Appraisal Institute®

KNOWLEDGE. | EXPERIENCE. | INTEGRITY.

Valuation Impacts of COVID-19

Appraisal Institute®

KNOWLEDGE. | EXPERIENCE. | INTEGRITY.

Valuation Impacts of COVID-19

Moderators: **Jefferson L. Sherman, MAI, AI-GRS,**
2020 President, Appraisal Institute

Bill Garber,
Director of Government and External Affairs,
Appraisal Institute

Appraisal Institute®

KNOWLEDGE. | EXPERIENCE. | INTEGRITY.

Valuation Impacts of COVID-19

Panelists:

Douglas K. Hodge, MAI, ARA, CCIM, MRICS,
Senior Appraiser, Farmers National Company

Grant Griffin, MAI,
Senior Managing Director, Valuation, BBG, Inc.

Zach Bowyer, MAI,
Executive Leadership, JLL Valuation Advisory

Ron DeVries, MAI, SRA, FRICS,
Senior Managing Director, Integra Realty Resources

Valuation Impacts of COVID-19

Panelists:

Robert Vodinelic, MAI, MRICS, National Practice Leader, Industrial and Logistics, Newmark Knight Frank

Anne R. Lloyd-Jones, MAI, CRE, Senior Managing Director, HVS

Brian Rapela, MAI, MRICS, Partner, Joseph J. Blake & Associates

James O'Neil, MAI, Senior Director, Practice Group Leader, Sports and Entertainment Group, Cushman & Wakefield

James A. Graber, MAI, Practice Leader, Senior Housing & Healthcare, CBRE

Appraisal Institute®

KNOWLEDGE. | EXPERIENCE. | INTEGRITY.

Valuation Impacts of COVID-19

Panelists:

Gary R. Free, MAI, SRA,
Senior Managing Director, Valbridge Property Advisors

Jerry Gisclair, MAI, MRICS, Executive Managing Director, National Client Services, Colliers International

Aaron Wright, MAI, MRICS, ASA,
President, Specialty Valuation Group

KC Conway, MAI, CRE, Director of Research and Corporate Engagement, Alabama Center for Real Estate

Getting Started

- 120 minutes
- Questions will be answered at the end of the webinar.
- Tech Issues: GoToWebinar (800) 263-6317

Valuation Impacts Of COVID-19: **MARKET CONDITIONS ADVICE**

Stephanie Coleman, MAI, SRA, AI-GRS, AI-RRS,
Director of Screening,
Appraisal Institute

The best we can do is talk to market participants – buyers, sellers, brokers, developers.

- What's happening with active escrows?
- Are buyers backing out?
- Are sellers holding off on listing properties? Reducing prices? Offering concessions? What's happening with days on market?
- What are brokers hearing? Are tenants renewing leases? Are businesses closing and vacating? Are vacant spaces getting leased?
- Are developers going ahead with development plans, or have they put them on hold?

Valuation Impacts Of COVID-19: **MARKET CONDITIONS ADVICE**

The answers to these kinds of questions provide clues. The appraisal report should include a discussion of them as part of the market analysis.

Finally, the appraisal report should address the uncertainty in the market caused by the COVID-19 crisis **not as a limiting condition, extraordinary assumption, or disclaimer**, but rather as part of the discussion of market conditions. While the crisis is still unfolding, it might also be a good idea to highlight key points in the letter of transmittal relating to COVID-19 as a significant factor.

Valuation Impacts Of COVID-19: **MARKET CONDITIONS ADVICE**

REMINDERS…

- Surveys of market participants are desirable in the absence of empirical evidence.
- Will some property types give us clues before others such as:
  - Self Storage rents?
  - Multi-Family rents?
- What about changes in list prices? Are markets responding quickly to the unknowns?
- Will properties with credit tenants be more sought after (increased demand) due to presumed lower risk than those without credit tenants?

Remember, it is our responsibility to form an educated opinion of the impact, if any, on the subject property's market value. To that end, a -0- adjustment is an adjustment, it says that there is no impact.

A Base Of Information to Consider

Guide Note 10: Development of an Opinion of Market Value in the Aftermath of a Disaster

Guide Note 11: Comparable Selection in a Declining Market

Guide Note 12: Analyzing Market Trends

Land & Agriculture

Douglas K. Hodge, MAI, ARA, CCIM, MRICS,

Senior Appraiser,

Farmers National Company

Valuation Impacts Of COVID-19: **LAND & AGRICULTURE**

DIVERSITY OF AGRICULTURE

- **Row crops/cropland – most common ag investment class**
- **Livestock**
- **Permanent plantings**
- **Nursery, greenhouse**
- **Agri-business**

Valuation Impacts Of COVID-19: **LAND & AGRICULTURE**

ROW CROPLAND

- Demand as an alternative investment remains strong, especially for top quality land.
- Not a lot of empirical data currently, relative to the impacts of the virus on land values.
- Anecdotal evidence from recent sale activity indicates that there is still farmer/investor demand, and values have remained relatively stable with pockets of both strong sales and areas with weakened prices, primarily for less than prime cropland.
  - Some sales have been postponed or canceled until a later date, others have been held with mixed results with some no-sales and others that have sold at good prices.

LIVESTOCK/PERMANENT PLANTINGS

- Livestock encompasses dairy, poultry, hogs, cattle and others. These markets were generally weak going into COVID and as this progresses there are additional stresses on markets that will likely continue to erode values going forward. Processing and delivery to consumers is becoming an issue.

