Q2 2020

COMMERCIAL REAL ESTATE
MARKET REPORT

JOHNSON NATHANIEL

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INTRODUCTION

To say that 2020 has been an eventful year would be an understatement. Significant global and domestic issues have filled the headlines from devastating brushfires in Australia to the impeachment of President Donald Trump to widespread protests in the United States. All of these significant events were colored by the prevalence of COVID-19, the most significant global health emergency since the 1918 influenza pandemic.

In times of uncertainty, information becomes even more valuable and that is one of the many reasons why Johnson Nathaniel has chosen 2020 for the inaugural issue of our commercial real estate market update. As one of the most significant components of the global economy, commercial real estate is uniquely affected by cultural, economic and social events. With this backdrop of our goal is to provide readers with timely information on a quarterly basis that touches on the current economic and real estate environment to help inform better decisions now and tomorrow.

We hope you will find this inaugural issue informative and helpful, and we welcome your feedback. In the future, we plan to incorporate areas of particular interest to our readers as well as timely survey information.

Please stay safe and healthy.

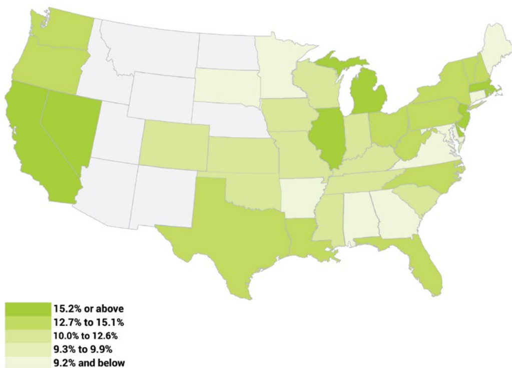
Visit johnsonnathaniel.com for additional insights.

GENERAL ECONOMIC OVERVIEW

COVID-19 makes itself felt

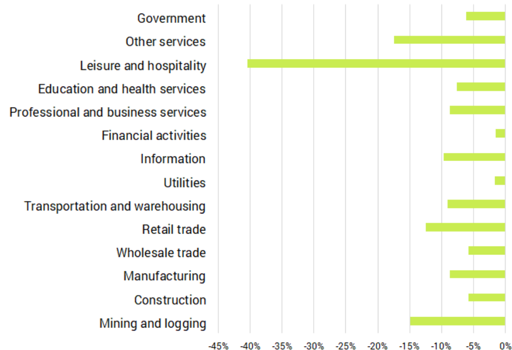
Government restrictions imposed to control the spread of COVID-19 resulted in widespread unemployment in the second quarter of 2020. As the map below shows, the densest population centers have suffered the most unemployment.

State unemployemt rates, May 2020, seasonally adjusted

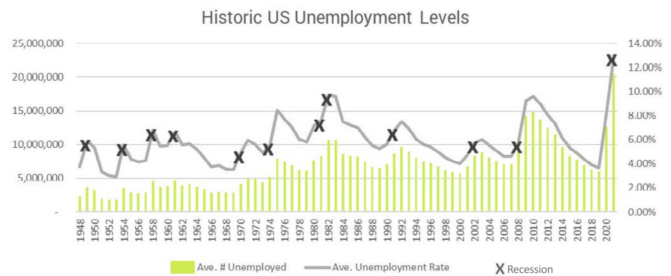


The wave of unemployment has also been unique in that it has lopsidedly impacted younger and lower income workers as sectors that relied on those cohorts for their employees, such as retail, restaurants and hospitality, were particularly hard hit.

12-month percent change in employment by industry

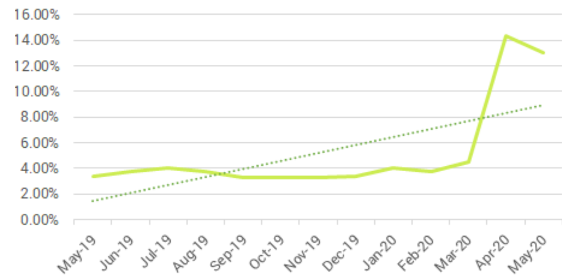


Unemployment spiked to historic levels, from some of the lowest recorded levels in the first part of 2020 to levels well above those observed during prior recessions.



Unemployment levels not only reached historical levels, but did so in an unprecedentedly rapid fashion from March to a peak in April 2020.

Trailing 12-month unemployment rate



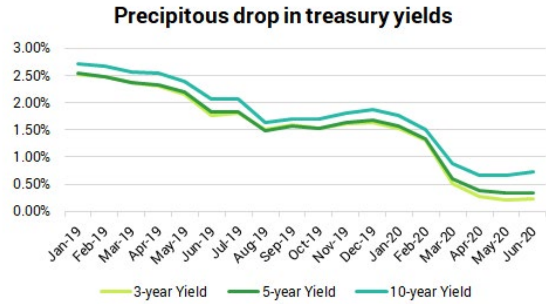
Government response

Significant government aid and assistance programs totaling $2.3 trillion are expiring or exhausting their allocated funds.

