SPECIAL REPORT

Marcus & Millichap

MARKET UPDATE: CORONAVIRUS IMPACT ON REAL ESTATE

MARCH 19, 2020

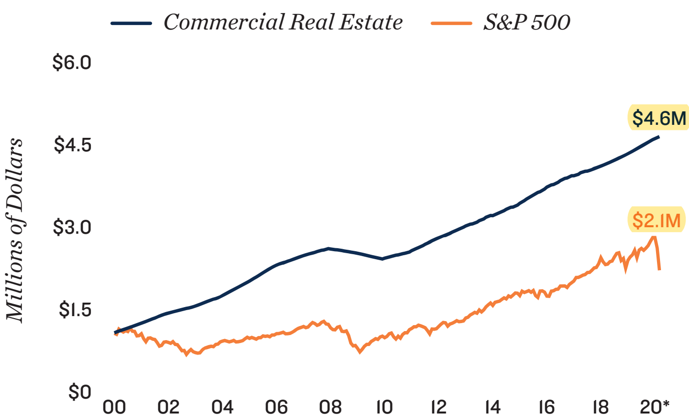
Stock Market Volatility Index Reaches Record High
Turbulence Reinforces Long-Term Strength of Real Estate

Stock market correction spurs portfolio recalibration. As the new coronavirus (COVID-19) broke free from China, the prospects of increased economic risks drove Wall Street into a flight to safety. Over the course of the following three weeks, the S&P 500 index fell 30 percent and pushed the 10-year Treasury to a record low, briefly touching 0.42 percent on March 9. Since bouncing from that intraday low, the Treasury rate has been on an upward trajectory. Market turbulence remains elevated, with the volatility index reaching its highest level on record. This has reiterated the comparative stability of real estate investments, while the record-low interest rates have sparked an increased appetite for acquisitions and a wave of refinance activity.

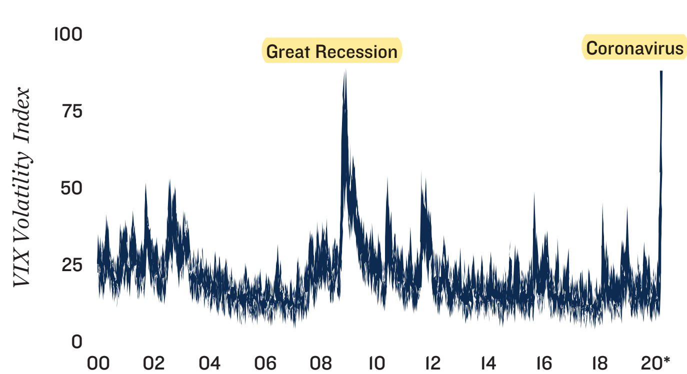
Federal Reserve takes decisive action to sustain market liquidity. To invigorate the economy during this period of uncertainty and proactively ensure capital markets do not lock up domestically or internationally, the Fed has taken swift action. On March 3, the Federal Reserve made an emergency 50-basis-point reduction to the overnight rate and later committed to more than $1 trillion of Treasury purchases and repurchase agreements. Following President Trump's declaration of a national emergency on March 13, the Fed followed with an additional 100-basis-point cut and a commitment to $700 billion of quantitative easing. This takes the Fed funds rate back the 0-0.25 percent range, where it was through much of the Great Recession, keeping the interest rate climate low to fuel spending to support economic growth. While the Fed's action has been so swift that it caught Wall Street by surprise, creating short-term volatility, it has also demonstrated the commitment to getting ahead of the biggest financial market risks.

Real estate investments deliver outsized long-term returns. While the stock market delivered exceptional total returns in excess of 25 percent last year, the recent correction has demonstrated how much volatility risk goes with that yield. Comparably, real estate investments averaged a total return of 7 percent last year, but without the whipsaw repricing experienced by Wall Street. Comparing the two asset classes over the long term demonstrates the advantages of real estate. An investment made 20 years ago, at the beginning of the year 2000, has delivered dramatically different results. The average total return on commercial real estate over this time has topped 359 percent while the stock market has delivered a 115 percent return. Even without considering the recent stock market correction, real estate outperformed.

