BEYOND THE GLOBAL HEALTH CRISIS

IPA | INSTITUTIONAL PROPERTY ADVISORS

Special Report

Tracking The Economic Recovery

Summer 2020

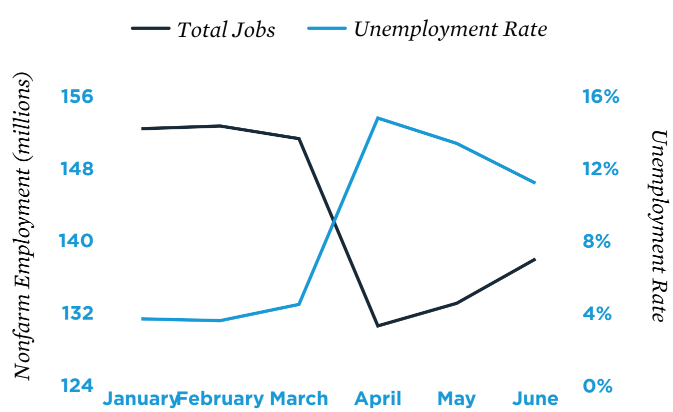
Reopening the Economy Results in Balancing Act as COVID-19 Cases Surge Alongside Job Gains and Greater Consumer Spending

Consecutive months of retail sales growth spur excitement, the reemerging health crisis poses risks. Many states began reopening in May, which helped prop up the economy after a lengthy shutdown. Allowing consumers to shop in person contributed to the largest monthly retail sales jump on record in May, followed by another gain in June. Consumers have been willing to spend despite the uncertain economic environment as the unprecedented government support provided over the past months has helped solidify household budgets. Through June, restaurant bookings, air travel and hotel occupancy have all been on the rise, proving that many consumers are ready to get out of their residences and willing to spend money. However, rising COVID-19 case counts and hospitalizations in states that reopened earliest are representative of the national risk that comes with trying to kick-start an economic recovery this summer. Reopening too quickly could strain hospital resources and coax legislators to re-enact restrictions, as seen with California's recent pullback, ultimately slowing the economic recovery in the long run. These trends exemplify why a medical solution is key to upholding consumer confidence and encouraging a return to pre-COVID-19 spending habits.

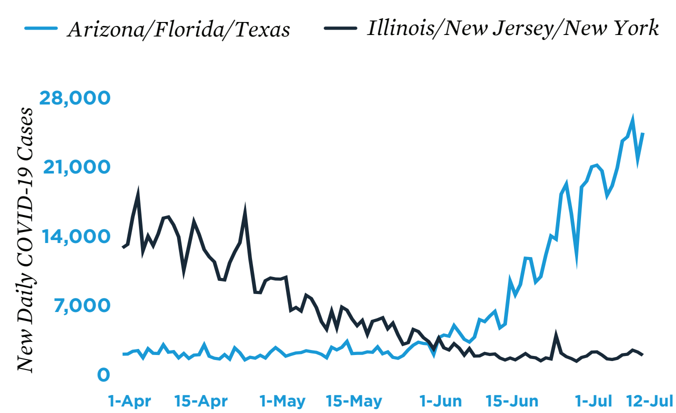
Looming expiration of federal unemployment benefits overshadows recent job gains. The May and June employment reports revealed positive momentum as a combined 7.3 million jobs were added. The gains came primarily from industries that drastically slashed headcounts amid the onset of the disruption, as a handful of temporarily laid-off personnel in the leisure and hospitality sectors were allowed back to their jobs. Nevertheless, despite the historic employment reports, the jobs recovered fell short of those lost in the previous months, leaving the unemployment rate in the double digits. Meanwhile, weekly initial unemployment claims continued to exceed 1 million through mid-July, pointing to a more broad-based labor market disruption with firms throughout the economy reducing headcounts. As the expanded federal unemployment benefits are set to expire at the end of July, some forms of commercial real estate could face steeper headwinds later this summer. Workforce housing, in particular, could see a drop-off in collections as renters in this segment are especially vulnerable to an abatement of government support.