- Many permanent planting crops such as apples, grapes, other tree fruits, etc. are just beginning their production season and it's too early to see an impact on pricing. Early spring weather will have as much impact on pricing as any other factor at this time.

Valuation Impacts Of COVID-19: **LAND & AGRICULTURE**

SO WHAT DOES THIS ALL MEAN?

It's too early to gauge any impact on agricultural values as a result of COVID.

There are a lot of moving parts in the world of agriculture:

- Commodity prices and supply/demand factors will have a bearing on future values
- Continued low margins for producers and suppliers will impact marketability and financial feasibility
- Agriculture reached a peak following the financial crisis with high commodity prices for several years.
- If foreign markets are lost for commodities, as recently experienced with tariff legislation, it is expected to have a negative impact on values.
- Most livestock enterprises have already been impacted and this trend is likely to continue as processers/packers struggle with labor and distribution issues.
- Likely to see lower cash rents and returns for cropland as margins continue to tighten

Commercial/Retail

Grant Griffin, MAI,

Senior Managing Director, Valuation
BBG, Inc.

Valuation Impacts Of COVID-19: **COMMERCIAL/RETAIL**

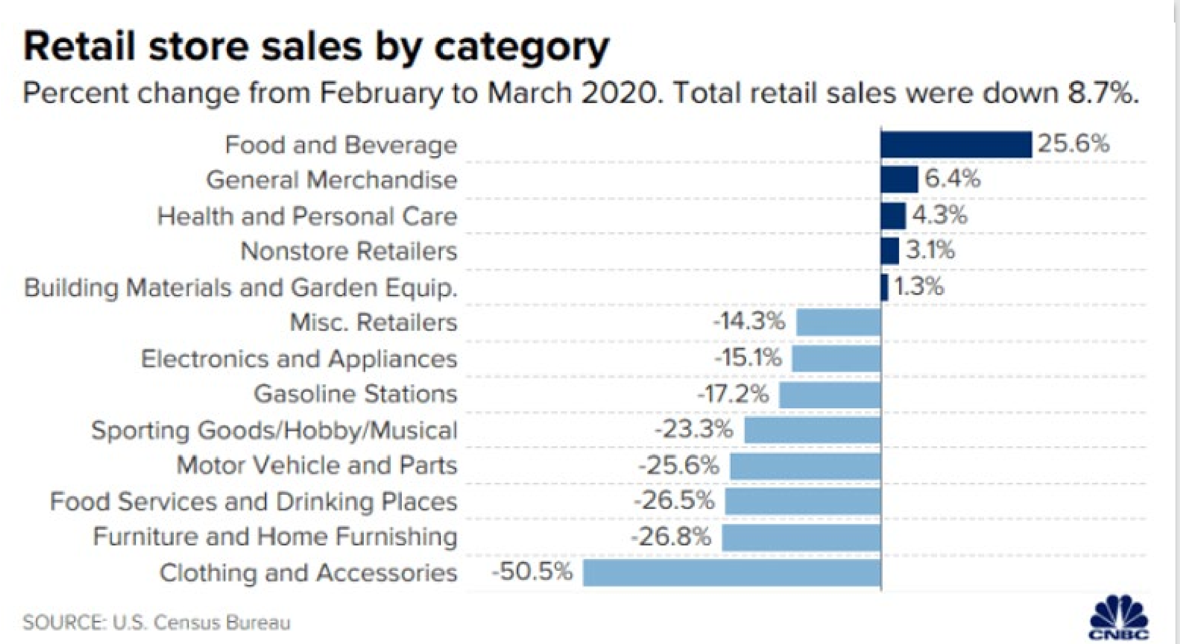
THE GOOD NEWS

- Abundance of demand for high-quality assets with investment grade credit tenants that are open and paying rent
- Financing is readily available primarily from banks
- Capitalization rates for high-quality assets are unchanged from pre-COVID-19

Valuation Impacts Of COVID-19: **COMMERCIAL/RETAIL**

THE BAD NEWS:

Literally Everything Else



Retail store sales by category

Percent change from February to March 2020. Total retail sales were down 8.7%.