— The Coronavirus Aid, Relief, and Economic Security (CARES) Act Funds

Source: U.S. Bureau of Labor Statistics

- Economic impact payments – one time grants of $1,200 for single and $2,400 for married filing jointly taxpayers in March 2020, subject to income limitations
- Paycheck Protection Program (PPP) – $131 billion in funding remaining for small businesses as of June 27, 2020, per the US Treasury Department. The filing deadline was extended to August 12, 2020.
- Coronavirus relief



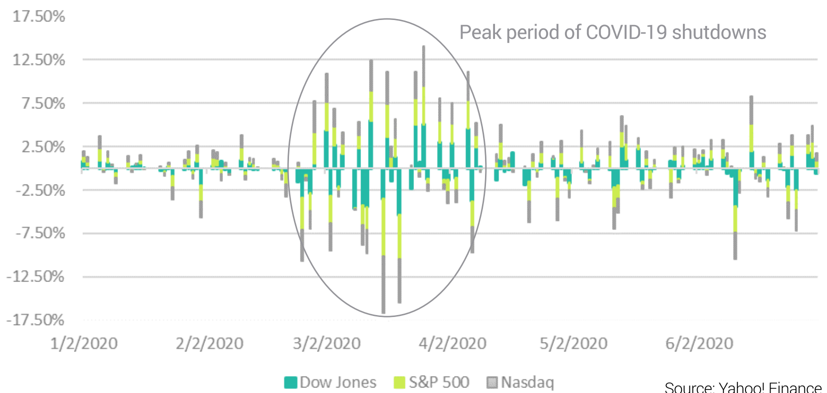
Source: U.S. Department of the Treasury

- Employee retention credits – refundable tax credit of 50% of wages up to $10,000 applies to wages from March 13, 2020, to December 31, 2020
- Leave credits – tax credits for paid family leave for employers with less than 500 employees for wages from April 1, 2020, to December 31, 2020

Federal Reserve activities to prop up markets have resulted in sudden and dramatic drops to Treasury yields.

Financial markets

Despite cheap capital, lenders are increasing requirements and implementing floors; in short, debt is available but only for the right details, which has lead to M&A and commercial real estate markets that are largely stagnant as investors take a "wait and see" approach or struggle to plug financial holes for deals.



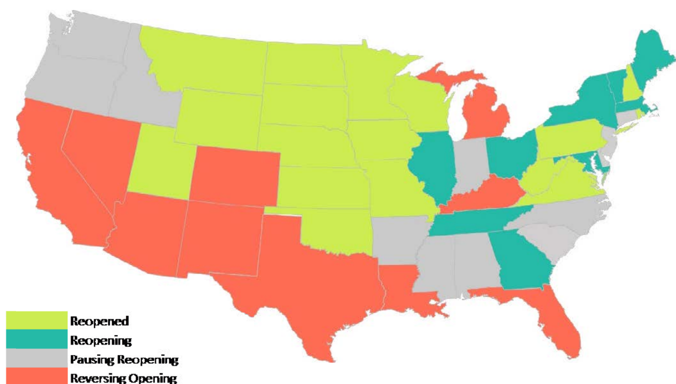
Source: Yahoo! Finance

According to a survey of 50 C-suite executives conducted by the Harvard Business Review, 51% indicated a temporary pause in current deal activity and 14% indicated they were stopping all current deals. The survey did note that late stage deals were still getting done. In addition, 26% of the respondents noted they anticipated no deal volume for the remainder of 2020.

Equities have been extremely volatile as can be seen in the chart above, which tracks the daily change in value of the major market indices over the first half of 2020. The extreme swings are indicative of uncertainty and investors' efforts to reallocate their investments.

Reopening the economy, or not

The peak of the initial reaction to COVID-19 was reached in April when 42 states shut down their economies to some extent. By the middle of June all states had reopened or were in the process of reopening; however, spikes in cases have emerged in numerous states, leading to restrictions being reinstated in some states and the reopening process being paused in others.



*Reopening of states are rapidly changing, map subject to change
Source: The New York Times

Conclusion

The combination of a number of forces has created a difficult environment. The ongoing health crisis has contributed to unstable employment and financial environments, which is exacerbated by the uncertainty of continued government assistance and a developing recession. Together with cultural unrest and a contentious November presidential election, the overall environment is one of extreme levels of anxiety and uncertainty. The overall effect of this at the personal, economic and societal levels is likely limited economic improvement until 2021, at the earliest.

All of the aforementioned issues have tapped the brakes on a commercial real estate market that was humming along in the first quarter of 2020. Real Capital Analytics reported that sales of commercial property sank again in May to their lowest levels since 2010, with no sector avoiding the decline. The industrial space experienced the smallest decline while retail and hospitality exhibited the most significant decline. Real Capital Analytics also notes that the number of deals in the United States falling out of contract is increasing, reaching 2.9% in May up from 2.1% in April and 0.7% in March. Market participants have reported deals falling apart due to an inability to close financing or buyers giving up earnest money (and in some cases entity policies) to avoid a transaction for which the fundamentals are no longer appealing. Notably, in April Blackstone Group exited a potential $405 million deal, giving up a $20 million deposit in doing so. The same week and in the same city Kaiser Permanente canceled plans for a $900 million headquarters.

Despite all of these uncertainties, Americans are continuing to live and work and the commercial real estate markets have continued to operate and serve as a microcosm for how the pandemic affects various areas of life differently. From the devastating impacts on retail and hospitality to the relatively steady-state of the industrial market we touch on these key sectors in the following pages.