Leisure and hospitality sector will not quickly recover in the absence of a health solution. The recovery of lost jobs is dependent upon the consumer spending that ultimately fuels the demand for labor within each industry. This creates a challenge for the leisure and hospitality sector. Its consumer base has typically been bolstered by high-earners, as they have the income to support discretionary spending. While purchasing power within this demographic is less impacted by financial constraints linked to job losses, the implications of the health crisis may continue to alter their consumption patterns. Until people feel safe leaving their residences, traveling and spending on services, the demand for labor within these industries will continue to fall short of pre-crisis levels.

Labor Market Shows Signs of Recovery



States' Reopening Timelines Impact Cases



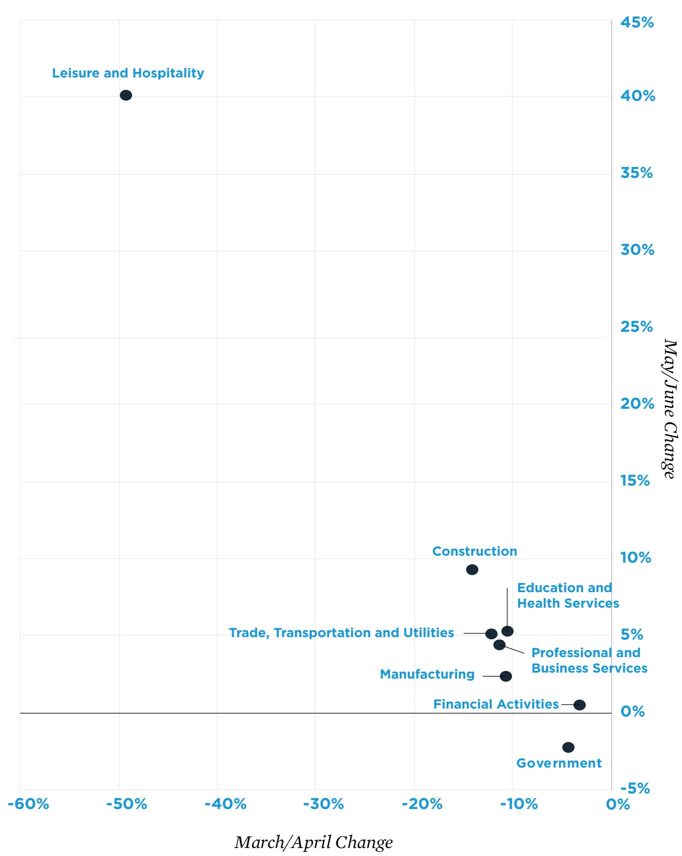
Sources: Federal Reserve; state and local health departments and hospitals; U.S. Bureau of Labor Statistics; U.S. Census Bureau

Rehiring in the Hardest-Hit Sectors Bolstered Job Gains; Quick Return to Pre-Crisis Employment Level Unlikely With No Health Solution

