A Long & Winding Road: The Outlook for Commercial Real Estate's Recovery
W/ RICHARD BARKHAM [08.07.2020]

Spencer Levy
I'm Spencer Levy and this is the Weekly Take. 2020 has been an unprecedented year. Hard to believe we're only little more than halfway through. But as we pass the midway point, still facing burning questions about the pandemic, the economy and an uncertain future, CBRE is publishing a comprehensive outlook on the state of markets and industries around the world.

Richard Barkham
The word unprecedented is used quite a lot, but in this particular case, it is valid.

Spencer Levy
That's Richard Barkham, CBRE's, Global Chief Economist and one of the leading authors of that report. Richard joins me from Boston to take a mid-term look at the markets, the real estate business and beyond. That's right now on the weekly take.

Welcome to The Weekly Take.

And my guest today is my friend, colleague and first second time guest on the weekly take, Richard Barkham, the Global Chief Economist for CBRE, the America's Head of Research. Richard, welcome.

Richard: Spence, delighted to be here.

Spencer Levy
The reason why we're bringing Richard back, among other things, is we just wrote a terrific new report, our mid-year global real estate outlook. And we normally don't do a mid-year report, but this year, circumstances certainly warranted it. So, Richard, tell us what's in the report and why we decided to do it.

Richard Barkham
So we've been to our research teams around the world and we've had a deep dove on the economy. And we're looking at just the progress of the recovery around the world. And then very quickly, we're going into what that means for capital markets and what it means for all of the sectors, what it means for offices, what it means for retail, what it means for industrial and what it means for alternative.

Richard Barkham
So it's been a very unusual year. God willing, the crisis of COVID-19 is coming to an end and we are in a recovery phase. But the COVID-19 crisis has raised some questions about real estate, and we're seeking to answer those in our Global Real Estate 2020 Mid-Year Outlook.

Spencer Levy
Well, let me ask about the timing of that. I know it's mid-year and we're in August, but the world is changing so rapidly. I use the example of our industrial forecast that at the beginning of the year was one thing, but now it's actually better today than it was then. But things like the office, extraordinarily fluid with work from home retail restaurants are still largely closed. How much of this report is going to be durable over the next couple of months?

Richard Barkham

Well, there are many aspects to recoveries. We've seen recessions before. We've seen recoveries from recession before. We're able to take that perspective and think through what it means for real estate.

Richard Barkham
So we want to look at really what the recovery means over the next 12 months if we slow, in some cases quicker in others. But it will play out in real estate. And I think our clients want to understand how we think each of the sectors is going to perform over the next 12 months.

Spencer Levy
We first spoke, I guess, about two or three months ago, and at that time we were both in the optimistic camp for the macro economy. We were optimistic for commercial real estate, but not nearly as so. Talking about these and Nike swoosh and other things like that, Richard, where are we today on the macro economy?

Spencer Levy
On the macro, I would say a little less optimistic. I think the virus flare up in the United States is put a little bit of a dampener on the US recovery, but not too much. The global economy is still in recovery phase. Certainly that seems to be the case in APAC and it is in EMEA. Maybe we've taken a pause on recovery in the United States, but we are bouncing back. The real time data shows that. So, broadly speaking, we remain optimistic.

Spencer Levy
Well, Richard, let me let me run right to it. It's fair to say that in the last six weeks or so, I think the intensity of the concern over our optimism has gotten greater. What do you say to those people?

Richard Barkham
Well, I think it reflects a little bit. The real estate market, you see most recessions create specific casualties. They're all the same, but they're all slightly different. In 2000, the specific casualty was the tech sector. In 2008, specific casualty was the banking sector and maybe the housing mortgage industry as well. I have to say, I think that real estate may be the specific casualty of this particular recession, or at least I should say the office sector, because the office sector really thrives when our big cities are thriving and COVID-19 is clearly, you know, put a doubt around mass transit. Some of the negativity that we see out there reflects the fact that the people we talked to are in an industry that has been particularly hard hit by the crisis. But I don't think that's true of the economy as a whole. And indeed, there are many bright spots in the economy as a whole.

Spencer Levy
Well, let me let me go to that point on the office market getting hit very hard today. What gives you your point of view that the office market is going to be challenged over the long term?