SECTION 1:
MULTIFAMILY HOUSING

As a whole, multifamily is expected to be one of the more defensive property types as the population will always require places to live and apartments are typically more accessible and flexible than home ownership. In discussions with property owners, we noted that while leasing activity has been down, existing tenants are proving more likely to stay on a month-to-month basis or renew given the uncertain environment. The result is that occupancy has generally been maintained or increased. On the other hand, some tenants face job loss and/or decreased income. So far most operators are reporting higher-than-expected rent collections, though many fear this could be largely buoyed by government assistance, which is set to expire and become depleted.

According to the National Multifamily Housing Council (NMHC), April rent collections through the first three weeks were higher than anticipated, signaling that the fundamentals had not yet been drastically affected by the early stages of COVID-19. Of course, in this period the government was issuing economic impact payments to help people make ends meet. Since then, despite generally better than expected performance, signs are appearing that unemployment and uncertainty are starting to weigh on multifamily revenue. According to research from LeaseLock, June first-of-the-month payments fell 2%, and 6% in aggregate since March 1. LeaseLock further notes that Google searches for rent assistance spiked significantly in mid-May. Data for the week July 1 through July 6 from the NMHC shows that 77.4% of tenants had paid their monthly rent, down from 79.7% in 2019. The summer should be telling for landlords as the number of unemployed and duration of unemployment increases with COVID-19 cases surging again in many markets.

The CARES Act instituted a 120-day moratorium on evictions and late fees for properties in receipt of any federal funds and there are some forces at work to assist owners of residential property including the loan forbearance periods granted to landlords by government-sponsored enterprises, which should also help alleviate the short-term impact of the crisis.

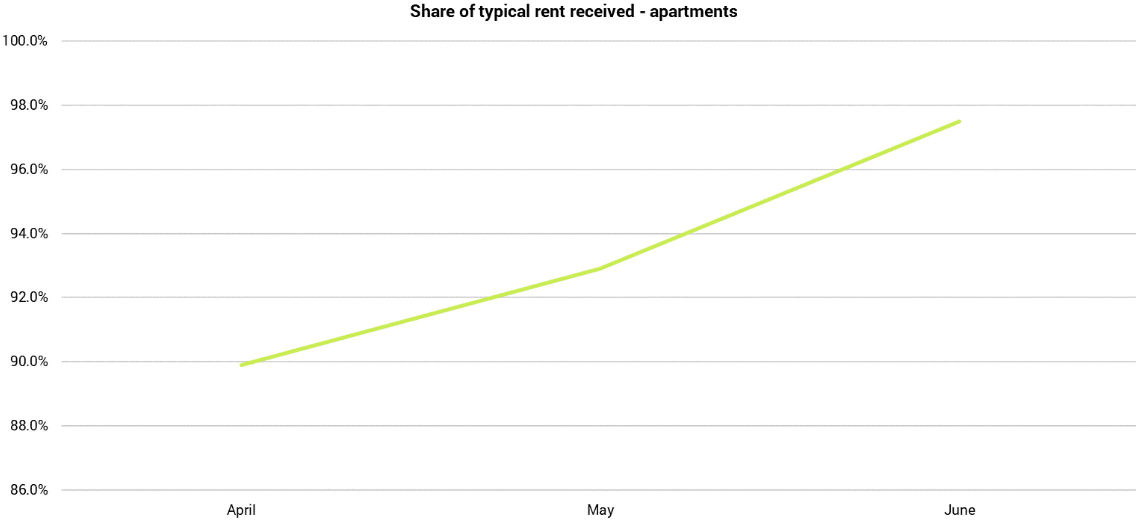
The long-term impact of COVID-19 on the multi-family asset class is uncertain, but structural changes are likely. Any shift in the workplace environment will trickle down to the residential environment as people generally balance the preference to live close to work with desires for greater amenities, more space, and better education options, among

other considerations. Could a reduction in commuting to large urban office centers negatively impact transit-oriented developments? Will a trend of reverse urbanization occur where telecommuting employees leave major cities to seek cheaper rents and more space in suburban or rural communities? Will the current environment of civil unrest in major cities tip people considering a move out of the city center to do so? At this time, there are more questions than answers.

Transaction activity has been limited, particularly as “pre-baked” deals have generally closed or been canceled. The past three months have seen little in the way of new deal origination. Social distancing measures have presented issues in performing diligence, but activity is not at a complete standstill. Notably, Greystar Real Estate Partners has acquired five assets since April 2020 and deployed over $275 million in the second quarter. Nonetheless, according to CoStar News, U.S. apartment sales fell from $30 billion in Q4 2019 to $10 billion in Q1 2020.

Given the absence of significant transactions, little evidence beyond the anecdotal exists for the impact of current events on cap rates; however, consistent with past economic disruptions, a brief uptick in cap rates would not be unusual.

REITs have also reported generally favorable rent collection data based upon data from NAREIT. After initial dips, which were likely based on an anticipation of poor performance at the property level, collections have increased as assets have generally performed better than expected.



Source: National Association of Real Estate Investment Trusts (NAREIT), per survey of members, public disclosures and FTSE NAREIT REIT index equity market capitalization as of May 31, 2020 via FactSet. Weighted based upon equity market capitalization.