SOURCE: U.S. Census Bureau

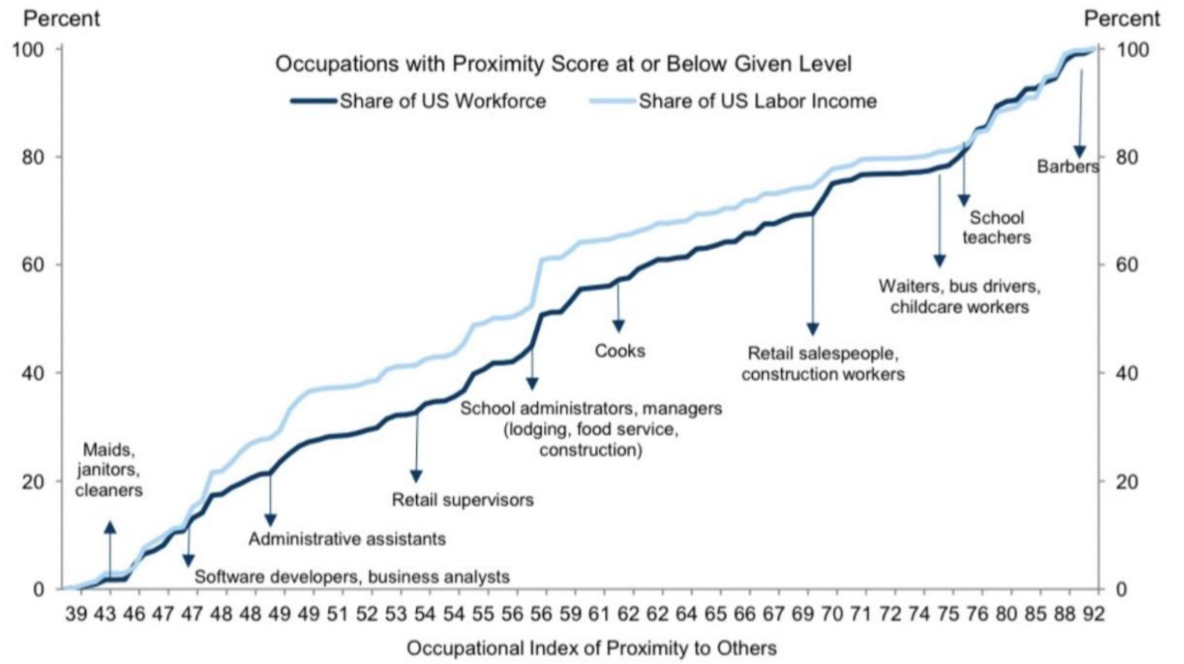
Key Takeaway: Non-credit retail market is on hold until investors and lenders gain more clarity, which is happening each week. The short-term outlook is negative, and no knowledgeable investor would sell in this market unless under duress. Many brokers are not willing to take properties to market at this time as it would be a disservice to their clients. There are numerous distressed asset and debt funds looking to buy at discounts.

- Non-credit retail is now among the least desirable assets for lenders second to hotels.
- CMBS and life cos are out. Banks more restrictive.
- 25%-50% of retail tenants paid rent in April. 30% of small businesses paid no rent or mortgage payment while 20% made a partial payment.
- Owners are budgeting 3-4 months lost rent (incl. April) for non-credit tenants which are closed or not paying rent. 3 months is most common (incl. April).
- Renewal probabilities have declined in the short-term. To what?
- On average, market rents have probably declined to levels seen 1 to 2 years ago.
- 10% to 40% of restaurants are projected not to reopen.
- In 2019, ~70% of QSR traffic was via drive-thru, delivery or carry-out. QSRs will bounce back quickly but investors will closely watch store sales.
- Casual dining will be hit the hardest.
- Expect very little leasing activity in the short-term.

Valuation Impacts Of COVID-19: **COMMERCIAL/RETAIL**

THE PATH FORWARD

Exhibit 7: Jobs and Activities That Require Less Physical Proximity to Others Will Likely Reopen Sooner



Source: Federal Reserve Bank of St. Louis, Goldman Sachs Global Investment Research

5+ years of e-commerce growth is being crammed into a single quarter and there will be lasting changes for the retail market:

- Will grocery stores need less retail space and more warehouse/cold storage space for deliveries? Will grocery stores require new designs to accommodate curb-side pick up?
- Will restaurants need fewer square feet dedicated to dining areas? Will restaurants need more kitchen space to accommodate deliveries (see PREP Atlanta)? Casual dining and QSR restaurants that develop efficient delivery processes will likely thrive.
- Big boxes will continue to downsize as e-commerce continues to grow at a more rapid pace.
- Small business formation will be low in the short-term.
- Credit tenants with strong balance sheets will expand.

Healthcare

Zach Bowyer, MAI,
Executive Leadership,
JLL Valuation Advisory

Valuation Impacts Of COVID-19: **HEALTHCARE**

Seniors Housing	**Capitalization Rate (%)**			*COVID-19	**Discount Rate (%)**			COVID-19
Investment Class	A	B	C	Impact (Bps)	A	B	C	Impact
Active Adult	4.8 - 6.0	5.8 - 6.6	7.0 - 7.7	25 - 100 ⬆	6.9	7.8	8.6	⬌
Independent Living	5.4 - 6.4	6.5 - 7.3	7.7 - 8.2	25 - 100 ⬆	7.7	8.5	9.3	⬌
Assisted Living	5.9 - 7.0	7.0 - 7.7	8.2 - 8.8	25 - 100 ⬆	8.2	9.0	9.9	⬌
Memory Care	7.3 - 7.8	8.1 - 8.5	9.1 - 9.4	50 - 100 ⬆	9.2	10.3	11.1	⬌
Nursing Care	11.0 - 11.4	12.0 - 12.7	13.1 - 14.0	50 - 100 ⬆	13.2	14.2	15.3	⬌
CCRC/LPC	7.4 - 8.0	8.2 - 8.7	8.9 - 9.7	25 - 100 ⬆	9.3	10.4	11.1	⬌

Source: JLL Valuation Advisory Spring 2020 Investor Survey

* Short-term indication only and applies to new listings. Long term impact on cap rates is still unknown.

Seniors Housing & Care Revenue: Declining occupancy is having the greatest impact on revenue. An April 12 survey of 146 seniors housing and skilled nursing operators indicated that 39% independent living, 54% assisted living, 38% memory care, and 70% nursing care properties experienced a decline in occupancy from one-month prior. The rate of decline varies, but averaging 300 to 500 basis-points since the onset of this pandemic. Contract rents are holding with relatively little change in loss-to-lease. Average daily rates at nursing homes have increased in most cases.

