

IMPACT PER REGION



The economic uncertainty brought on by COVID-19 is unlike anything the real estate industry has experienced. The effects have been wide-ranging and have caused massive disruption to daily lives and businesses, including commercial real estate. The following article will look at how regions across the United States are faring and how top commercial real estate markets have responded.

The Impact on the Economy

Just a couple months ago, the economy was doing great, unemployment was at an all-time low, and real estate fundamentals were solid. So far, this is not a liquidity crisis, although certain parts of the market are experiencing issues. The pandemic has already led to the fourth largest decline in global GDP in the last century. In the past, events that caused mass deaths, such as wars and pandemics, have had significant long-lasting economic consequences. In May, retail sales in the U.S. bounced back after falling drastically in March and April, reflecting the reopening of businesses in many U.S. states.



Retail sales were up **17.7% from April to May**, following a decline of **14.7% in April and 8.3% in March**.

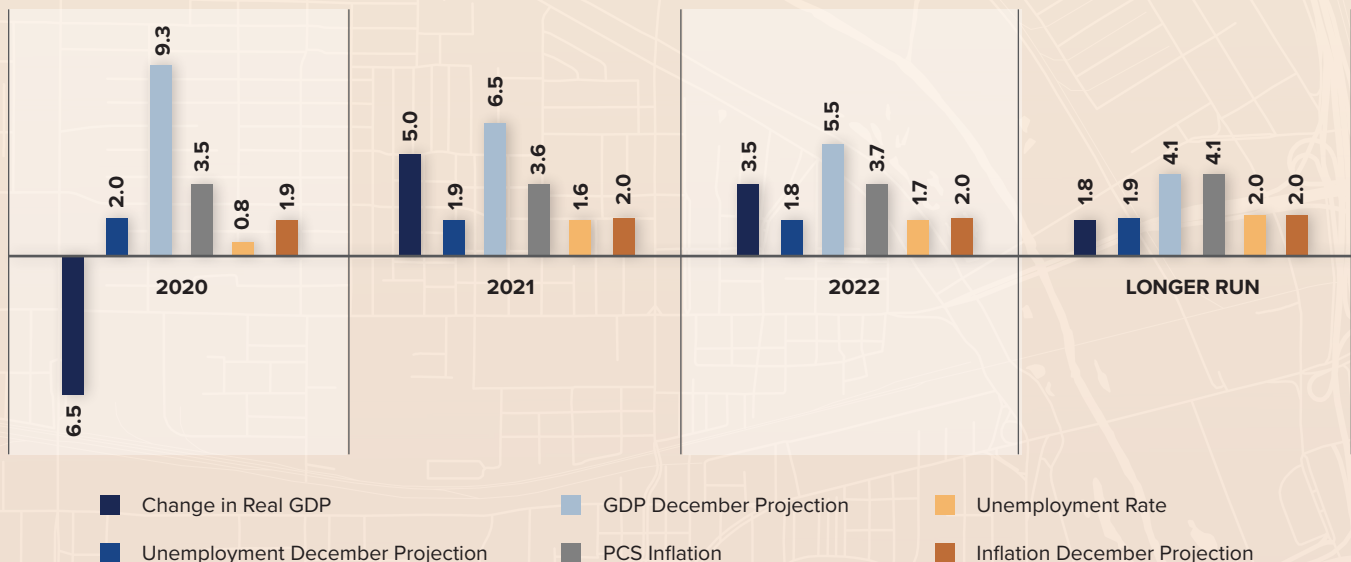


Employers added **2.5 million jobs** in May to bring the **unemployment rate down to 13.3%**.

Economists at the International Monetary Fund (IMF) measured the long-term consequences of pandemics, going back nearly a millennium. IMF economists determined that pandemics lead to a sustained period of lower real borrowing costs and higher wages. The reason being that pandemics often cause a shortage of labor relative to capital. Moreover, pandemics are usually followed by an increase in private savings that leads to slower growth of demand, according to Deloitte.

Summary of Economic Projections Graph (Median)

Source: Federal Reserve



The good news, pandemics cause a decline in borrowing costs and a rise in private savings. Therefore, the recently massive increase in government debt will be more easily serviced. All other things being equal, the bad news is, it appears that pandemics are followed by slower economic growth, at least initially. **There are, however, some caveats to the analysis performed by the IMF economists.**



The death of working-age people in past pandemics caused a labor shortage, but today's advanced medical care prevents such catastrophic deaths.