Richard Barkham
Well, I didn't mean to say that it would be challenged over the long term.

I mean, what we've seen in the course of the crisis is just the rapid growth of the digital economy, in particular, the rapid adoption of technologies around meetings. I think it just gives businesses much more flexibility about how they run their platforms with much more scope for people working from one or two or three locations and remote working. And, you know, we remain convinced, I remain convinced that the office sector is viable in the long term. It's where people meet. It's where creativity happens. It's where clients get helped. That's where we train and bring in younger people into the workforce. And all those things are going to need to reestablish themselves. I think what I meant was really that, you know, the economy took a big hit from COVID-19, which it will recover from. I think the office sector took an even bigger hit. It's a specific casualty will bounce back. But the near term outlook is not that bright. And are people we talk to looking at the world from that perspective?

Spencer Levy
Let's get a little wonky here for a second. Richard, I want to know, for all the clients that are asking us and we know there's dozens of our clients asking us every day: how do we predict the future in office? What do we do? How do we do that, Richard?

Richard Barkham
Well, I think, as you say, we need to get a little bit wonky, really. We need to first work out broadly speaking, what we think are the number of people that are going to work in the office full time, always in the office after the crisis is over. And I think we were in a situation where it was about 63 percent of people worked in the office the whole time prior to the crisis. We had in our recently released Real Estate 2030 outlook, which was released prior to the crisis, thought that that might drop to 52 percent. I've seen some estimates now that that post-crisis the number of people that work only in the office might drop to 20, 25 percent. So we're working that through when more of the office population work more remotely. What that means for office demand. We've had the wind behind us over the last 20 or 30 years, which is continual growth in the office sector, continual growth in the amount of space that's devoted to office. Of course, you've got offsetting pressures as well. One is that people may need more space. The reverse the trend densification. Under most of the scenarios I've seen, the trend to remote working is offset by decreased densification. I don't know that we can rely on decreased densification in the long term.

Spencer Levy
So, Richard, let's pull the lens back out again. Let's go back macro for a moment. Are there some macro things that you want to address as it relates to our forecast, specifically government support. And we've seen the massive amount of fiscal and monetary stimulus from the U.S. The EU has jumped in. China has jumped in. How important was it to where we are today and how important will it be for the economy to continue to recover going forward?

Richard Barkham
Enormously important, Spence. You know, the COVID-19 caused private sector demand dry up, actually not COVID-19, let's get it right. It was a lockdown that the governments introduced caused private sector demand to dry up and the government had to step in to provide support for workers. And the central banks have had to step in and provide liquidity and they have done so. The word unprecedented is used quite a lot. But in this particular case, it is valid. Governments around the world have used unprecedented levels of stimulus, wartime levels of stimulus to keep the economy going. It hasn't been quite as easy as we first thought to get the virus under control. And I don't think we're far away from getting a vaccine, but it is likely to keep the recovery on track we're going to need more stimulus, fiscal stimulus around the world. And I think, you know, one reason we're optimistic, I think that that's what will happen both prior to the US election and post-election. So very important, particularly central bank liquidity. And it's really, I think you'd agree, really remarkable how credit markets have remained open. I mean, credit markets a bit more conservative now, but they didn't really break step for a major recession. That just tells you how vigorous an effective central bank liquidity support has been.

Spencer Levy
Well, I would agree with you. But there are some people who are concerned about unleashing inflation. They are concerned about the deficit. They are concerned about the long term implications of spending all this money. What is the long term implication of spending all this money?

Richard Barkham
Governments are going to end up with debt to GDP ratios that are much higher. And, you know, we will have to pay for some of that debt out of our taxes. Our children have to pay. You know, some of their taxes will go to paying the interest on that debt. In the case of certain countries, you might find that they issue so much debt that the market decides they can't repay that interest. So, you know, interest rates will go up. I don't think that will happen in the United States. But, you know, we will ourselves and our children will probably end up paying a little higher tax to pay for this recession, to pay for the support on this recession. I would argue it's money well spent. And you know that that's what we're doing ourselves a favor from staving off the worst damage that will come along and the effect of a recession. But I do think. There's an interesting statistic I am fond of quoting Spence, which is over the last 10 years, we've had monetary growth in the United States of about four per cent per annum and we've had a decade of low inflation. US monetary growth in the last three months has been about 100 per cent. So there has been a big build up in the money supply. And not every economist believes that the growth in the money supply fuels inflation. But I think a combination of factors with the build up of the money supply, fiscal stimulus, we may even get more reassuring of economic activity or manufacturing activity, too high cost locations. Perhaps all those three things add up to a higher rate of inflation going forward than people currently expecting, not in the near term, but maybe 24, 36, 48 months.