Seniors Housing & Care Expenses: Increased insurance, staffing and personal protective equipment (PPE) cost have had a significant impact on operating expenses. PPE is the largest with a forecasted a spend of $500 to $700 per unit. Most of these expenses, with the exception of insurance, are short-term and are expected to normalize post-pandemic. Some longer term impact on staffing expenses is likely.

Net Operating Income: Initial research estimates project negative NOI growth in 2020, returning to a stabilized average ~3% growth in 2021-2024. Expect prolonged re-absorption above traditional industry averages of four to five residents per month due to acuity creep and increased regulatory requirements. The more traditional seniors housing properties are expected to lead the way to recovery.

Valuation Impacts Of COVID-19: **HEALTHCARE**

Medical Office	**Capitalization Rate (%)**		COVID-19	**Unlevered IRR (%)**		COVID-19	**Residual Cap Rate (%)**		COVID-19
Product Type	Low	High	Impact	Low	High	Impact	Low	High	Impact
Core	4.3	5.3	↔	5.5	6.8	↔	5.0	6.0	↔
Core-Plus	5.8	7.0	↑	7.0	10.0	↑	6.3	7.5	↑
Value Add	N/A	N/A	↑	9.0	14.0	↑	7.5	9.0	↑

Source: JLL Healthcare Capital Markets

Medical Office: Healthcare providers will likely emerge from the coronavirus episode with a focus on providing even more care outside the inpatient environment as well as further use of technology to provide patient care. Outpatient medical settings will evolve to provide more clinically acute care. Well-located MOBs (on campus and off) with strong healthcare provider sponsorship and long-term leases have performed well, some at pre-crisis pricing levels.

- Core pricing largely unchanged, as there is a highly constrained supply of this MOB product today (new construction, single tenant health systems). Particularly in times of uncertainty, capital will migrate towards quality and high stability.
- Core-plus pricing has softened; capital is available but investors are cautious on pricing and being more selective. Debt is less available for this profile, and MLAs are being highly scrutinized. Tenants with non-essential services have been disproportionately affected by the shutdown – primarily elective surgery centers, dentists, etc. Landlords have indicated on average that 10-25% of tenants have requested rent relief for MOB space vs. 70%+ for retail tenants.
- Value-add for repositioning, redevelopment, significant lease-up is challenging. This is a turnabout as MOB investors sought yield recently as downward pressure on returns prevailed in recent years, and took advantage of off-campus, outpatient conversions of existing office and retail product. Virtually, no opportunistic investment due to lack of financing. Expecting a lag in this property profile; likely more distressed sponsors than properties.
- Development deals are still taking place, but limited to single-tenant or highly pre-leased projects. Most lenders are focused on evaluating their portfolios, closing existing commitments, and working to determine next steps.

Valuation Impacts Of COVID-19: **HEALTHCARE**

Seniors Housing & Care Valuation Themes: Transactional activity has slowed, primarily due to logistical challenges and internal portfolio evaluations. The Agencies and other traditional lending sources are taking additional steps including requirement for 12-18 months of debt service reserve to further underwrite the additional risk exposure. Rent deferrals or loan forgiveness requests are increasing, but not as prevalent as other sectors.

Most lenders and investors are relying on the discounted cash flow analysis due to the volatility of short-term cash flows and negligible transactional data for extracting capitalization rates. Understanding short-term vs long-term impact on property financials is critical and may not be reflected by current statements. Short-term impact on valuations are being reported at a 5% discount to pre-COVID-19 pricing.

While COVID-19 is testing the recessionary resilient reputation of seniors housing, market participants do not expect changes in long-term demand. The demographic “silver tsunami” demand is building among baby boomers. The $2 trillion CARES Act will help the sector survive this pandemic.

Medical Office Valuation Themes: Diversified healthcare REITs with seniors housing holdings have been sidelined. Several public healthcare REITs are benefiting from pre-COVID-19 virus debt and equity offerings at favorable cost of capital. Major institutional investors and funds with significant dry powder and solid lines of credit in place remain cautiously active. Notable investors see this as a favorable pivot point for investment with certain capital sources sidelined. It has yet to be determined how the divergence in public vs. private capital pricing will impact private investment valuations.

Healthcare systems and hospitals that are market leaders, typically well rated (A2 or higher), with substantial liquidity, and at the vanguard of healthcare delivery, while challenged in the current environment, will perform the best and will likely thrive and take market share. Weaker hospitals will face increasing pressures and difficult decisions that will impact the communities they serve. Independent physician practices, the target of acquisitions by health systems for the last 10-15 years, will likely reconsider their market position following this pandemic.