20-Year Total Return on a $1M Investment

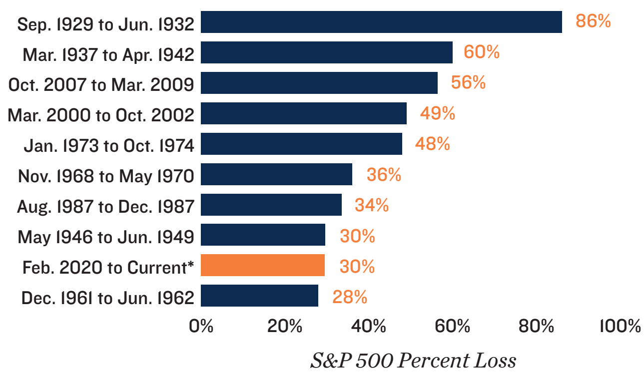


Stock Market Volatility Hits All-Time High

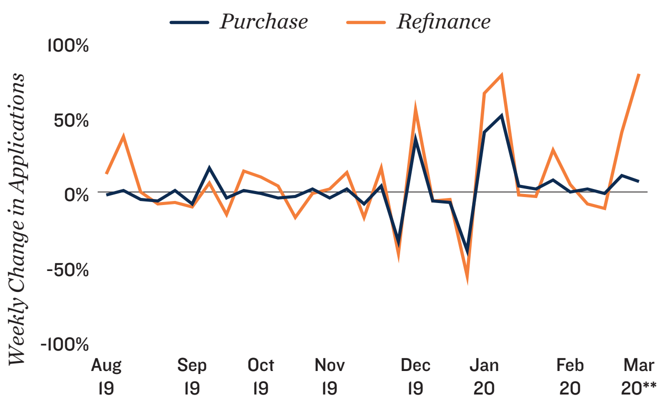


** Through March 16*

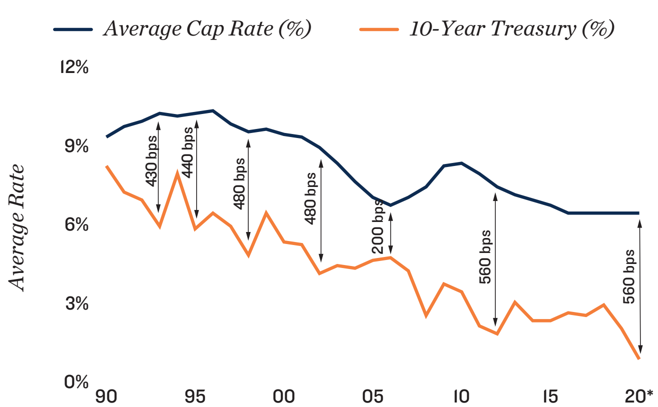
Largest Stock Market Declines on Record



Low Rates Spark Surge in Refinance Activity



Yield Spread At Record High



* Through March 16
** Through March 6

Financial Market Trends

Wall Street downturn significant but moderate compared with past corrections. Over the course of three weeks, the stock market fell by 30 percent with dramatic single-day moves both up and down. While the new coronavirus sparked the selloff, the stock market was particularly vulnerable to a correction. Over the course of 2019, the stock market valuation increased to a record level that was not substantiated by comparable earnings in the 12 months leading up to the virus outbreak. By comparison, the stock market fell by 56 percent during the financial crisis in 2007 and by 49 percent in the early 2000s as the dot-com bubble burst. Though this downturn is significant and has yet to fully play out, much of the current momentum is fear-driven. As additional information and clarity emerges, market dynamics should begin to stabilize.

Record-low interest rates boost investor returns. The flight to safety placed strong downward pressure on interest rates, pushing the 10-year Treasury to an all-time low. Investors have responded with a surge of refinancing activity and an increased interest in acquisitions. Total refinance activity surged in the first week of March, climbing by 79 percent over the last week of February. Numerous buyers also capitalized on the unique timing to lock in rates in the high-2 percent to low-3 percent range. While investors can still capitalize on low rates, many lenders have opened their spreads to moderate their downside risk. The low interest rate climate will help investors achieve stronger levered yields as the spread between the 10-year Treasury and average cap rates set a new 30-year record.

Investment Trends

Yield spreads offer unique investment climate. While investors often anticipate buying properties at reduced prices during periods of uncertainty, similar results can be created by locking in lower interest rates. Obtaining an exceptionally low interest rate generates a stronger yield as positive leverage delivers the upside. If an investor borrows money at 3 percent to purchase a property with a 5 percent cap rate, their 2 percent arbitrage lifts their levered yield significantly. While some investors go to the sidelines and await market clarity, others are maximizing their returns by locking in a lower cost of capital.

For information on national commercial real estate trends, contact:

John Chang
Senior Vice President, National Director | Research Services Division
Tel: (602) 707-9700 | john.chang@marcusmillichap.com

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SPECIAL REPORT

SUBURBS OUTPERFORM CITIES AS RENTERS RELOCATE

AUGUST, 2020

Rent prices in urban city centers are down for the first time in a decade, according to a new report from Marcus & Millichap.

The national shift toward remote work is shifting rental demand from urban areas to suburban areas, as many workers across the country look for more space at a lower cost, according to a new report from Marcus & Millichap.

Vacancy rates in suburban markets dipped below central business districts in the second quarter of 2020, according to the brokerage firm's special report on multifamily "Beyond the Global Health Crisis." From 2002 to 2015, suburban vacancy held steady at a couple percentage points above CBD. That divide began to narrow in 2016, before finally dipping below urban areas in the second quarter of this year.

The report attributes a few factors to what's impacting the numbers: health concerns are leading many to stay wary of crowded areas, urban amenities remain shuttered and many offices in central business districts are allowing employees to continue working remotely. Late last month, The Wall Street Journal reported that in Manhattan, one of the largest office markets in the country, fewer than one-tenth of office workers had returned to their workplaces.

Major tech companies like Uber, Facebook and Google have made announcements in recent weeks that all employees at their firms may work remotely for the next several months, leading many urban apartment dwellers to leave the city and head elsewhere. The exodus has led to falling demand for luxury apartments, Marcus & Millichap reported earlier this month.

"These trends may push more individuals to the suburbs, which could create new suburban employment hubs within metros that in turn fuel strong household formation," Marcus & Millichap researchers wrote in the report.

The brokerage firm predicts that in the coming years, less densely populated and lower-cost markets in the Sunbelt and inland California could attract renters and employers relocating from more expensive coastal areas like Los Angeles and the Bay Area.

However, while urban rental markets face multiple headwinds, they could end up just being short-term difficulties, according to the report. Proximity to urban amenities and walkability will continue to draw renters to downtown areas, back-filling units left vacant by renters who left for the suburbs.

The rental market may also get a boost from the rising homeownership rate. The pandemic led many older millennial to purchase their first homes, limiting the supply of single-family homes and raising prices. This could lead many, particularly within the upper-tier segment, to stay renting longer.