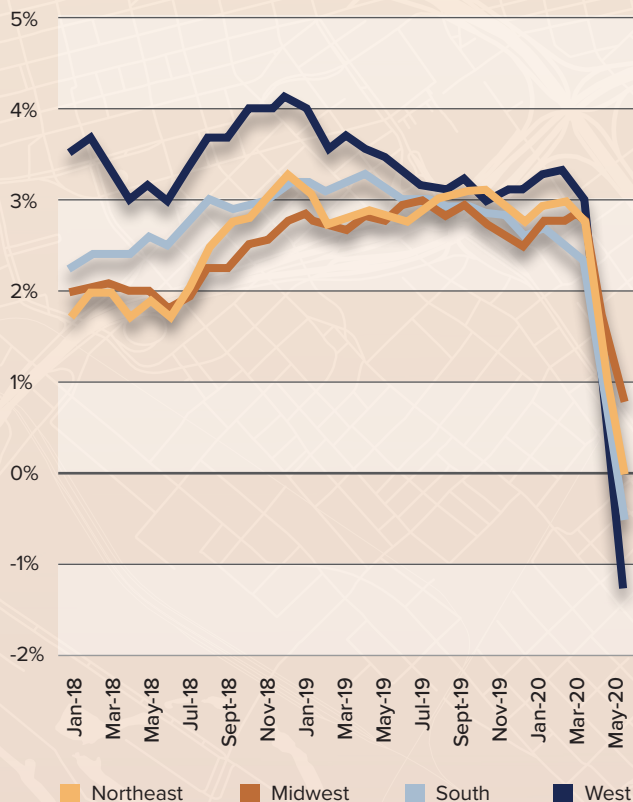
Governments have taken aggressive measures to offset negative consequences, potentially boding well for a more rapid return to healthy growth.

With these factors in mind, economists conclude that a sustained period of low real estate interest rates is still expected. Low rates should provide welcomed fiscal space for governments to mitigate the consequences of the pandemic aggressively. Although it is still too difficult to discern what those consequences will be, examining the past is one of the useful ways to understand how pandemics influence economic events.

Jerome Powell, Chair of the Federal Reserve, anticipates this downturn to be shorter than The Great Depression but warns that unemployment could reach depression levels. According to Steven Mnuchin, Secretary of the U.S. Treasury, there could have been permanent damage to the U.S. if the shutdown continued for months. As a result, the Trump Administration reopened the economy, lifting restrictions under particular guidelines. Recovery is dependent on how well the virus is controlled and whether people feel safe to go back to work. However, as states began to reopen mid-May, at the end of June, states started putting restrictions back in place as cases hit record highs around the country.

Regional Rental Impacts

Source: RealPage, Inc.



On the bright side, CRE economists don't think the downturn will be as bad as the 2008 financial crisis. The Urban Land Institute's latest Real Estate Economic Forecast shows a short-lived recession and above-average GDP growth in 2021 & 2022.

- ★ GDP is expected to grow 3.9 percent in 2021 and 3.6 percent in 2022, both well above the long-term average of 2.1 percent.
- ★ For 2020, net job growth is expected to reach negative 10 million, but the forecast estimates U.S. employment at 11.3 percent at the end of 2020, with a decline to 5.9 percent by the end of 2022.
- ★ Real estate transaction volumes will decrease to \$275 billion in 2020, but forecast transaction volumes over the next two years show a much healthier capital market than in 2008.
- ★ Commercial real estate price growth as measured by Real Capital Analytics Commercial Property Price Index (CPPI) is projected to fall by seven percent in 2020, less than the 13.6 and 20.8 percent decrease during 2008 and 2009, respectively. Economists believe that one reason for this is more debt financing is available compared to 2008.
- ★ Rent growth expectations for the next three years is expected to be led by the industrial sector, averaging 2.2 percent from 2020 to 2022.

According to a survey conducted by the National Association of Realtors, on average, respondents reported a one percent decline in their commercial sales volume during the first quarter of 2020 compared to transactions in the same period last year. Further, respondents reported a two percent decline in the dollar volume of new leases than the level one year ago. Respondents also reported higher vacancy rates for office, retail, multifamily, but rates remained flat for industrial properties. **Now, let's take a look at how regions are performing relative to commercial real estate sectors.**



NORTHEAST



NH, MA, RI, CT, NJ, DE, MD, ME, VT, NY, PA



The Northeast is one of the most affected areas in the U.S. in the number of total cases and deaths, with New York being the epicenter of the pandemic. There is confidence in the Northeast market's ability to come out of this downturn with strength given the region's prior fundamentals, unmatched density, and concentration of workers, residents, and tourists. Looking beyond the initial wave of infections, the Northeast has allowed the region to begin reopening its economies slow and steady. However, an extended recovery timeline would temper with the outlook. This more deliberate pace of reopening could benefit the region in the next year or two by preventing a second wave of infections.

De-urbanization?

One of the main reasons for New York's high COVID-19 cases is its population density, making it difficult to engage in social distancing.

There is evidence that New York residents are departing as a result, and the demand for suburban homes has soared as professionals trade their small New York City apartments for larger homes with office space. This move is likely driven, in part by, the need to work from home given the difficulty of enforcing social distancing when traveling to and from office buildings, or in elevators.