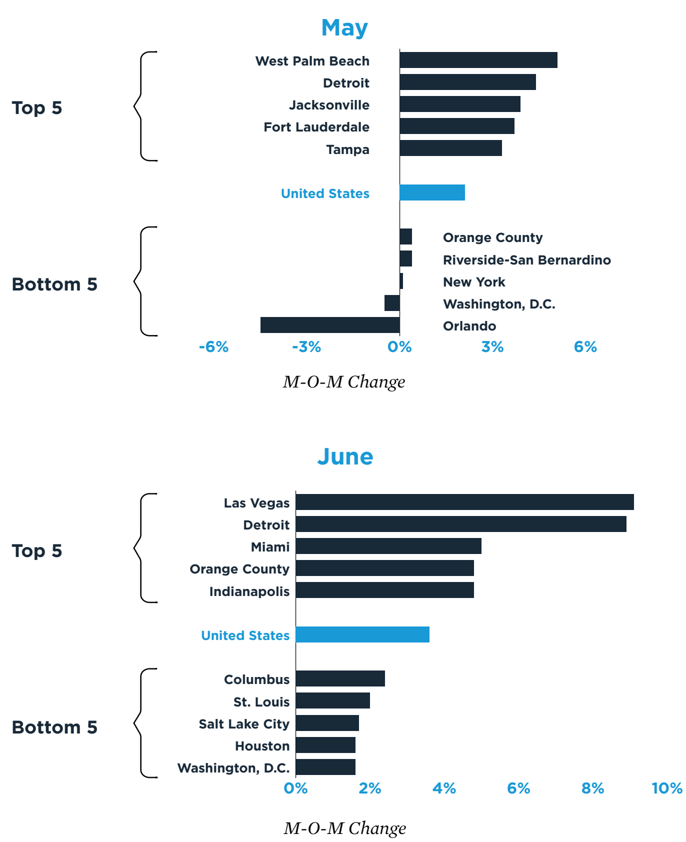
As some furloughed workers return to their jobs, more layoffs are becoming permanent. Nonfarm employment rose by 4.8 million jobs in June, building onto the 2.5 million roles added in May. The leisure and hospitality sector led the way after being disproportionately impacted in the previous months. In May, Florida markets paced the nation as the state aggressively reopened businesses, allowing more workers to return to their jobs after temporary layoffs. However, gains in Florida will likely subside as the upward trend of COVID-19 cases may constrain economic activity. On a national level, employment gains will likely taper as well in the coming months, with many industries still burdened and unlikely to replenish their workforces back to pre-COVID-19 levels. Additionally, weekly jobless claims continue to soar above historical averages, revealing a more broad-based labor market disruption than what transpired in earlier months. Firms may be reducing their headcounts of skilled workers to offset financial losses, which could weigh on the economic recovery. Consumer spending will be more significantly impacted in the long term if job losses become permanent, high-wage positions are terminated, and wage growth is sluggish.

Expiration of federal unemployment benefits holds repercussions for commercial real estate. Ramped-up unemployment benefits included in the CARES Act have mitigated the damage of high unemployment so far. However, the additional $600 per week on top of state benefits is set to expire at the end of July. With hiring likely to be centralized to a few resilient industries, such as e-commerce and necessity-based retailers, high unemployment will persist beyond the expiration of these benefits, posing risks to several forms of commercial real estate. Workforce housing in higher-cost markets faces steep headwinds in this scenario as renters who remain jobless may no longer be able to meet their financial obligations. Additionally, the expiration of federal benefits coincides with the lifting of the federal eviction moratorium, and a slew of units could go vacant over the coming months. Experiential and nonessential retailers will also face burdens as cautionary consumer spending among the lower-wage demographic will parallel a continued reduction in foot traffic. Discussions are underway to extend the federal unemployment benefits; however, policymakers are cautious not to disincentivize workers from returning to their jobs.

Sector Volatility Amid the Disruption



Employment Change by Market



Source: U.S. Bureau of Labor Statistics

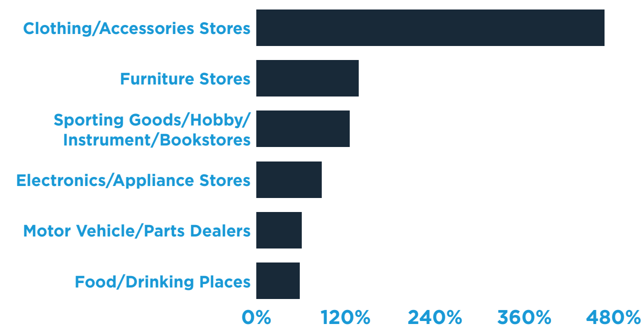
Shoppers Eager to Spend After Tightening Budgets in Spring; High-Income Earners Pivotal to Reigniting the Economic Engine

Retail sales bounce back emphatically, yet obstacles still weigh on the industry. Total retail sales increased by a record 18.2 percent month over month in May, and an additional 7.5 percent in June. These strong gains pushed retail sales to positive territory on a year-over-year basis. Pent-up demand for clothing and accessories, after these retailers were forced to close their doors for months, contributed to a two-month jump in sales exceeding 450 percent for this segment. Additionally, auto sales moved up soundly, assisted by favorable financing and low interest rates. Typically, durable good purchasing would remain sluggish during a recessionary period, so this gain indicates that many consumers remain confident in their financial situation. However, the expiration of federal unemployment benefits also has the potential to impede momentum as consumers lose a key source of financial support. Meanwhile, the shift to online shopping raises questions regarding the future of small retailers who will struggle to compete as consumer spending trends may be permanently shifting. Online retail transactions were up 81 percent year over year in May, and many of those new to shopping online will continue to use e-commerce going forward.

