THE
WeeklyTAKE

MARKET UPDATES

COVID-19 Impacts on U.S. Commercial Real Estate

May 1, 2020

WEEK IN REVIEW

Ignore Q1 GDP; Difficult Q2 Will Give Way to Staged Recovery

- We appear to be past the peak of infections, but U.S. GDP is expected to contract severely in Q2 before giving way to stronger growth starting in Q3, supported by government stimulus and pent-up demand.
- While New York faces job losses in April and May, office-using employment is down only 0.8% from its peak, reflecting the local economy's strength heading into the crisis.
- First-quarter seasonality typically reduces Chicago's total employment by 2.0%. The drop in Q1 2020 was not far off at 2.5%. With stay-at-home restrictions through May 30, job losses likely will worsen.
- Los Angeles job losses have been heavily concentrated in retail and hospitality; a quick rebound is anticipated as the local economy may reopen within weeks.
- Dallas/Fort Worth, Houston and Atlanta are hopeful markets to watch as their economies begin to reopen in phases.
- Washington, D.C. has been less severely impacted than other markets and has a stable outlook, underpinned by the government sector.
- Boston and Philadelphia are bolstered by a tenant base weighted to life sciences, which remains a growth sector.
- The presence of fledgling venture-backed firms raises caution in tech-driven San Francisco.
- In Asia Pacific, loosening restrictions in Hong Kong, Shanghai and Beijing have precipitated economic growth as retail activity picks up under a phased reopening.

ECONOMY

In Height of the Storm, Positivity Remains

U.S. GDP contracted by 4.8% in Q1, slightly better than CBRE's expectation of negative 5.1%. The big hit to the economy will come in Q2, with an expected decline of around 42%. However, the economy likely will stabilize and begin to recover long before Q2 GDP is announced in late July. Initial unemployment claims, although unacceptably high, are trending down week-on-week, with 3.8 million claims this week and an estimated 3.0 million next week. Nevertheless, April employment numbers, reported next Friday, will be grim. There has been strong demand for small-business support funds (Paycheck Protection Program), as government stimulus is finally kicking in. Further emergency stimulus of around $2 trillion likely is forthcoming, on top of the $3 trillion already provided. Alongside pent-up demand and government backing for economies elsewhere in the world, these measures will drive growth of 29% in Q3 and 10% in Q4, which will ultimately reverse the rise in unemployment.

NEW YORK

Minimal Impact from Job Losses in March; More Expected, but Some Positive Signs

March employment in New York City declined significantly, particularly in office-using sectors such as financial, professional and business services. These losses likely will mount in April and May. However, New York City office-using employment is only down 0.8% from its peak, reflecting the local economy's strength heading into the crisis. There has been little increase in office sublease space, and average asking rents have held steady to date. Through April 24, no major Manhattan office occupier has filed a Worker Adjustment and Retraining Notification (WARN) with New York State indicating plans for substantial layoffs—an encouraging signal of near-term market stability despite the ongoing COVID-19 crisis.

LOS ANGELES

Professional Services Sector Remains Resilient Despite Widespread Job Losses

Office-using employers in Southern California shed a relatively modest 11,800 jobs (-0.5%) in March. Regional layoffs and furloughs totaled 219,000 through mid-April and are concentrated in the retail and hospitality sectors. Approximately 88% of the job reductions are temporary, suggesting a possible rebound in employment once social-distancing regulations are eased. Local government has indicated that a phased reopening of the economy could begin in two weeks if infection rates continue to slow. If the moderate impact to office-using employment is sustained, Southern California's office market could be spared from the severe dislocations that are hammering the retail and hospitality sectors.

CHICAGO

Stay-at-Home Order Extended Through May 30; Negative for Jobs

First-quarter seasonality typically reduces Chicago's total employment by 2.0%. Preliminary numbers indicate this year isn't far off, with employment dropping by 2.5% or 95,500 jobs, including 19,000 (0.5%) in March. Leisure, hospitality, trade and transportation were directly impacted by social-distancing guidelines. However, professional & business services—a sector with many office-using jobs—lost 12,500 (1.8%) in March alone. With Illinois extending its stay-at-home order through May 30 and the mounting weekly initial jobless claims, these numbers likely will worsen over the next two months.

DALLAS/FORT WORTH

Largest Decline in Employment on Record

March employment in Dallas/Fort Worth (DFW) declined by the largest annualized rate on record (-9.3%), according to the Dallas Fed. The Fort Worth-Arlington metro had the biggest drop of 18.4%. Nevertheless, DFW had the largest year-over-year Q1 employment gains in the country, with 86,200 jobs added. Looking ahead, shopping centers (including malls), restaurants and movie theaters will be allowed to reopen at reduced capacity of no more than 25% occupancy beginning today. This will be the first step in getting the retail and F&B sectors on the road to recovery—industries that together account for about 20% of DFW's total employment.