Resources

National Investment Center fort the Seniors Housing & Care Industry: COVID-19 Resource Center
JLL Valuation Advisory: Seniors Housing & Care Spring 2020 Investor Survey & Valuation Index

Housing (Multifamily/Apartments)

Ron DeVries, MAI, SRA, FRICS

Senior Managing Director
Integra Realty Resources

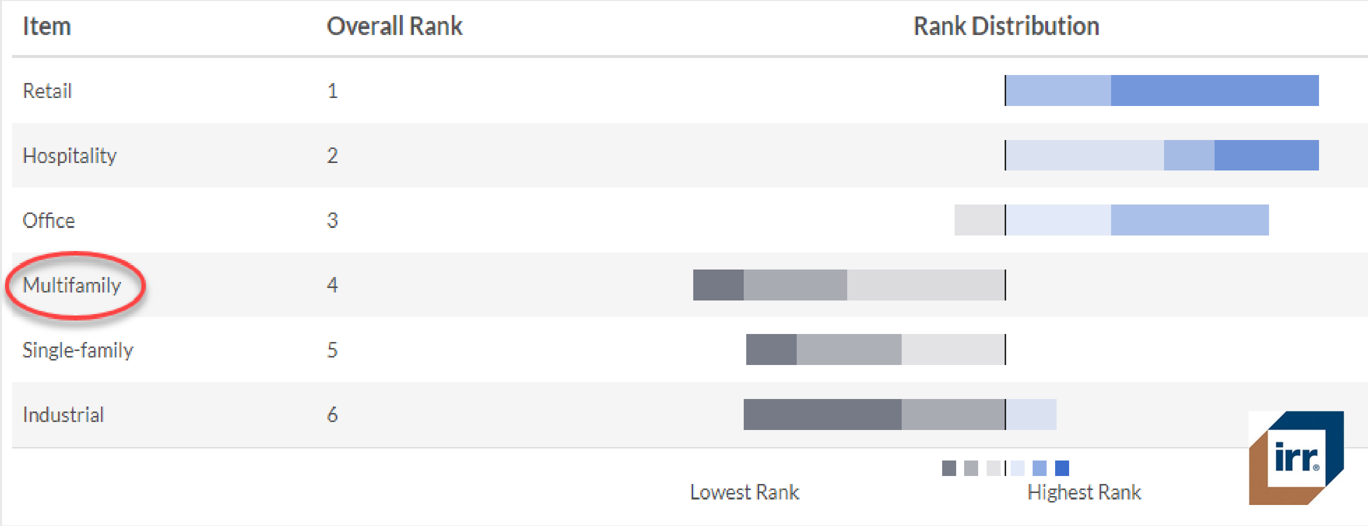
Valuation Impacts Of COVID-19: **HOUSING (MULTIFAMILY/APTS)**

MULTIFAMILY SECTOR – EXPECTED DEPTH AND DURATION OF CRISIS

Perception is Multifamily will NOT be hit hard – and will recover quickly on a relative basis

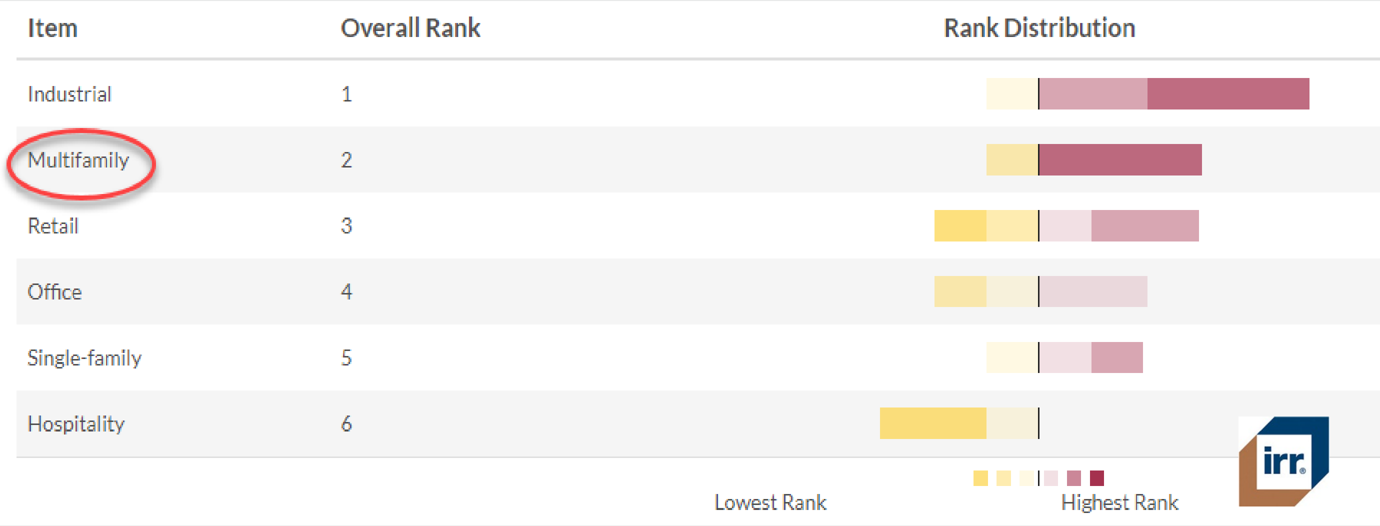
Source:
Integra Realty Resources
National Market Participant Survey

HARDEST HIT?