The need for affordable residential options, particularly in the Northeast's largest metros, has become even more critical. Tenants who cannot afford market-rate apartments may look to lower-cost suburban opportunities. Though, as more upper-tier apartments continue to be built, short-term vacancy issues may arise, particularly in Northern New Jersey. The market boasts the region's highest Class A vacancy, around 12 percent, according to CoStar, and the most significant 2020 development pipeline relative to inventory. Meanwhile, Baltimore may be the most exposed to lost Class C rental needs. According to RealPage, rent change in the Northeast fell stagnant, compared to the three percent growth in 2019.

In many Northeast states, including New York, Maine, and New Jersey, the high costs of living and doing business could slow the recovery in this region. This outcome would prompt investors to rebalance their risk exposure, likely refocusing on stable assets in areas with strong demographics. Metros with less diversified economies, such as Baltimore, could face an extended period of unemployment that could curb consumer spending and restrain corporate budgets, further limiting hiring and investment in the metro. This dislocation could also cause retailers to contemplate the value proposition of operating high-cost stores in popular locations. If more people opt to live and work outside of the core or do less physical shopping, it may change the importance of these premier storefronts.



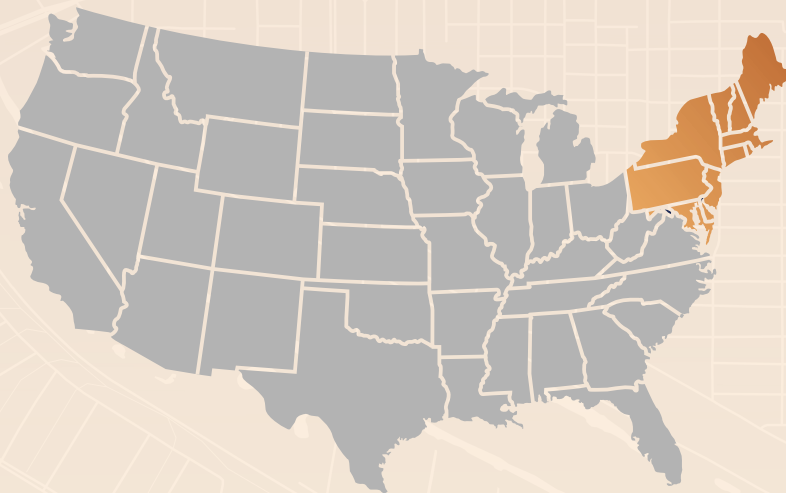
The high use of public transportation will limit how quickly employees will return to the office. Companies located in high-square footage high-rises in New York City or D.C. **may consider more affordable low-rise space** in New Jersey or Baltimore.

Several large projects in New York City are still in the pipeline, with almost four million square feet of retail space expected to be completed by year-end. Many of these projects' open dates have been delayed due to halted construction across the metro. Fortunately for Northern New Jersey, it does not have to contend with much supply risk, although retailing existing tenant base will be challenging.

Landlords will also be forced to reduce rents in order to attract tenants, as retail drivers and consumer spending slow. In Boston, rent growth outperformed the national average. Over the forecasted period, rent losses are predicted to exceed the national average,

but specific retail clusters could weather the storm based on favorable localized demographics.

Commercial real estate deals in Boston are still getting done, but they are generally expiration-driven or were near the finish line at the onset of the pandemic. According to experts in the Boston retail market, achieving outsized rents is dependent on cultivating an optimal retail mix. In New York, leasing declined 50 percent quarter-over-quarter. In New Jersey, the industrial market's impact has been from short-term supply chain disruptions and from keeping supply chains fluid, as many non-essential retailers and manufacturers shut down.



Unemployment Rate

Source: Bureau of Labor Statistics

NH	14.5%	MD	9.9%
MA	16.3%	ME	9.3%
RI	16.3%	VT	12.7%
CT	9.4%	NY	14.5%
NJ	15.2%	PA	13.1%
DE	15.8%		

Where the Northeast stands | Q2 2020

Source: RCA

BOSTON	7,190.9 Vol (\$m)	200 # Props	MANHATTAN	7,914.5 Vol (\$m)	161 # Props
NORTHERN NEW JERSEY	3,710.9 Vol (\$m)	234 # Props	BALTIMORE	1,938.3 Vol (\$m)	105 # Props
D.C.	2,452.3 Vol (\$m)	51 # Props	PHILADELPHIA	2,245.3 Vol (\$m)	156 # Props



WEST



WA, MT, OR, ID, WY, CA, NV, UT, CO, AZ, NM



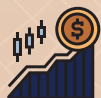
The Western region has taken a more pragmatic approach to managing the pandemic, by staying under lockdown for a longer duration than other states, while also implementing statewide and local measurements that support tenants and businesses. As the region begins to come out of the shutdown, the underlying strength of these markets will help in recovery efforts.

Asset classes in the West were some of the nation's best performers before COVID-19, which positions the region for sound recovery. For example, Los Angeles has some of the most prized and expensive retail real estate in the nation, commanding some of the highest rental rates. However, as states enter the multiphase reopening process, the continued acceleration of cases has occurred in recent weeks, presenting more potential problems for the region. California, Washington, and Oregon already faced substantial hurdles with record-level unemployment.