In general, given the uncertain transactional environment, institutional investors are focused on managing their current assets, evaluating opportunistic deals and tenant health, and dealing with requests for rent relief while awaiting further clarity on the future.

SECTION 2:
OFFICE

One of the most notable cultural shifts precipitated by COVID-19 has been a widespread adoption of working from home. While few people are prognosticating a complete shift away from traditional urban office environments it is clear that change is in the air. Facebook CEO Mark Zuckerberg has indicated that as many as half of the company's more than 48,000 employees would work from home over the next decade. Twitter and Square both announced that employees would be allowed to work from home "indefinitely."

Some likely trends that have been identified include:

- Moving towards a hub and spoke system where urban core offices are maintained, but likely reduced in size with the addition of numerous smaller suburban or regional offices.
- Reversing the trend toward open offices and lower square foot per employee as companies provide space for their employees to maintain distancing. The need for more space per employee will serve as a buffer against the reduction of office demand.
- Shifting suburban office environments from standalone islands in a parking lot to integrated mixed-use environments with open spaces and live/work components.
- Moving to flexible or team-based scheduling in which employees who were traditionally 100% in the office combine some mix of working from home with office time.

Since the onset of the COVID-19 pandemic, investors and property owners alike knew that rent relief would be a primary component of handling the crisis for both tenants and owners. JLL notes in a May 2020 report, "Measuring the Impact of COVID-19 Across U.S. Office Buildings," that requests for rent relief mounted from the week ending March 6th to April 3rd, then tapered off. The report further noted that just under half of rent relief requests were from retail or non-office space users, which is consistent with the undue impact of COVID-19 on retail and service providers.

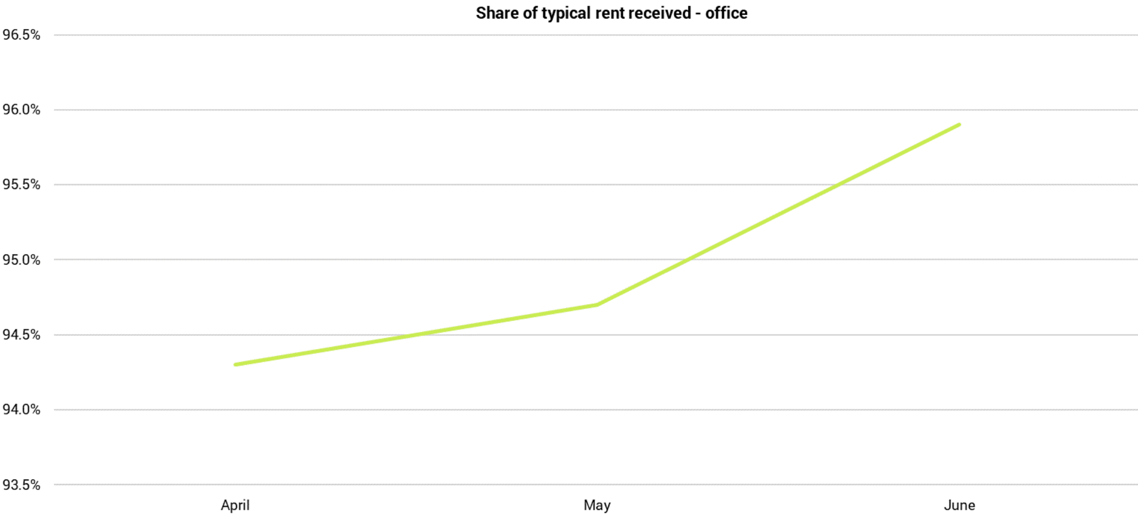
Based on discussions with market participants Baker Tilly noted that property owners are facing significant challenges in evaluating requests for rent relief.

Separating those tenants seeking to take advantage of the situation from those in genuine need of assistance is difficult in real time. One common refrain has been that smaller tenants and companies have generally been more forthcoming and frank about their challenges and space needs as compared to larger corporate tenants.

While many office tenants are slowly trickling back into their spaces, all of them are considering their future needs for physical space. The impact of COVID-19 will likely play out over a course of years as companies work through existing leases and adjust to an evolving work environment and shifting employee preferences. The existence of long-term leases will serve as a buffer for property owners to adapt their space over time and for investors to adjust their asset holdings, but will also present challenges as tenants encounter financial difficulties and seek rent relief in various forms, including breaking leases.

Co-working is facing unique challenges as the current environment has significantly reduced new memberships and tenants can more easily vacate unused space under short-term leases. Despite short-term challenges, the flexibility offered by co-working is likely to have significant long-term appeals to users who will be even less likely to enter into long-term space commitments in the wake of COVID-19.

Office rent collections have generally been strong as evidenced by the data from NAREIT below, consistent with the theme that the impact of COVID-19 on the office sector is more likely to be long-term in nature.



Source: National Association of Real Estate Investment Trusts (NAREIT), per survey of members, public disclosures and FTSE NAREIT REIT index equity market capitalization as of May 31, 2020 via FactSet. Weighted based upon equity market capitalization.

Capital is available for transactions, but deals are hard to come by as bid-ask spreads are wide due to uncertainty. Additionally, banks are tightening lending requirements and debt is more readily available for highly stable, risk averse assets. Given potential long-term shifts in office demand and utilization and major uncertainty in the near term in major urban commuter markets, investment grade activity in office assets is likely to remain light for the foreseeable future. Activity will be focused in suburban areas or smaller markets where concerns around mass transit and density are less pronounced.