Health concerns limit high-income earners' willingness and ability to spend. In the second quarter, a dramatic cutback in consumer spending accelerated the decline in GDP from the 5 percent drop recorded in the first quarter. It is notable that the steepest decline in consumption over the past few months has come from the higher-income demographic as reflected in the record-level spike in the personal savings rate to 33 percent in April, which nearly doubled the previous high set in 1985. This creates the potential for a boost in spending in the coming months, as money has been accumulating on the sidelines. Unleashing this stock of cash into the economy would help fuel the recovery as the hard-hit leisure and hospitality sector relies on spending by higher-income earners who are more inclined to make discretionary purchases. However, as long as people feel unsafe traveling and leaving their residences to purchase luxury services, the economy cannot bounce back to full capacity.

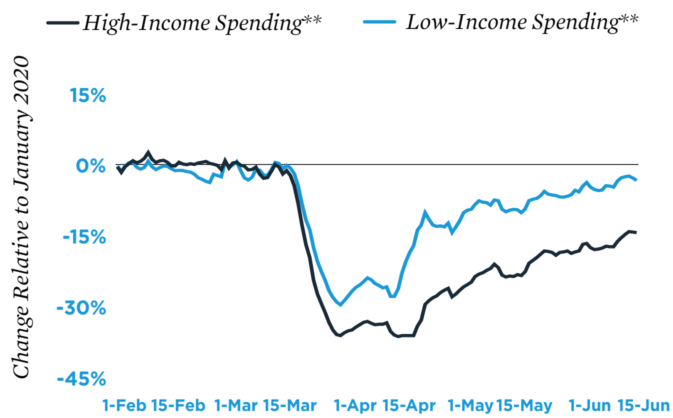
Implications of the pandemic buoy single-family housing demand. New home sales rose 16.6 percent month over month in May, pushing the rate up by double digits on an annual basis. Additionally, purchase mortgage volume was up 33 percent year over year as of late June, pointing to further gains in the coming months. The largest jumps have come from the Northeast and Western regions of the U.S. as people are looking to get out of dense cities that are more at-risk for COVID-19 community spread. Conversely, existing home sales were down year over year in May when lack of inventory and logistical hurdles complicated the process. Additionally, qualified buyers with higher incomes shifted their focus to new homes, while purchases at the lower end were likely delayed.