Item	Overall Rank	Rank Distribution
Retail	1	
Hospitality	2	
Office	3	
Multifamily	4	
Single-family	5	
Industrial	6	

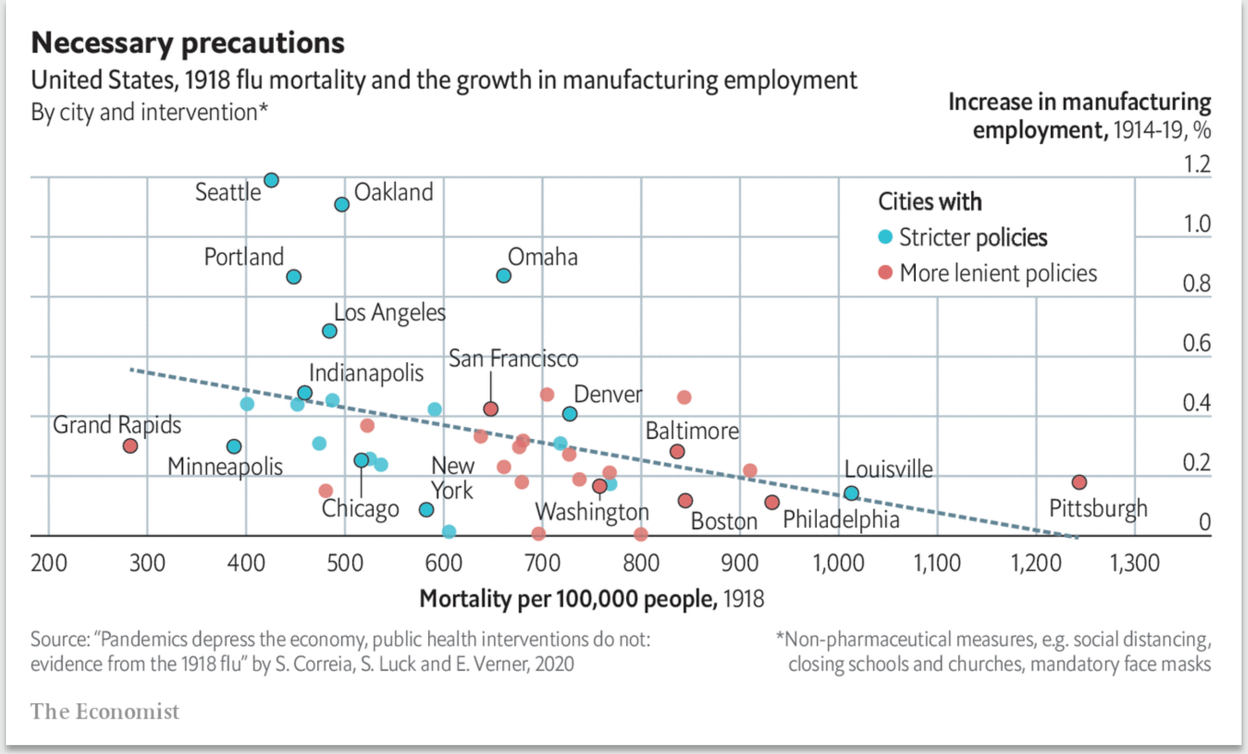
FASTEST TO RECOVER?



Item	Overall Rank	Rank Distribution
Industrial	1	
Multifamily	2	
Retail	3	
Office	4	
Single-family	5	
Hospitality	6	

Valuation Impacts Of COVID-19: **HOUSING (MULTIFAMILY/APTS)**

VALUATION IMPACT – RISK VARIES BY LOCATION & CLASS



Necessary precautions

United States, 1918 flu mortality and the growth in manufacturing employment

By city and intervention*

Source: "Pandemics depress the economy, public health interventions do not: evidence from the 1918 flu" by S. Correia, S. Luck and E. Verner, 2020

*Non-pharmaceutical measures, e.g. social distancing, closing schools and churches, mandatory face masks

The Economist

HISTORY SHOWS

Stricter Policies ▶ **Lower Mortality** ▶ **Greater Employment Rebound**

Employment, Employment, Employment

- Markets quicker to shut down and slower to open may fare better
- Tech vs. Tourism employment markets

Operational Risks

- Rent collections
  - – Luxury vs Non-Luxury
  - – NMHC Rent Tracker – 84% paid by 4/12/20 vs 91% by 3/12/20
  - – What will May bring?
- Vacancy

  Short term vs long term – beware of double hitting
- Expenses

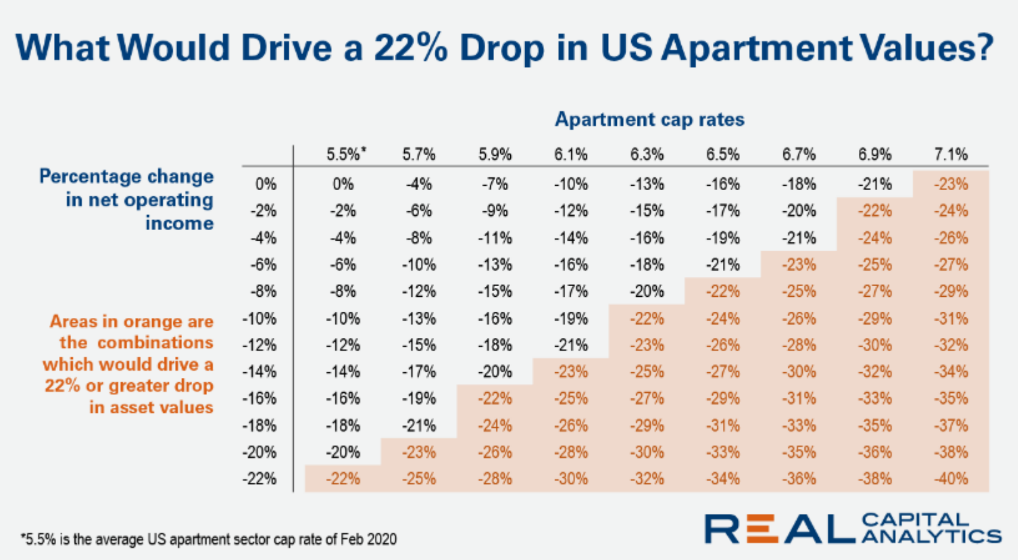
  New normal for cleaning and operations?