SECTION 3:
RETAIL

Retail, along with lodging, has been the sector most significantly impacted by COVID-19 and related social distancing and shutdown policies. Rent collections are significantly below other sectors and are around 50%, and major property owners have reported even lower figures. CBL & Associates reported collecting only 27% of its rent in April and similar amounts for May. Non-credit tenants face significant risk of not being able to reopen; specifically 10% to 50% of restaurants may not reopen. Leasing activity is at a stand-still.

Bankruptcies have accelerated among retailers including: Art Van Furniture, Ascena, J.C. Penney, J. Crew, Lucky's Market, Garden Fresh Restaurants, GNC, Gold's Gym, Stage Stores, Neiman Marcus, Le Pain Quotidien, Modell's, Papyrus, Pier 1 Imports, True Religion, Rio Bravo, Stage Stores, Tuesday Morning, Hair Cuttery and Aldo

Other retailers at risk for bankruptcy based on public filings: J. Jill, Tailored Brands and Stein Mart

Strain is beginning to show in the sectors most impacted by COVID-19. Per a June 3rd article from CoStar News, many retail landlords have spent the better part of the past few years juggling escalating vacancies and falling rents as some tenants have been slow to adapt to the dramatic shifts in consumer spending. Store closings have reached record numbers, and 2020 is already on pace to blow those figures out.

CBL & Associates Properties, a retail REIT, became the first mall owner to miss a bond payment, a first step to a default. By failing to make the $11.8 million interest payment CBL triggered a 30-day grace period before it is considered an official default. In a July 1 filing with the SEC, CBL indicated that they were in forbearance with respect to their 2023 notes and credit agreement, and that they were in negotiations with the holders and lenders of the company's debt.

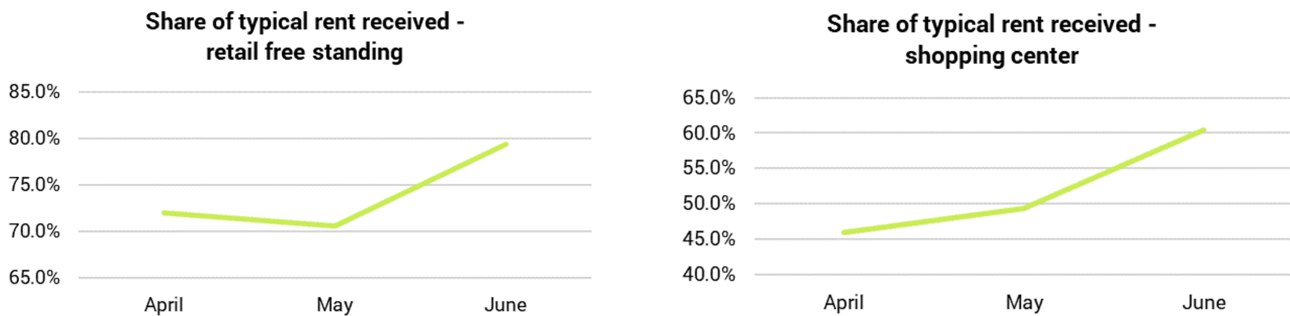
Prior to missing the bond payment CBL reported that it collected only 27% of April rent and anticipated similar

collections in May as most tenants sought rent relief.

PREIT, another retail REIT, noted in its earnings filings that there was substantial doubt about the company's ability to continue as a going concern, citing bankruptcy filings by Modell's, Papyrus, Pier 1 Imports, J. Crew, True Religion, Rio Bravo, Hair Cuttery and Aldo.

The retail transactions environment is virtually non-existent, including the termination of deals that were in-place, such as Simon Property Group's attempt to terminate its planned $3.6 billion merger with Taubman Centers, which had been struck on February 9, 2020.

This strain is evidenced by REIT rent collections as shown below, which further displays the disadvantage of shopping centers versus free standing retail in the current environment, but also highlights the recovery as restrictions have eased.



Source: National Association of Real Estate Investment Trusts (NAREIT), per survey of members, public disclosures and FTSE NAREIT REIT index equity market capitalization as of May 31, 2020 via FactSet. Weighted based upon equity market capitalization.

In addition to the financial stress on retail owners and investors, the second quarter of 2020 presented unique operational challenges. The civil unrest following in the wake of the death of George Floyd resulted in significant property damage to some properties, particularly in major cities. Properties which were operating under COVID-driven restraints found themselves dealing with property damage and business disruptions that were not anticipated.