Spencer Levy
So let's turn back to commercial real estate for a second. Let's talk about alternatives. When people are looking outside the five major asset classes, where are some of the opportunities and alternatives that you think may have accelerated as a result of COVID?

Richard Barkham
Yeah, I think it would be fairly obvious to mentioned data centers. I mean, they were a pretty hot alternative. But, you know, the growth of the digital economy is extremely good for data centers. And I think also if we were to look within industrial and logistics, logistics is clear beneficiary of the growth of the digital economy. And interestingly enough, Spence retail sales are now back to their pre COVID levels. And not all of that is going through stores that's going through our industrial and logistics sectors. That's very hot at the moment and looks likely to continue, but within that sector as well. I think particularly in the United States, the growth of refrigerated logistics, you know, as e-commerce gets into the grocery sector is another alternative that is likely to do well out of COVID-19. Not every alternative benefits from COVID-19. Student housing, seniors housing, maybe, you know, that kind of communal living has been a little called into question by COVID-19. But I think in that case, we need to remember that, you know, there will be a world after COVID-19 and the long term demographics points, you know, heavily towards more seniors housing and also more student housing.

Spencer Levy
Richard, let me ask you an aspect of this report, because it's not just a U.S. report, it's a global report. So let's talk about that for just a moment. Let's go outside the United States to Canada, to Latin America, to Europe. And many of these places are struggling, much like the U.S. is today with the crisis of the virus. Some of them are doing much better. Why is that? And what will be the short and long term implication of that for the growth of our economies outside of the United States?

Richard Barkham
Well, Canada is doing well. Canada's done very well at controlling the virus. I mean, Canada always seems to have a nice blend of American dynamism and European planning and a European social provision. And in recent years as well, Canada, because of its resource bases, has done very well on the on the back of China growth. And Canada as well has a very, very interesting immigration policy. It's been one of the most successful economies in the world at attracting graduates. So Canada and

Australia, big, big attractors of graduates and Canada goes after talent around the world. So I think, you know, there is a lot of positives with Canada.

And I think, you know, within LATAM, I mean, Mexico being part of NAFTA is clearly an essential part of the US auto and manufacturing industry now. And so Mexico will do well when the US bounces back. And, you know, to a certain extent, as the US does well, that provides a market for Latin America. But Latin American exports have boomed in recent years, largely on the back of China growth. If China struggles in terms of its growth rate, that could be, you know, less optimistic for parts of Latin America going forward. So it's a mixed picture. But but but largely good. We've got to always remember Spence that although it's a hard thing to say at this point, recessions are rare. Growth is the norm. Take the last hundred years, the number of years in which you've actually had falling GDP, probably less than 10 percent growth is the norm. So, you know, everything bounces back to growth. You know, if it's given good stimulus and has a good business friendly environment.

Spencer Levy
Well, that's an optimistic comment for sure. But let's get a little bit more micro, a little bit short term right now.

It does appear that Asia is doing a better job handling the virus than the United States. And there are certain markets, Germany in particular in Europe, that are doing a better job in the short term, at least than the United States. What have they done that we haven't? And what does that mean for their economic growth versus that in the United States?

Richard Barkham
I think they'd been much better at social distancing and mask wearing. And in the first instance of the crisis, they managed to enforce a lockdown much more successfully. They controlled the virus, but it came at the cost of the economy in the US, much less effective lockdown, but actually a lower impact on the economy. But going forward, you know, I think the kind of the lack of ability that the flare up in the virus in the states is clearly causing a very promising recovery in the states to ease back a little bit. And we don't see that so much in Europe. We see the recovery on track in Europe, and APAC.

Spencer Levy
Will we see an influx of foreign money coming to the United States because of the cheap U.S. dollar, cheap hedging costs make the U.S. on sale.