Technology-focused markets, including Seattle and those in the Bay Area, are the best suited for a rapid, V-shaped economic recovery, as the sector was

less impacted by the temporary shutdowns, and consumer spending will drive stabilization. Seattle attracts both foreign and domestic interest, and in terms of job growth, the metro has outperformed the national average with many additions in high-paying sectors. However, metros geared toward tourism and entertainment, such as Los Angeles, San Diego, and Orange County, may be less likely to recover. The Western logistics hubs could prompt a second wave of infections as workers navigate in and out of the region. The burdens of living on the West Coast could inspire people to move to less costly areas. Phoenix is the top market in the nation for net migration. Many people living in dense and expensive cities may consider moving to the metro in search of job prospects and a more affordable cost of living.

The multifamily sector may be the more durable asset class as long-term demand drivers remain intact in the West. Over the near term, the sector does face challenges from historic unemployment, which could push vacancy higher as state and local eviction moratoriums expire.



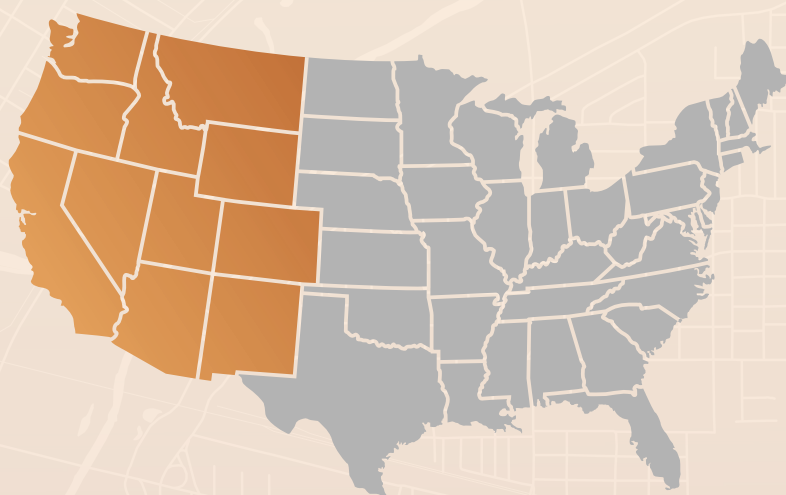
One of the underlying advantages of Los Angeles retail, compared to most national markets, is its **relatively low retail stock per capita**. Los Angeles only has **3% more** total retail square footage than Dallas-Fort Worth (DFW) despite the metro having **58% more** people than DFW.

In Los Angeles, vacancies have already exceeded the highs seen during the last recession. With this, roughly 50 percent of households rent their home in the Los Angeles market, one of the highest renter-to-owner ratios of any major metro in the country. As demand is anticipated to soften, this will provide welcomed relief to many markets as the construction pipeline has swelled in recent years. At the same time, construction activity in Phoenix has continued, nearly undisturbed. About 16,000 apartment units are underway and slated to deliver over the next several quarters, according to CoStar. Rent growth in the region will most likely taper and turn negative, as many Class A units will need to increase concessions to attract new residents.



For office space, the region will see the **restructuring of floor plans & a positive outlook** with a robust mix of tech-centric companies.

Retail supply growth was moderate over the past cycle, contributing to favorable fundamentals before the pandemic. With reduced inventory growth, the impact on shuttered storefronts will decrease, and the vacated space will create some opportunity for investors. For the Phoenix market, the retail sector is in a better position than in years past, thanks to moderation in new supply. Since the Great Recession, Phoenix's retail development has been limited to build-to-suits and heavily pre-leased grocery-anchored retail centers. The slowdown in construction has enabled retail vacancies to return to historic lows, and job and population growth will support retail demand in Phoenix. While Phoenix has not been immune to national store closures, some retailers have expanded, especially grocery, restaurants, fitness, and furniture retailers.



Unemployment Rate

Source: Bureau of Labor Statistics

WA	15.1%	NV	25.3%
MT	9.0%	UT	8.5%
OR	14.2%	CO	10.2%
ID	8.9%	AZ	8.9%
WY	8.8%	NM	9.2%
CA	16.3%		

Where the West stands | Q2 2020

Source: RCA

LAS VEGAS	1,516.0 Vol (\$m)	97 # Props	SAN FRANCISCO	4,183.0 Vol (\$m)	124 # Props
LOS ANGELES	7,550.1 Vol (\$m)	635 # Props	SEATTLE	2,742.5 Vol (\$m)	172 # Props
PORTLAND	2,385.9 Vol (\$m)	163 # Props	PHOENIX	4,678.3 Vol (\$m)	289 # Props
SALT LAKE CITY	1,385.9 Vol (\$m)	111 # Props	DENVER	4,607.0 Vol (\$m)	219 # Props

A stylized graphic of a city skyline in silhouette against a blue gradient background. The skyline includes various building shapes, a prominent arch bridge, and two cable-stayed bridges on the left. A large, light blue circle is positioned in the upper left sky area.

