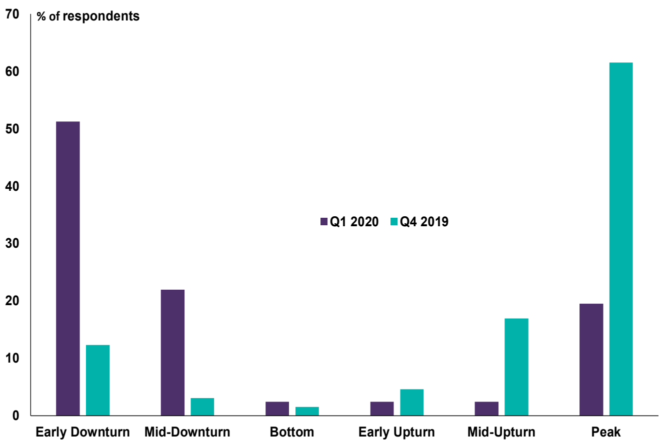


Chart 6: Canada Perception Regarding Cycle

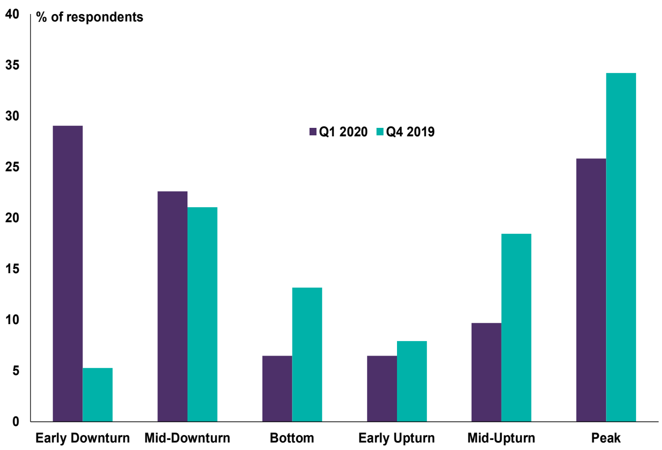


Chart 7: Credit Conditions

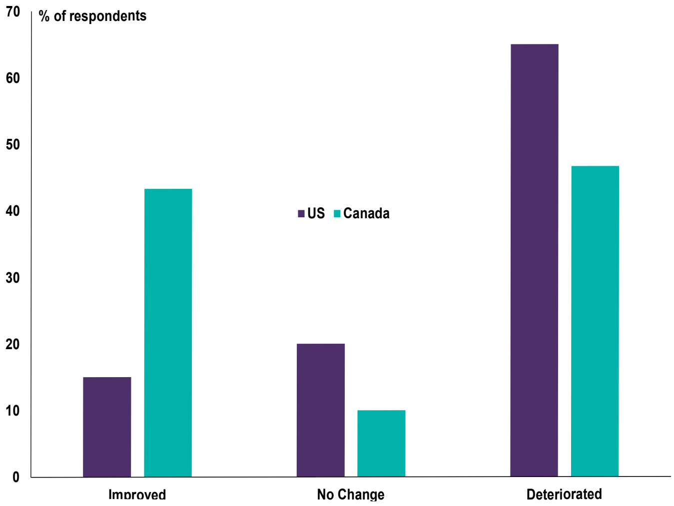


Chart 8: Preception Regarding Valuation

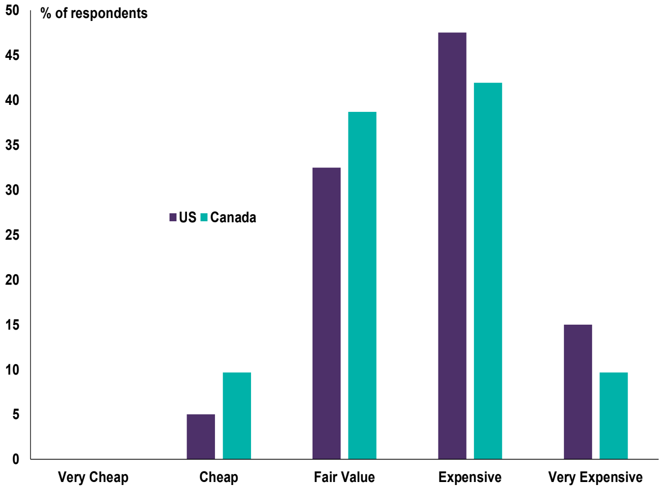


Chart 9: Which international market do you expect to see the strongest growth in cross-border capital