Nonetheless, reopening of local economies has led to some encouraging signs:

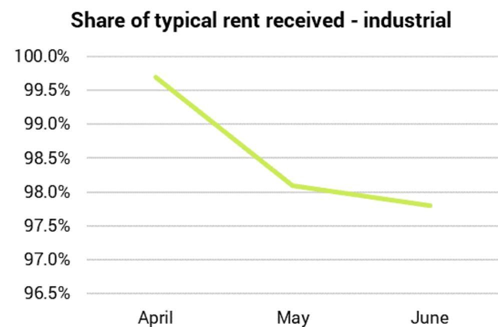
- American Eagle Outfitters reported that sales in its 556 locations that have reopened are averaging 95% of normal levels
- Cheesecake Factory reported sales volume at 75% of the same time last year, despite restrictions at most locations

There are some other bright spots in retail going forward, such as grocery-anchored product and retail deemed "essential" during the COVID-19 crisis; however, overall investor sentiment remains low, particularly for regional malls and urban retail centers whose tenants require high levels of foot traffic to remain profitable. Rent relief requests are disproportionately impacting retail property owners, putting strain on landlords' cash flows. Additionally, one trend prior to COVID-19 was a move to experiential retail to replace traditional mall tenants, but social distancing restrictions have hit that sector hard and questions abound if this trend has the momentum to pick up in the wake of a global pandemic. Regardless, general sentiment remains the same as pre-COVID-19: the most desirable assets are grocery-anchored shopping centers in growing markets.

SECTION 4:
INDUSTRIAL

Transaction volume in industrial assets was up significantly in the first quarter of 2020 compared to the same period in 2019, bolstered by the $13 billion buyout of Liberty Property Trust by Prologis. While volume was down across all property types in Q2 2020, industrial, and most notably logistics, which was already benefiting from the shift to e-commerce, showed the most life. The industrial sector is uniquely positioned in the post-COVID-19 world and has seen some deal activity. Key players that have benefited from the COVID-19 crisis such as Amazon, UPS and Fedex are all major tenants of institutional grade industrial property.

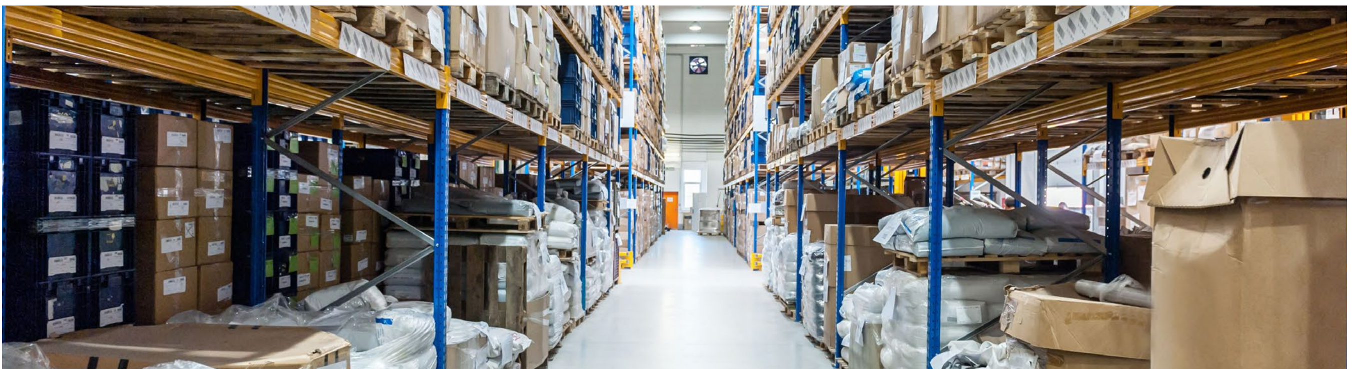
This strength has been reflected in rent collections as shown, which while they have slipped slightly from nearly 100% in April are still very healthy relative to other property types.



Source: National Association of Real Estate Investment Trusts (NAREIT), per survey of members, public disclosures and FTSE NAREIT REIT index equity market capitalization as of May 31, 2020 via FactSet. Weighted based upon equity market capitalization.

The biggest risk factor for industrial properties is the health of their tenants and employees during the pandemic. Furthermore, tenant creditworthiness and ability to pay rent could be impacted by an evaporation of demand for their products due to broader economic issues.

Industrial properties could face operational challenges if COVID-19 or another pandemic impacts their workforce and ability to operate. There are likely to be additional tenant-specific and location -specific downsides that are difficult to predict or address adequately.



Unlike most other sectors, industrial transaction activity has continued with a number of notable transactions in the second quarter of 2020. These transactions are notable first for simply occurring in significant volume as opposed to other property sectors, but also because many are symptomatic of trends in industrial properties towards large distribution and single-tenant properties.

Buyer	Close date	Price ($m)
Kohlberg Kravis Roberts & Co. L.P.	June 20, 2020	$176.00
Granite REIT Holdings Limited Partnership	June 20, 2020	$246.10
Oak Street Real Estate Capital	June 20, 2020	$725.00
Lineage Logistics Holdings, LLC	June 20, 2020	Und.
BentallGreenOak	June 20, 2020	$164.00
Preylock Holdings, LLC	May 20, 2020	$110.00
Dairy Farmers of America	May 20, 2020	$433.00
Blackstone Group	April 20, 2020	$650.00

Sources: Milwaukee Business Journal, Granite REIT, Columbus Business First, JLL, ROINJ, News Break, StarTribune

- KKR acquired an Amazon logistics center in the Chicago MSA for $176 million and Preylock Holdings acquired another Amazon fulfillment center in Las Vegas, Nevada for $110 million.
- Oak Street Real Estate Capital entered into a $725 million sale leaseback transaction with Big Lots related to distribution assets for their retail business.
- Blackstone acquired a portfolio of 59 industrial properties in Minneapolis and Colorado for $650 million.
- BentallGreenOak acquired a 925,000 square foot industrial facility occupied by LG Electronics under a long-term lease.
- Lineage Logistics closed on two portfolios of cold storage assets in the Pacific Northwest and Chicago, respectively.