MIDWEST



ND, SD, NE, KS, MN, IA, MO, WI, IL, MI, IN, OH



The Midwest region experienced the pandemic later than most other regions. Although there were pockets within the region where the level of impact varied, overall, the region was insulated from severe impact. This was due to the region's lower population density and stay-at-home orders. As a result, unemployment fared better in the Midwest when compared to other areas. Since May, all Midwest states have reopened with limitations in place.

In the first quarter of 2020, more than 7,600 apartment units were completed in the top ten Midwest metros. By the end of 2020, these metros were scheduled to deliver 30,000 apartments, following 22,000 units in 2019. The delivery of these thousands of units will likely be pushed to 2021, putting downward pressure on rents and occupancy. In Cleveland, multifamily development remains high, and units under construction represent over 60 percent of new supply market-wide. However, demand in the market may weaken in the coming quarters, with weakness concentrated at the higher end, due to new supply, and likely the lower end, due to rising delinquencies.

The Midwest region was the only region to avoid apartment rent cuts in May. The area is still seeing

rent growth with prices up by 0.8 percent year-over-year; Cincinnati posted growth of 2.8 percent, and Indianapolis and St. Louis saw increases close to 2.0 percent, according to RealPage. Rent growth in Cleveland has trended upward since May after a brief pause in the early weeks of shelter-in-place orders. Acquiring stabilized apartment properties at low interest rates brings interest to the Midwest apartment market.

Mass merchants, grocers, dollar stores, and drugstores outperformed relative to other regions, specifically in Chicago, Detroit, Cleveland, and Minneapolis. As far as retail vacancy goes, Chicago and Detroit saw the highest numbers and are considered more at-risk. The total square footage impacted by store closures in Chicago will hit a post-global financial crisis high, with four million square feet in 2018. Minneapolis and Columbus saw below four percent vacancy heading into the pandemic and have the flexibility to manage shuttering retailers. Older properties located in areas that have experienced significant economic decline will be the first of the store closures in the Midwest. There has been a renewed focus on supporting well-located, high-performing stores, and closing low-performing stores, which has the industry right-sizing.



Cincinnati's apartment market fundamentals are **relatively robust**, with a historically **low vacancy rate, affordable rents, and manageable development pipeline**.



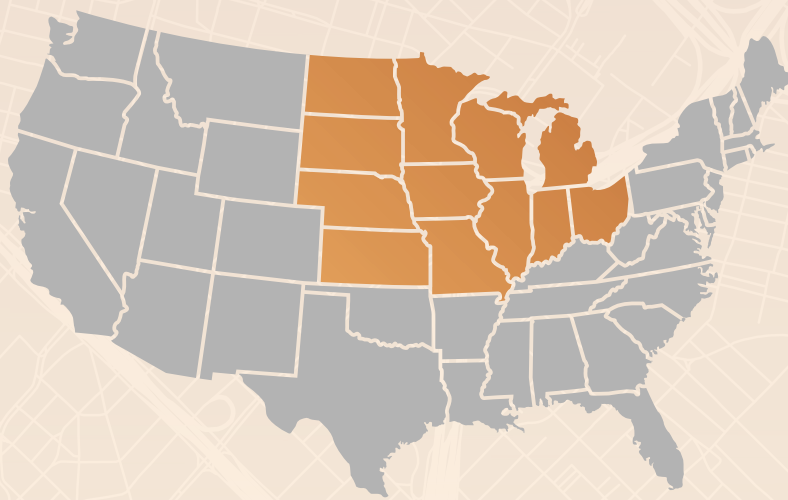
Cleveland's years of out-migration and economic underperformance have **reduced the area's spending potential and reinforced pockets of extreme wealth and poverty.**

Retailers that depend on central business districts (CBDs) are the most at risk, where traffic may take months to resume to normal levels. Core metros, such as Columbus and Cleveland, have seen pockets of strength and may outperform other metros in the short-term. Indianapolis, Kansas City, and St. Louis recorded the lowest change in employment following the pandemic, giving these markets a shorter road to recovery.

Compared to other regions, the Midwest's lower cost of living and more affordable office rents will attract companies back to the market. The average asking rent per month for office space in the Midwest is nearly less than half of larger coastal gateway cities, which

provides significant cost savings for firms. Operators will need to stay mindful of shifting market trends.

For industrial, the increased need for storage space will benefit significant logistics markets such as Indianapolis, Chicago, and Columbus. Well-located warehouse and distribution assets with credit tenants throughout the Midwest remain attractive to investors. Manufacturing hubs in the Midwest, deemed essential, have shuttered for short periods due to high rates of employees with COVID-19. Most Midwest markets could outperform the national average in 2020, keeping investors interested in industrial assets at lower entry costs and higher cap rates than in major coastal metros.