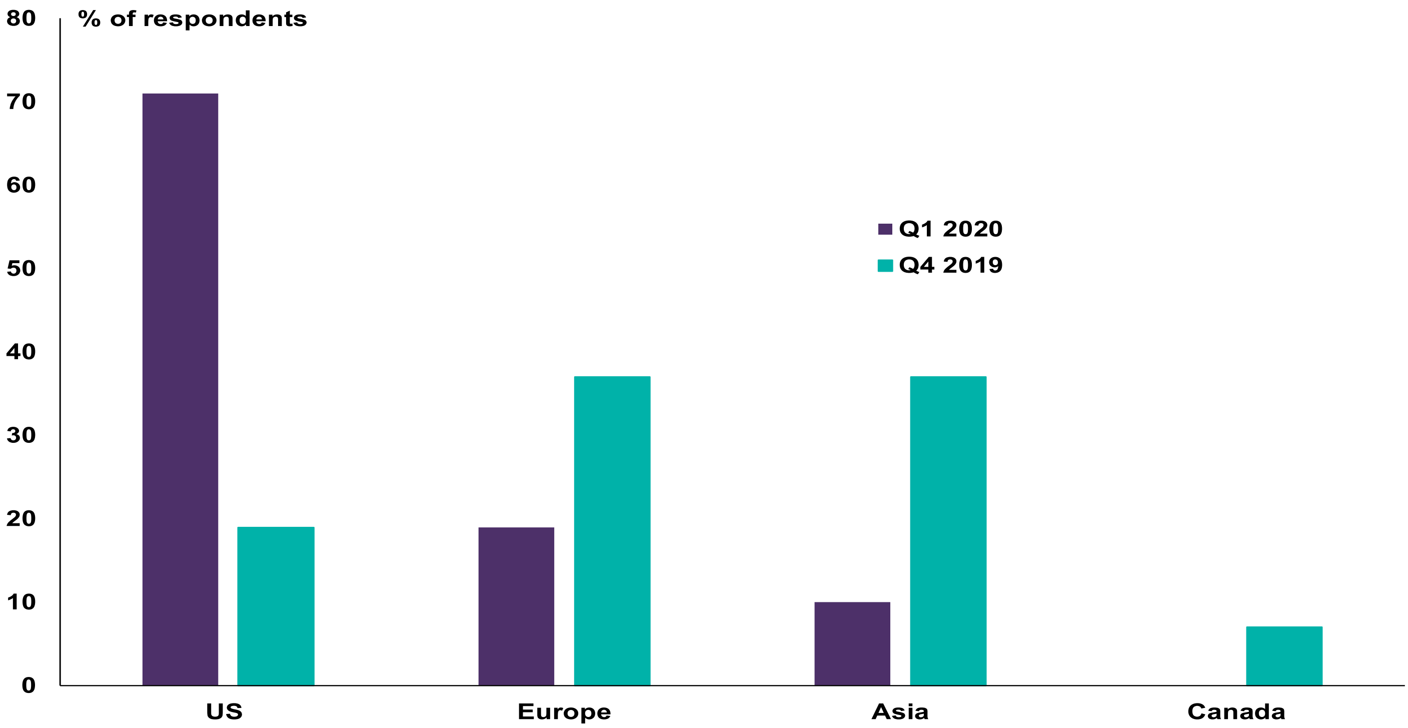
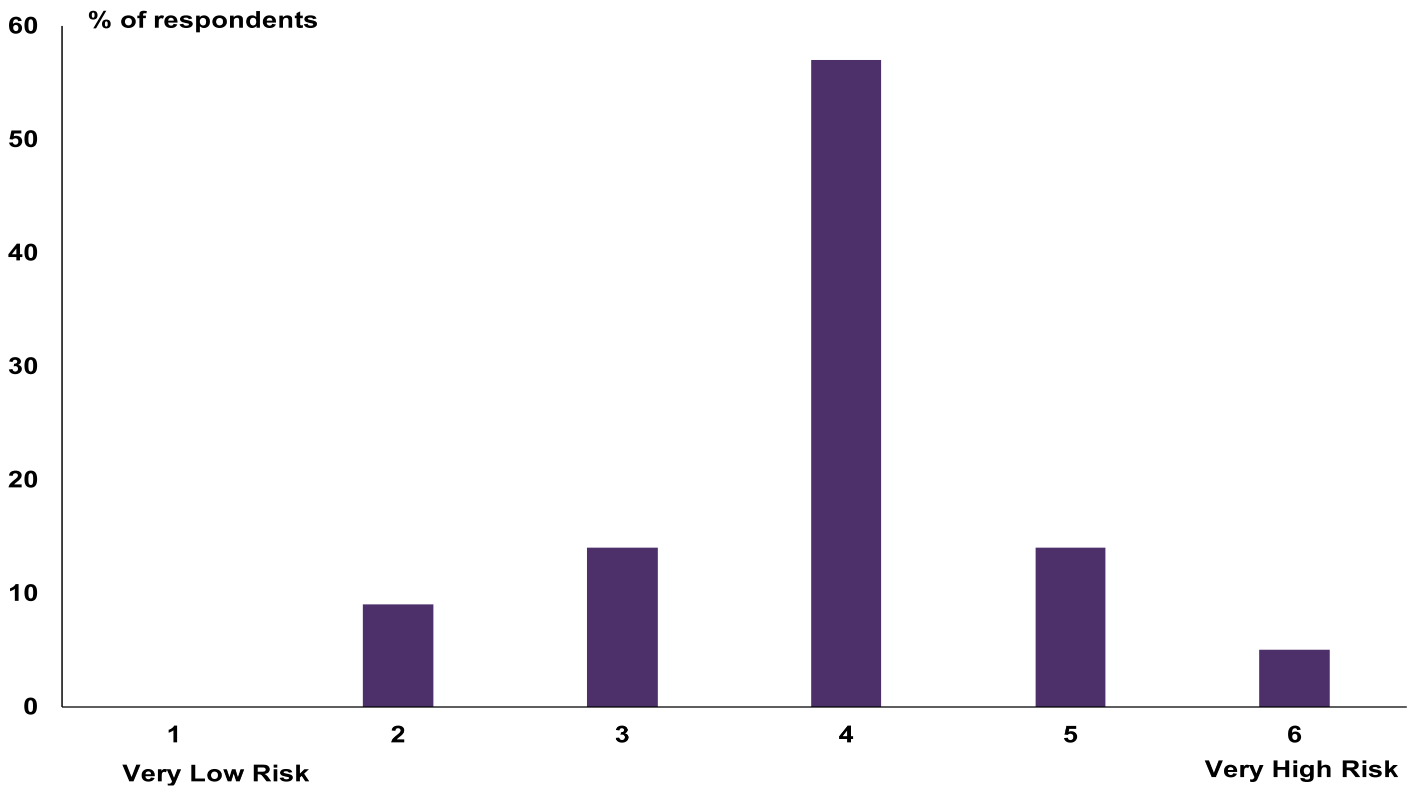