Valuation Impacts Of COVID-19: **HOUSING (MULTIFAMILY/APTS)**

VALUATION IMPACT – RE-PRICING CONSIDERATIONS

Re-pricing risk

- Multifamily has held favored status
- Availability and cost of capital – upward pressure on cap rates
    - Agency lenders, many banks and HUD remain active
    - Interest rates are roughly 50bp higher - varies
    - I/O loans are all but gone
    - LTVs are pulling back
    - Loan escrow requirements up for PITI – DCR testing at exit
    - Equity is seeking a modestly higher return
- Watch for denominator effect on institutional assets along with redemption issues
- Market value requires a willing buyer and willing seller
- Ongoing survey of market participants is key
  Are deals closing? Re-trades? At what discount?



What Would Drive a 22% Drop in US Apartment Values?

Apartment cap rates

Percentage change in net operating income

	5.5%*	5.7%	5.9%	6.1%	6.3%	6.5%	6.7%	6.9%	7.1%
0%	0%	-4%	-7%	-10%	-13%	-16%	-18%	-21%	-23%
-2%	-2%	-6%	-9%	-12%	-15%	-17%	-20%	-22%	-24%
-4%	-4%	-8%	-11%	-14%	-16%	-19%	-21%	-24%	-26%
-6%	-6%	-10%	-13%	-16%	-18%	-21%	-23%	-25%	-27%
-8%	-8%	-12%	-15%	-17%	-20%	-22%	-25%	-27%	-29%
-10%	-10%	-13%	-16%	-19%	-22%	-24%	-26%	-29%	-31%
-12%	-12%	-15%	-18%	-21%	-23%	-26%	-28%	-30%	-32%
-14%	-14%	-17%	-20%	-23%	-25%	-27%	-30%	-32%	-34%
-16%	-16%	-19%	-22%	-25%	-27%	-29%	-31%	-33%	-35%
-18%	-18%	-21%	-24%	-26%	-29%	-31%	-33%	-35%	-37%
-20%	-20%	-23%	-26%	-28%	-30%	-33%	-35%	-36%	-38%
-22%	-22%	-25%	-28%	-30%	-32%	-34%	-36%	-38%	-40%

Areas in orange are the combinations which would drive a 22% or greater drop in asset values

*5.5% is the average US apartment sector cap rate of Feb 2020

REAL CAPITAL ANALYTICS

- **NCREIF data showed 4% drop in NOI in last recession**
- **Cap rates increased 130 bps**
- **How will the current crisis compare for demand?**
- **Falling interest rates and rising rental demand bailed us out before**

Industrial

Robert Vodinelic, MAI, MRICS

National Practice Leader, Industrial and Logistics
Newmark Knight Frank

Valuation Impacts Of COVID-19: **INDUSTRIAL**

WHERE WE ARE (1Q 2020)

- 4Q 2019 Newmark Knight Frank Research report was very prescient
  - "Economic growth has been uneven around the globe, and the need for new distribution centers may diminish quickly if international trade were to slow abruptly."
- Flat short-term rent projections – potential for increases later in 2020/2021
- New industrial construction continues although much speculative construction on pause
- Still ample capital on the sidelines waiting to be deployed in the sector
- Some rent deferrals are being requested, although much less than other property types
- Industrial investment sales started off hot in 1Q 20, headlined by completion of ProLogis $4.0 billion acquisition of Industrial Property Trust in January
- Amazon expands aggressively
  - 40%+ of e-commerce market – hiring another 75,000 in April 2020, after the 100,000 in March