Unemployment Rate

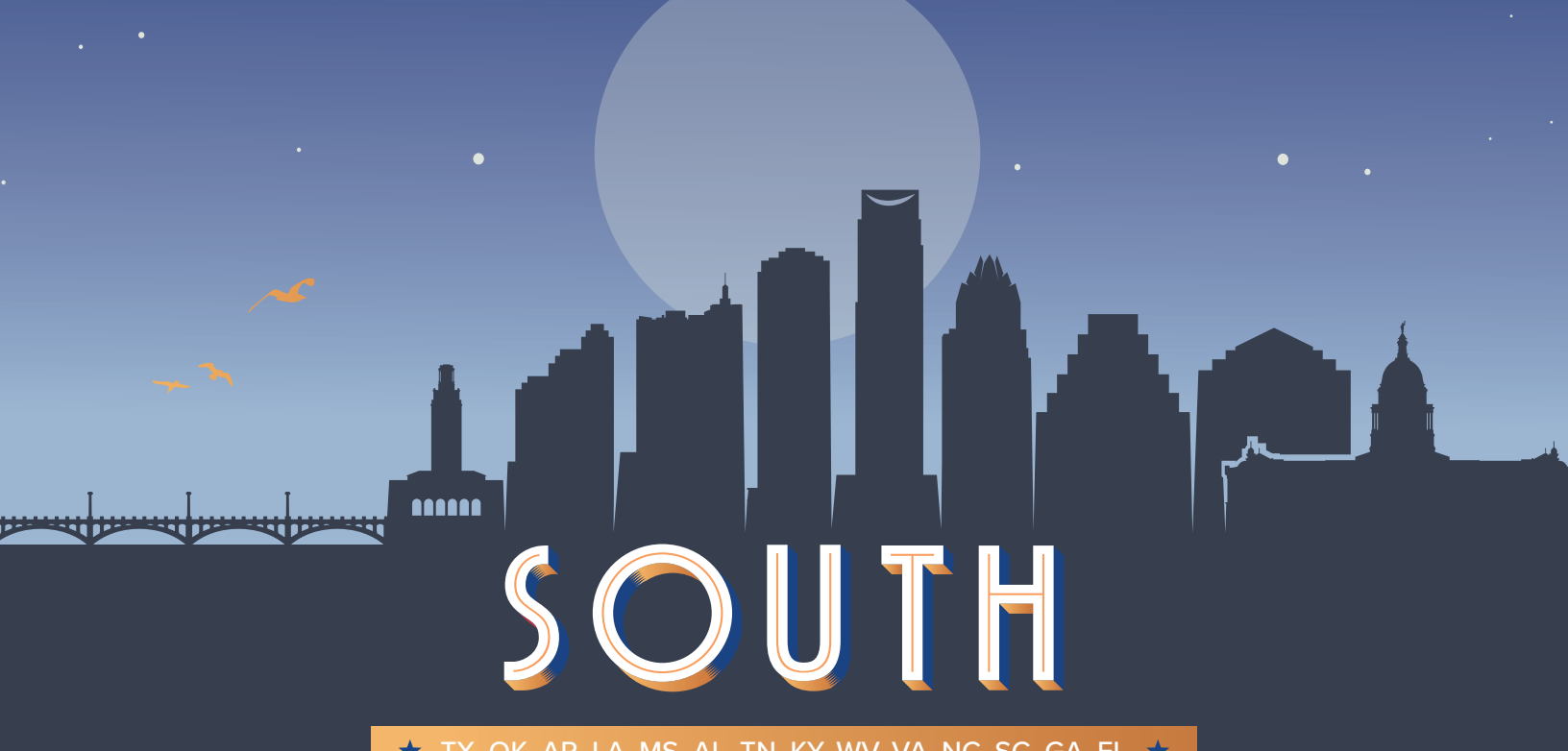
Source: Bureau of Labor Statistics

ND	9.1%	MO	10.1%
SD	9.4%	WI	12.0%
NE	5.2%	IL	15.2%
KS	10.0%	MI	21.2%
MN	9.9%	IN	12.3%
IA	10.0%	OH	13.7%

Where the Midwest stands | Q2 2020

Source: RCA

CHICAGO	6,118.2 Vol (\$m)	468 # Props	DETROIT	697.4 Vol (\$m)	67 # Props
CINCINNATI	1,047.9 Vol (\$m)	79 # Props	INDIANAPOLIS	1,555.8 Vol (\$m)	99 # Props
CLEVELAND	357.2 Vol (\$m)	37 # Props	KANSAS CITY	1,197.1 Vol (\$m)	92 # Props
COLUMBUS	1,304.8 Vol (\$m)	67 # Props	MINNEAPOLIS	2,723.8 Vol (\$m)	200 # Props



SOUTH

★ TX, OK, AR, LA, MS, AL, TN, KY, WV, VA, NC, SC, GA, FL ★

The Southern region largely avoided the worst of the health crisis in the first couple of months before adopting flexible and early reopening plans. Assuming the recent flare-up in cases does not force more businesses to close, the aggressive relaxation of lockdown policies can save a higher number of small businesses in the South. As a result, real estate fundamentals could face lower hurdles as the economy begins to recover. This should bring investors back into the market ahead of areas where economies are slower to open.