Overall, sentiment in relation to the industrial sector remains positive in spite of the challenges presented by COVID-19, and has likely improved for certain sub-types such as build-to-suit logistics assets. The situation has created some short-term financing challenges and debt spreads have widened, but long-term access to capital for attractive industrial investments is not likely to be affected.

SECTION 5:
HOSPITALITY

Hotel performance was off to a good start in 2020 year-over-year, and only a few markets had shown declines relative to 2019. March 2020, however, brought an occupancy decline that was both sudden and merciless, and some average rate discounting began. According to STR, room nights declined from February 2020 to March 2020 by over 40% (an occupancy decline from 62.1% to 39.4%).

STR reported in a year-over-year comparison for April and May that the industry recorded major slides.

The absolute occupancy and RevPAR levels for April were the lowest for any month on record in the U.S., while the average daily rate (ADR) value was the lowest since December 1997. However, recent weekly data suggests that performance likely reached the bottom in early April, as the May numbers improved slightly and demand increased for four consecutive weeks.

	April year-over-year performance	May year-over-year performance
Gross operating profit	(116.9%)	(110.0%)
RevPAR	(92.9%)	(88.3%)
EBITDA PAR	(140.2%)	(130.9%)
Labor costs	(72.8%)	(69.5%)

Source: STR

Valuation impacts

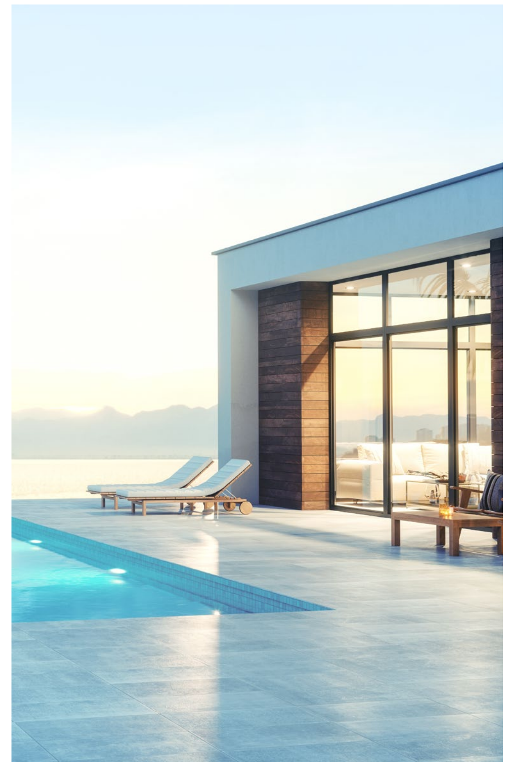
Multiple sources have predicted that the long-term impact of COVID-19 on hospitality values could range from a 15% to over 50% decline in value, with most anticipating a long road to recovery.

At this time, most closures are expected to be temporary. Phased “re-opening” for states and local jurisdictions are underway in all states, despite roll backs of reopening in some states. Logistics for safe hotel and travel behaviors are being developed. Nevertheless, there is more uncertainty than confidence about the next few months. Policies around social distancing and masks—as well as personal concerns about safety and wellness—will likely persist until therapeutics and/or a vaccine for COVID-19 are available on a mass scale.

Operators are assessing cleaning protocols, access to and level of amenities to provide, viability of food service as well as adjusted operating models for low occupancy environments.

Hotel supply is anticipated to fluctuate for some months. Most hotels are reopened or reopening as the economy and demand recovers, though some properties may not. Some developers of under-construction projects are trying to keep those developments going, while others are seeking to delay opening until adequate demand returns. Proposed hotel projects that have not started construction are likely to be delayed or cancelled.

Because the majority of hotel owners across the U.S. have been financially impacted, their ability to service debt has become a challenge. Conventional lenders are actively working with owners on debt restructuring, though as owners miss mortgage payments, debt holders may respond unfavorably. Still, debt remains favorably priced—an advantage for owners and lenders—and many hotels are structured with lower leverage relative to prior downturns.



Businesses are going to restrict travel for their employees as they evaluate the health and safety for their employees, the cost, and alternatives to in-person meetings. Given the acceptance of video conferencing, meetings have become easier to schedule and attend while unlocking additional time for nearly no cost. The CEO of Spirit Airlines Ben Baldanza estimated a 5% to 10% permanent loss of business travel, which would have a significant impact across all hotel service sectors. Conventions, events and other large gatherings are still not allowed in most states and likely will not be commonplace until after the development of a vaccine, which will seriously impact occupancy at many properties. Long-term shifts and demand or risk perception could lead to long-term increases in capitalization rates and decreased values.

Based on discussions with operators and investors, understanding the value of hotel properties at present requires an acceptance of uncertainty and developing scenario analyses. These analyses will consider the impact of COVID-19 on various aspects of a property such as occupancy, ADR, food & beverage revenue and banquet revenue, and the fact that these areas will be impacted in different ways and durations. Some properties may be affected significantly on a long-term basis, whereas others may see less long-term impact. For example, a large, upscale hotel in Las Vegas with a significant convention business will likely see more significant long-term value erosion than a select service property catering to highway travelers. Nonetheless, when valuing existing assets or underwriting new transactions, an extremely high standard of diligence will be required.