Richard Barkham
And that would be the normal pattern, Spence. You know, I think people for the last several years, 23 years, Asian investors in particular, have found it difficult to invest in the United States because of the high value of the dollar and the hedging costs. That's all eased off now. We have heard some instances in the U.K. of transactions going through where the buyers have been Asian and they have not even visited the property. But I still think probably the lack of ability to travel is going to hold back foreign capital coming into the US. But I can't help but think in talking to investors that a lot of eyes on the US as an opportunity. As soon as the travel picks up, as soon as the restrictions come off, I can't help but think there will be a real strong upsurge in capital markets activity. And I suspect because of that, although all of the fundamentals point to rising cap rates, we're not actually going to see rising cap rates. Partly that's because there's insufficient evidence and trading to crystallize those cap rates. But partly because I think, you know, sellers will hold on until late. They achieve the prices that they want. And before long, foreign capital will be back in a bidding quite aggressively.

Spencer Levy
Well, we've got a lot of uncertainty between now and 12 to 18 months from now whenever this crisis is

over. Let's take out our crystal balls here for a moment. And I'm not going to ask you who's going to win the U.S. presidential election, but that's certainly another piece of uncertainty out there that some of our investors may cite for more or less capital before the election. But from your point of view, here we sit today on August the 4th, 2020 when we sit here again on August the 4th and 2021. Are we going to be in our offices? Are we going to have an economy that's continuing to grow? Or are we still going to be similar to what we are today?

Richard Barkham
So I'm going to say yes and yes. We're going to be back in our offices and the economy will be growing. The year will have turned out much better than we expect right now. So, you know, I can understand the lack of confidence that the flare up in the virus, particularly in the United States, has not been well handled. It dealt a big blow to confidence and that might delay the recovery.

The Q3 recovery may not be as strong as we previously expected. But the Q4 recovery will be more stimulus will come along. And we're not, as I have said, I think, too far away from a generally available vaccine. It may not be a cure all, but therapeutics are coming. And so I think the outlook for 2021 is much better than people expect. We will be back in our offices. We will be back in shops. And the economy will be growing at a fair old clip. Well, ahead of the two percent that we had predicted pre-COVID.

Spencer Levy
Next crystal ball question. I did two hundred thousand miles last year and you probably get about the same. When's your next business trip?

Richard Barkham
I don't see that taking place till Q1 next year at the earliest. And we talked earlier about, you know, specific casualties. And the travel industry is one of those. So the airlines that continue to feel this COVID crisis until a proper therapeutic comes along. I was in the process of planning a trip to Asia to take place in October this year, but I don't think it's going to happen.

Spencer Levy
Well, I was able to make two trips to Europe this year, and I don't see me getting back to Europe anytime soon. And by the way, this year I'm turning 50. And I was supposed to go to Ireland this summer to play golf to celebrate that birthday party. So do my friends in Dublin and in Belfast and elsewhere. I'm sorry I won't see you this year, but doggone it, I'm going to be there next year. So, Richard, last thought, still optimistic and what do you say to those folks who aren't?

Richard Barkham
I say that growth is the norm. These big shocks can be very, very uncomfortable. But history tells us we always bounce back. This is a particularly tricky kind of shock because it's a virus that we can't quite fight right now. But the tools are available. We will get in control of the virus and the vaccine is coming. And I think with the stimulus and the pent up demand, it still points to a to a strong economic growth in 2021.

Spencer Levy
Well, Richard, you and I don't agree on everything, but we are both optimistic. So on behalf of the Weekly Take, Richard, I want to thank you for being my friend, my colleague, and being our first two-time guest on the Weekly Take. Hope to see you again in a few months when hopefully the economy is continuing to improve. Thank you very much. Richard.

Richard Barkham

Thanks Spence, nice to be here.

Richard Barkham
To read more about CBRE, his outlook on the global economy, check out our 2020 Mid-Year Global Real Estate Market Outlook at CBRE.com/GlobalOutlook. It's a truly fascinating, informative report. It couldn't have come at a better time. And for more information on our show, go to CBRE.com/TheWeeklyTake. Until next time, I'm Spencer Levy, be smart, be safe, be well.