Some markets in the South may face uncertain paths moving forward due to reliance on tourism. These markets include Orlando, Miami, and New Orleans. Before the pandemic, Orlando boasted the most visitors in the U.S. annually, and 20 percent of local jobs were in leisure and hospitality. Though domestic tourism should regain traction as plans around reopening unfold, the consequences of shutting down these sectors could result in a longer recovery timeline.

Southern cities with business-friendly climates, such as Nashville, Charlotte, and Atlanta, are best positioned to recover quickly. Industrial properties and multifamily across the region could rebound quickly if the reopening process goes smoothly. The relatively dispersed population and low public transportation usage should dampen the likelihood of a second shutdown.



If Disney World and Universal Studios have trouble reopening and attracting park visitors, the implications to Orlando's economy could be significant.

An extended downturn might encourage workers and firms in high-cost markets to migrate to low-cost Southern metros. During the economic expansion, numerous Class A apartments were delivered, providing options for work transitions. After many years of substantial building levels, Charlotte is one of the fastest-growing apartment markets in the country,



Retail and multifamily vacancies are **predicted to rise** in Miami **over the next few quarters**, as the upcoming supply is high and demand will suffer from COVID-19 economic fallout. Miami has **one of the highest retail construction pipelines** in the country, relative to inventory, but has **high pre-lease rates**.



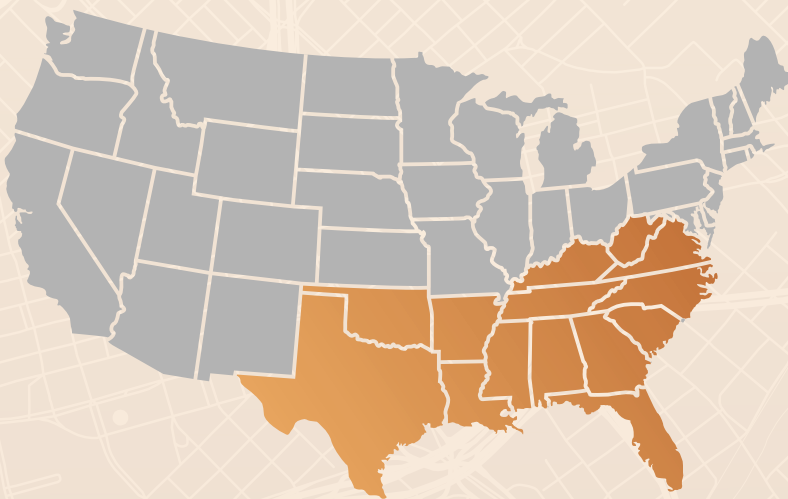
The South contained a ***few of the first states to allow retailers and restaurants to open***, but as with Texas and Florida, ***early reopening plans have resulted in COVID-19 spikes and closures***, once again.

and vacancies are already back near historical norms. According to RealPage, rent prices were cut by 0.5 percent year-over-year, 1.1 percent below last year's increase. Only South Florida has rents above the national average. In Atlanta, rents have begun to rise once again since mid-May, signaling that the situation might be stabilizing for now. The allure of low interest rates will attract investors to Southern multifamily properties.

This current situation leaves investors with the opportunity to find investments in tourist areas that were previously too expensive. Over the past decade, Atlanta, Nashville, Austin, and Charlotte, saw some of the strongest job growth and household formation,

which helped drive consumer spending and retail demand. This strong demand, coupled with minimal supply additions, allowed landlords to push rents at an accelerated pace heading into 2020, even though rent levels are still near where they were just before the Great Recession.

Affluent suburbs, fast-growing exurbs, and the markets with densifying urban core are set to come out strong. For example, Charlotte, boasts a median household income of more than 20 percent above the state's average, which has attracted premium retailers to the metro. Laggards include submarkets with weaker demographic profiles, such as those that overbuilt retail in previous building cycles.



Unemployment Rate

Source: Bureau of Labor Statistics

TX	13.0%	AL	9.9%	NC	12.9%
OK	12.6%	TN	11.3%	SC	12.5%
AR	9.5%	KY	11.0%	GA	9.7%
LA	13.3%	WV	12.9%	FL	14.5%
MS	10.6%	VA	9.4%		

Where the South stands | Q2 2020

Source: RCA

ATLANTA	5,779.5 Vol (\$m)	326 # Props	NASHVILLE	2,217.4 Vol (\$m)	109 # Props
CHARLOTTE	2,727.7 Vol (\$m)	145 # Props	ORLANDO	2,627.9 Vol (\$m)	110 # Props
MEMPHIS	1,000.2 Vol (\$m)	75 # Props	AUSTIN	2,216.8 Vol (\$m)	125 # Props
MIAMI	2,216.8 Vol (\$m)	135 # Props	DALLAS	9,558.9 Vol (\$m)	430 # Props