As mentioned prior, COVID-19 will have an impact on all lodging properties; however, as the table below shows, locational and operational factors will lead to a greater risk of significant downside:

Greater risk	Lower risk
Conference or event driven	Drive-to markets and resorts
Destination markets (i.e., Las Vegas, Orlando)	Transient-driven properties
Airport properties	Strong national brands
Small operators (limited liquidity)	Limited and select service properties
Large full service and luxury properties	Extended stay properties

REIT issues

REITs have begun to report some green shoots as the severe lock down restrictions are lifted in most areas and leisure travel is beginning to resume. Drive-to destinations in particular are likely to bounce back relatively quickly. Nevertheless, the situation is taking a toll as evidenced by announcements from several hospitality REITs:

— Colony Capital reported in May that it was in default on $3.2 billion in loans on its portfolio of 157 hotels. Colony reported same store revenues for the first quarter were down 18.4% and net operating income was down 44.7% for the hotels.

— Ashford Hospitality Trust announced in an SEC filing that it has agreed to forbearance terms with several lenders and has drastically cut costs to preserve cash. Initiatives to conserve cash included furloughing 90% of field employees, reducing the 2020 CAPEX target to $30 - $50 million, down from $125 - $145 million, and cutting corporate G&A and cash reimbursables by 25%.

S&P Global Market Intelligence reports that six hotel REITs withdrew the full remaining capacity on their revolving credit facilities. Among those, Host Hotels & Resorts, Inc. withdrew almost $1.5 billion and Park Hotels & Resorts, Inc. emptied its full $1 billion facility. This does not imply immediate distress but is indicative of the stress on the system and entities' desire to maintain as much financial flexibility and access to capital as possible.

SECTION 5:
CAPITAL MARKETS

Over the short term, transaction activity will continue to be slow as uncertainty and a period of price discovery are contributing to a stagnated deal environment. Defensive sectors such as healthcare and logistics continue to garner interest as active investors consider stable income, operational essentialness and occupational density as mitigating factors against asset and market specific risk factors. While debt and equity capital is available, however, lenders are reticent to take on risk and most investors are still in the process of triaging their current assets and taking a wait and see approach while looking for opportunistic investments.

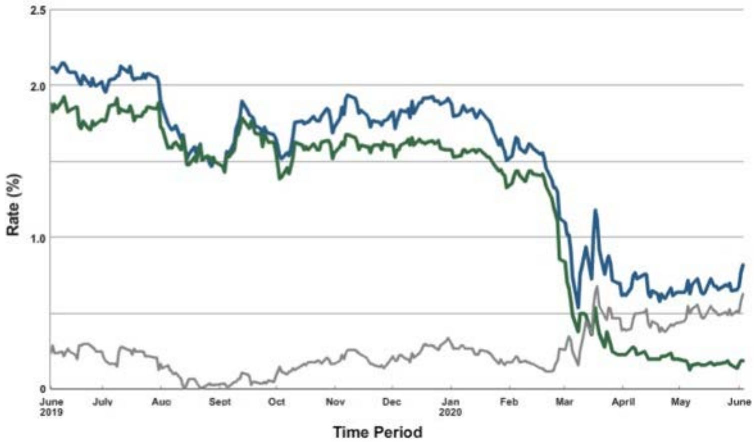
It is likely that private equity and investors with significant dry powder who are open to value-add or opportunistic investments will be the early adopters in the next wave of transaction activity while REITs and other highly leveraged players dependent upon rent collections will focus on managing their assets and optimizing portfolios. Challenged sectors such as hospitality and retail will likely see activity in distressed situations as well as the potential for business combinations driven by depressed equity values.

REITs are tapping revolving credit lines to maintain liquidity. According to data published by S&P Global Market Intelligence, REITs drew down $37.19 billion from their credit facilities, a 150.5% increase from the fourth quarter of 2019. Over half of this amount came from REITs focused on retail and hospitality.

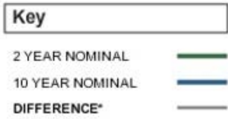
Property class/sector	% of monthly CMBS loans in grace period or beyond grace period	CMBS delinquency rate (>30 days)	# of REITs	YTD total return
Office	1.92%	2.66%	20	(24.51%)
Industrial	1.55%	1.57%	14	2.30%
Retail	5.42%	18.07%	39	(36.81%)
Residential	1.45%	3.29%	21	(17.65%)
Hospitality	7.91%	24.30%	17	(48.65%)

Sources: Trepp as of June 25, 2020 and National Association of Real Estate Investment Trusts (NAREIT) and FTSE as of June 30, 2020

The chart below from the U.S. Treasury Department shows the nominal rates on two- and ten-year Treasury notes. The sharp decline is indicative of government activity to support the economy during the COVID-19 crisis. At present, real estate capitalization rates are generally stable or slightly up according to most sources, implying a significant increase in the spread between capitalization rates and Treasury rates. If Treasury rates remain low, however, the spread is likely to return to more normal levels, which could result in lower capitalization rates for the primary sectors and assets perceived as less risky.



Source: U.S. Department of the Treasury



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