Hardest-Hit Retailers Had Greatest Rebound *

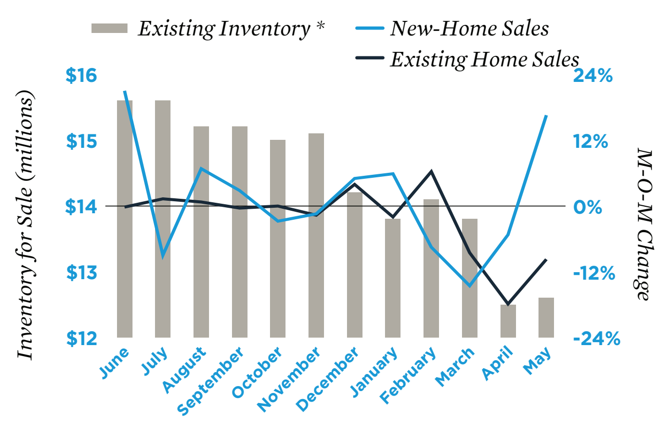


May and June Combined Change in Sales

High-Income Consumers Spending Less



New-Home Sales Surge on Lack of Existing Inventory



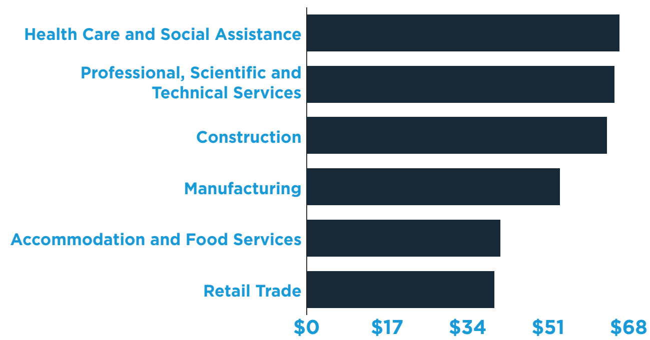
* Seasonally adjusted
** Categorizations based on average income by ZIP code
Sources: Advance Monthly Retail Trade Survey; Federal Reserve; National Association of Realtors; Opportunity Insights' "Economic Tracker"; U.S. Census Bureau

Government Action Helps the Economy Weather the Storm in the Short Term; Commercial Real Estate Lending Becoming More Obtainable for Some Assets

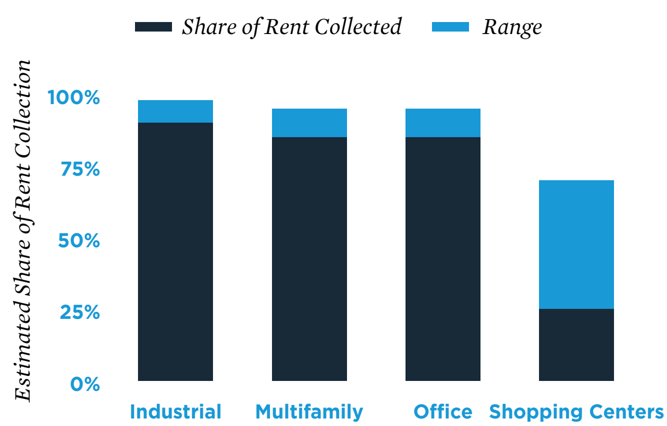
Government agencies leveraging all resources to keep the economy afloat. In early June, the PPP Flexibility Act was signed, resolving some of the flaws of the original program, which was a key aspect of the CARES Act. The act now allows borrowers an additional 16 weeks, adding on to the initial eight weeks, that they are allowed to spend the funds. This will provide businesses such as experiential retailers more accommodation to use the loans as they may need to remain closed or at limited capacity for longer. Additionally, the repayment period was extended by three years and businesses that took loans can delay payroll taxes this year. It is also important to note that borrowers are now required to use only 60 percent, instead of 75 percent, of the funds on payroll expenses. This allows business owners to allocate more of the funds toward other obligations such as rent, benefiting property owners. The Federal Reserve has also been adaptively assisting the economy, recently pledging to buy individual corporate bonds in attempt to backstop companies. With many businesses facing substantial financial burdens, access to capital is crucial to help weather the storm.

Positive economic momentum resolves some financing uncertainty. Underwriters are beginning to get a clearer picture on valuation as more data comes out revealing performance during the disruption. Optimism surrounding industrial has actually increased, contrary to other segments of commercial real estate, and the accelerated adoption of e-commerce will support continued growth for the sector. Multifamily has also exceeded expectations to this point, with rent collection surveys showing only a slight year-over-year drop, although the sector will face steeper headwinds if the federal unemployment benefits are not extended. Retail and office assets remain more highly scrutinized; however, reopening processes support more optimism going forward, and assets that proved resilient over the past few months will be in high demand. On the other hand, hospitality and seniors housing assets face a tougher recovery, and lending for these will likely come with an abundance of caution.

PPP Funds Disbursed Among Industries



Rent Collections Stable in Most Sectors



** Approvals through May 30*
*** Includes estimated rent collections for April, May and June*
Sources: Small Business Association; IPA Research Services

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Sources: IPA Research Services; Advance Monthly Retail Trade Survey; Federal Reserve; National Association of Realtors; Opportunity Insights' "Economic Tracker"; Small Business Association; state and local health departments and hospitals; U.S. Census Bureau; U.S. Bureau of Labor Statistics

Price: $1,000