Chart 10: How risky is the current macro environment for returns on commercial real estate investment?



Comments from Survey Participants in North America

Los Angeles

“Market concerns regarding the COVID-19 coronavirus and “Stay at Home” orders have resulted in substantial volatility and increasing uncertainty in the marketplace. As a result, it is difficult to predict what may happen to real property values over time. Tourism, lodging, and tourist-related F&B and retail sectors are likely to feel negative effects first due to the substantial decline in social activity. A prolonged outbreak could have significant impact on other RE sectors”

Toronto

“Office and Industrial continue to do very well with high demand for space and low availability. Retail, as in many markets, is struggling with increasing bankruptcies and increasing vacancies. The current pandemic is drastically changing everything we know”

Ontario

“Covid-19 environment makes future predictions on direction of market extremely difficult. Prime interest rate has dropped .75 basis points in the past two weeks - and may see further decreases impacting credit and markets”

Dallas

“The impact of the Covid-19 virus is hard to estimate at present, but will be significant. Until sales take place, values in this new environment are difficult to assess. However, the impact upon smaller retailers, restaurants and offices is already profound. Many tenants are already asking for rent reductions, and tenant credit will likely be lower. With uncertainty continuing, the outlook for the markets is challenging. Industrial will likely fare best”

Austin

“Conditions are about to deteriorate further with the advent of the Coronavirus”

Nashville

“The Covid 19 virus spread provides changes in the marketplace that we have no history in which to compare. While the results may be similar to the 2008 financial recession, the effects will create drastic long term changes in the office and retail markets”

Information

Global Commercial Property Monitor

RICS' Global Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets. The report is available from the RICS website www.rics.org/economics along with other surveys covering the housing market, residential lettings, commercial property, construction activity and the rural land market.

Methodology

Survey questionnaires were sent out on 11 March 2020 with responses received until 13 April 2020. Respondents were asked to compare conditions over the latest three months with the previous three months as well as their views as to the outlook. A total of 2604 company responses were received, with 592 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland. Responses for Spain and Portugal were collated in conjunction with Iberian Property. Responses for New Zealand were collated in conjunction with Property Council New Zealand.

Responses have been amalgamated across the three real estate sub-sectors (offices, retail and industrial) at a country level, to form a net balance reading for the market as a whole.

Net balance = Proportion of respondents reporting a rise in a variable (e.g. occupier demand) minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%). Net balance data can range from -100 to +100.

A positive net balance reading indicates an overall increase while a negative reading indicates an overall decline. The RICS Occupier Sentiment Index (OSI) is constructed by taking an unweighted average of readings for three series relating to the occupier market measured on a net balance basis; occupier demand, the level of inducements and rent expectations. The RICS Investment Sentiment Index (ISI) is constructed by taking an unweighted average of readings for three series relating to the investment market measured on a net balance basis; investment enquiries, capital value expectations and the supply of properties for sale.

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AFIRE is the association for international real estate investors focused on commercial property in the United States.

Established in 1988 as an essential forum for real estate investment thought leadership, AFIRE members gather throughout the year to help each other become Better Investors, Better Leaders, and Better Global Citizens through conversations, research, and analysis of real estate capital markets, cross-border issues, policy, economics, technology, and management. Representing a "who's who" in the global real estate investment industry, AFIRE membership is exclusive to principals and senior executives. In addition to meetings throughout the year around the world, AFIRE publishes research, analysis and original thought that includes SUMMIT, the AFIRE journal of ideas, insights, and member points of view; surveys on global investing, leadership, and management best practices; and books, such as the AFIRE Guide to US Real Estate Investing.

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