HOUSTON

Oil Price Crash & COVID-19 Create Biggest Challenge in Decades

The combined impact of COVID-19 and the oil price crash has yet to be fully reflected in Houston's economic data. With 577,000 sq. ft. of negative net absorption in Q1 and a vacancy rate already at a historically high 20.0%, Houston's office market fundamentals are expected to deteriorate further in 2020. Recent estimates are that nearly 400,000 initial claims for unemployment insurance were filed in the Houston metro since early March. On the positive side, Houston—and all of Texas—will begin the first phase of reopening its economy today, encompassing shopping centers (including malls), restaurants and movie theaters (at no more than 25% occupancy).

WASHINGTON, D.C.

Strong Public-Sector Presence Drives Continued Job Growth

Washington, D.C.'s economy had been gaining momentum in early 2020, with jobs growing at their fastest rate in almost three years. In March, however, job growth declined to a year-over-year rate of 0.9%, compared with 1.7% in February. Largely due to the stabilizing presence of the federal government, the decline in job growth was less severe than for other large cities. Notably, office-using employment was barely affected in March, while the impact on leisure and hospitality employment was relatively moderate. While the federal government's presence will limit the damage to the region's economy, historically high office vacancy will climb further in the near term.

PHILADELPHIA

Diversified Economy Provides Employment Stability

Greater Philadelphia's diversified economy should enable it to sidestep the most severe impacts of this downturn. March employment growth decelerated to an annual rate of 0.4%, a less severe drop than nearby markets like New York and Boston. The world-class educational and health-services institutions, which account for 34% of Philadelphia's jobs, have spawned dynamic life-sciences activity that should provide considerable stability for local commercial real estate markets. Construction activity, which had been strictly curtailed, has been approved to restart today.

ATLANTA

Georgia First State to Attempt Reopening

The shutdown of the economy has driven statewide unemployment in Georgia to 13.6%, the nation's fourth highest rate. Among states with stay-at-home orders, Georgia is the first to begin the process of reopening its economy. Non-essential businesses, such as barbershops, gyms and nail salons, were permitted to open on April 24, followed by movie theaters and dine-in restaurants on April 27. If successful, the phased reopening will provide business owners an opportunity to bring back workers and generate income, which in turn will provide some support to retail property fundamentals.

BOSTON

Life Sciences a Bright Light Despite Disruption to Tourism Economy

The Boston life-sciences market, particularly biomanufacturing, has been resilient, with leases continuing to close and companies with new requirements entering the market—including some that are interested in repatriating manufacturing operations from overseas. It is anticipated that life-sciences markets will remain almost as tight as they have been over the past few years. More than 80,300 Massachusetts residents filed a claim for unemployment insurance last week for a total of more than 630,000 since mid-March (approximately 17% of the state's labor force). This was a 28% drop in claims from the previous week, as many workers who lost jobs in the wake of non-essential business closures mandated by the state on March 23 filed claims in prior weeks.

SAN FRANCISCO

April Job Losses Expected Among Fledgling Tech, Hospitality and F&B Companies

As California's total unemployment claims reached 3.4 million this week, the state continues to prioritize citizens' health and safety by maintaining its shelter-in-place order. The hardest hit are individuals employed in the leisure and hospitality and retail trade sectors, which make up nearly 18% of the Bay Area workforce. Many of these workers are temporarily jobless, but the city and county of San Francisco are more dependent than most markets on the stability of fledgling tech firms (often venture-capital-backed), as well as hospitality and F&B companies. Notably, additional data shows that there have been more than 30,000 tech layoffs and furloughs globally, with nearly one-third of them in the Bay Area. Social distancing measures have resulted in deferred real estate decisions and reduced demand to 3.9 million sq. ft. in Q1, resulting in supply outpacing demand by more than 2:1.

ASIA PACIFIC

Further Signs of Recovery in Greater China

Hong Kong reported no new COVID-19 cases on April 28 for the fifth time in nine days. This prompted the government to announce that quarantine restrictions on schoolchildren and businesspeople traveling from mainland China would be relaxed soon, and civil servants will return to their workplaces on May 4. In-store retail activity has picked up in recent weeks, although the F&B sector will take longer to recover as it remains subject to certain social-distancing restrictions.

In mainland China, the delayed annual general assembly session of the National People's Congress will commence in Beijing on May 22, reflecting the central government's confidence that the pandemic is under control. While some restrictions on business and social activity remain in place in Beijing, partly due to the upcoming NPC meeting, Shanghai is seeing a strong uptick in retail activity. One luxury retailer reported weekly sales recovering to levels of the same period a year ago, while others are importing large volumes of goods to meet excess domestic demand resulting from Chinese shoppers' inability to travel abroad. In the office sector, most companies have reopened their workplaces, with the lack of business travel and a reduction in in-person client meetings resulting in above-average attendance and near-full capacity. While some firms have allowed employees to continue to work from home, the experience in China underlines the need for a staged resumption of office operations and the close monitoring of capacity.

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