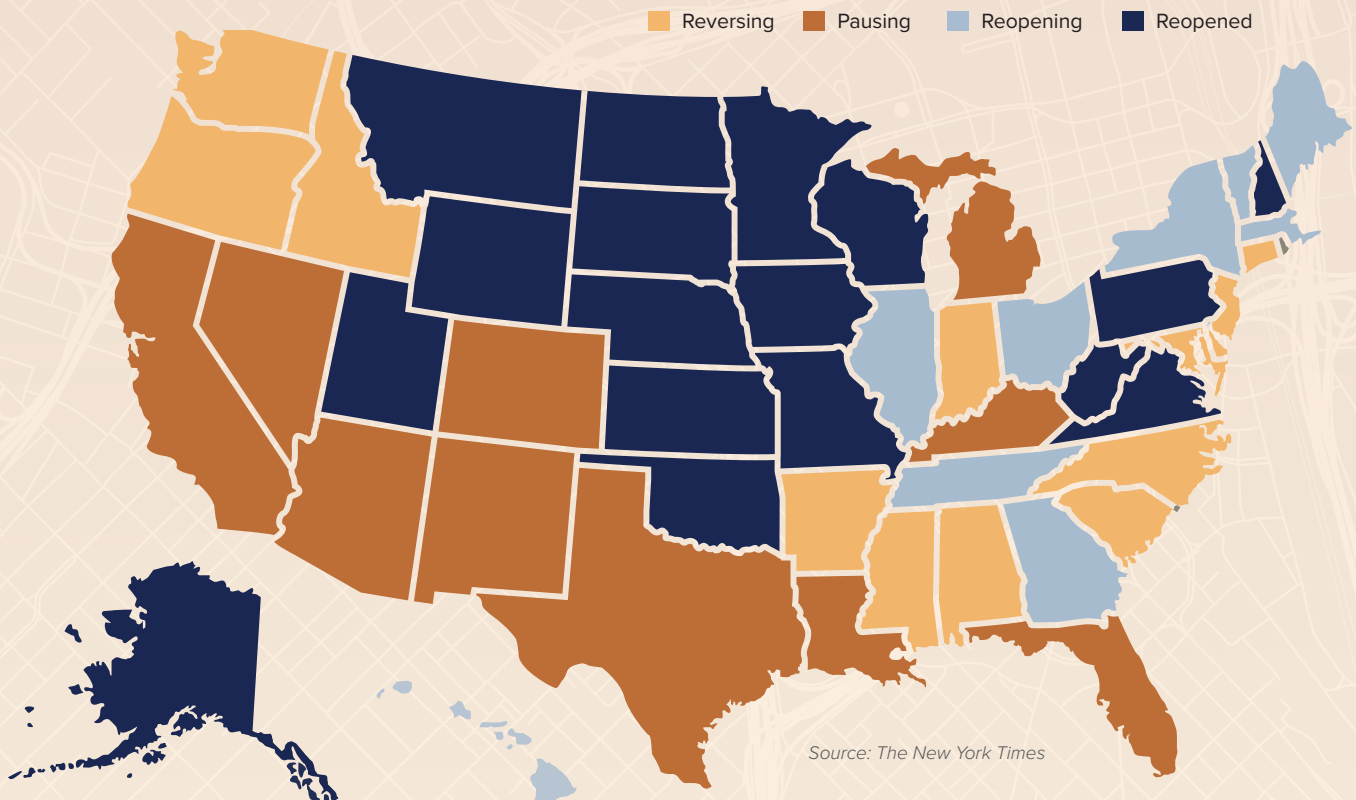
Could the Reopening of the Economy Lead to a Second Wave?

Over the last couple of months, there has been a disconnect between analysts and economists in the private sector and public health experts in the United States. Public health experts warned that if economic restrictions are lifted too early, there could be a rebound in the virus outbreak, also known as a second wave. The private sector downplayed the warning and celebrated the lifting of restrictions, anticipating a sharp rebound in economic activity.

If recent large public gatherings accelerate new infections, businesses could once again have to close, such as in Dallas, Austin, and Los Angeles. In this scenario, additional fiscal stimulus would be needed, mainly as many people remain unemployed. While rent collections were better than expected in May and June, unemployment benefits expire in July, and residential eviction moratoriums are lifted in some regions.



Research undertaken by the Federal Reserve found that, **in 1918**, those U.S. cities that removed restrictions early **had a massive outbreak and a slower economic recovery** than otherwise.



An additional forced shutdown will push retailers to focus more on omnichannel offerings, impacting industrial logistics. The evolution in customer behavior will change how storefronts, shopping centers, and parking lots are designed. Simultaneously, urban office demand will not disappear, but firms might adopt a hub-and-spoke configuration where multiple sizable

suburban satellite offices support a smaller central urban office. Of course, this is dependent on the path of the virus, and until confidence is regained in the market, questions regarding the speed of recovery still remain. **For more information on how regions are performing across the nation, please contact a Matthews™ specialized agent.**