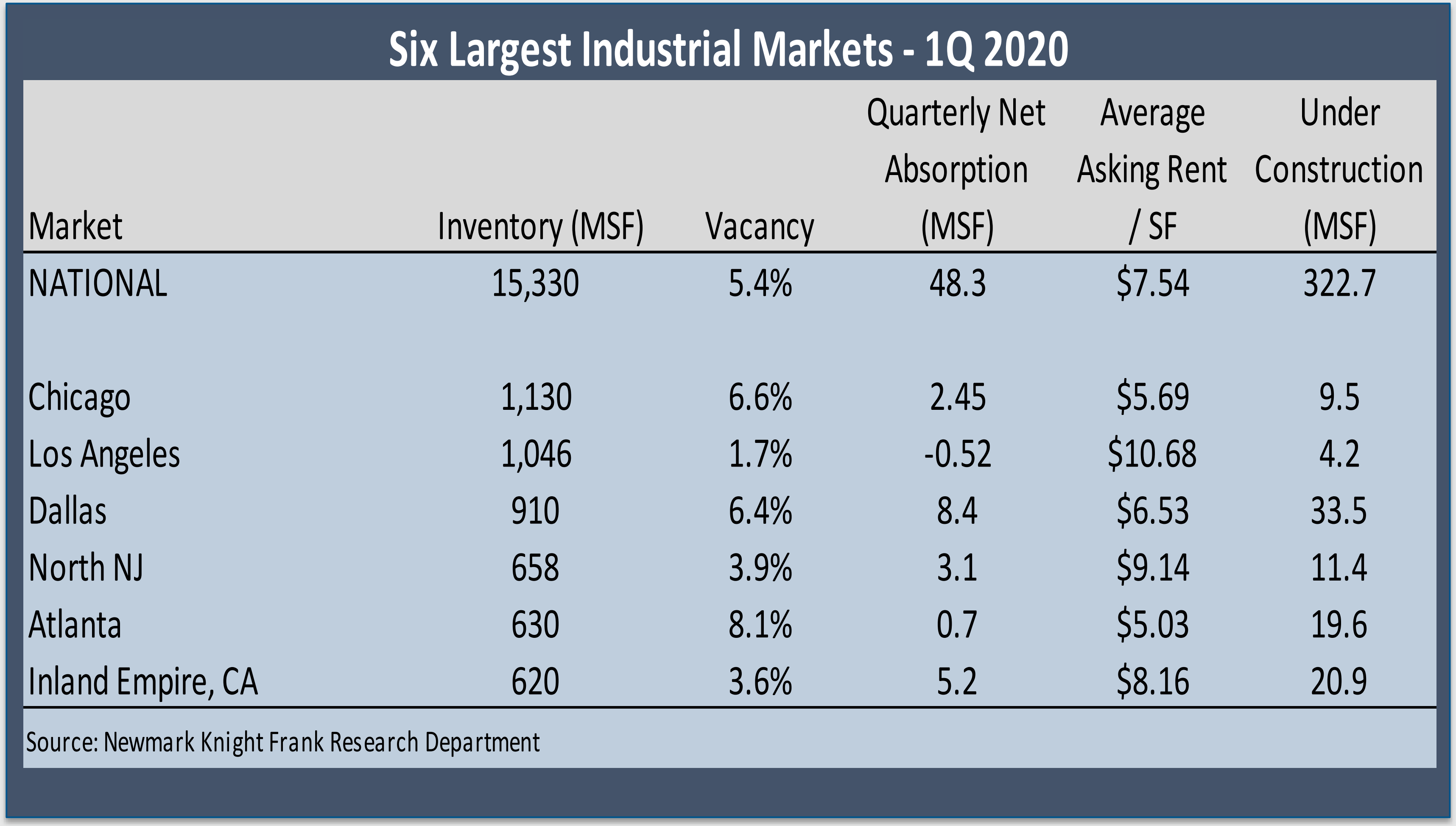
Valuation Impacts Of COVID-19: **INDUSTRIAL**

SUPPLY CHAIN DISRUPTIONS

International shipping volumes plummet and restrictions on many products is slowing trade.

SIX LARGEST INDUSTRIAL MARKETS IN 1Q 2020

Some weakening trends with upticks in vacancy, slower net absorption, and a surge in construction still taking place.



Six Largest Industrial Markets - 1Q 2020

Market	Inventory (MSF)	Vacancy	Quarterly Net Absorption (MSF)	Average Asking Rent / SF	Under Construction (MSF)
NATIONAL	15,330	5.4%	48.3	$7.54	322.7
Chicago	1,130	6.6%	2.45	$5.69	9.5
Los Angeles	1,046	1.7%	-0.52	$10.68	4.2
Dallas	910	6.4%	8.4	$6.53	33.5
North NJ	658	3.9%	3.1	$9.14	11.4
Atlanta	630	8.1%	0.7	$5.03	19.6
Inland Empire, CA	620	3.6%	5.2	$8.16	20.9

Source: Newmark Knight Frank Research Department

Valuation Impacts Of COVID-19: **INDUSTRIAL**

WHERE WE'RE GOING:

- Tech disruption will continue to be to the benefit of industrial
- Long term there may be more potential for on-shoring of production
- "Just-in-Time" to "Just-in-Case" inventory management will result in more warehouse demand
- E-commerce Demand Growing
  - $600 billion in 2019, 11% of overall consumer retail sales
  - In some countries, e-commerce already represents a much larger share of retail expenditure
- Cold Storage Growth
  - COVID-19 will increase online orders of perishables permanently
  - Online food/beverage - $143 billion by 2025 (source: FMI – The Food Industry Association/Nielsen)
  - May see shift in grocery store design incorporating more storage and fulfillment areas which could compete to some extent with warehouse/cold-storage

Valuation Impacts Of COVID-19: **INDUSTRIAL**

WAREHOUSE DESIGN/OPERATIONS WILL CHANGE SIGNIFICANTLY

- More robotics and automation to limit labor risks including low unemployment rates and disruptions such as COVID-19
- Kroger is designing fully-automated 350,000 SF+ warehouses which can fill online grocery orders. Costs are high though as the warehouses cost about $55 million to build ($150+/SF)

LAST-MILE DISTRIBUTION

- Same-day and "instant" delivery may end up with a 25% share of the market by 2025 (McKinsey & Company)
- Costco invests $1 billion in acquisition of Innovel Solutions logistics company to bolster its last-mile distribution capabilities
- Multi-story facilities are gaining more traction
  - Several have been built in New York, San Francisco and Seattle metro areas

Lodging and Hospitality

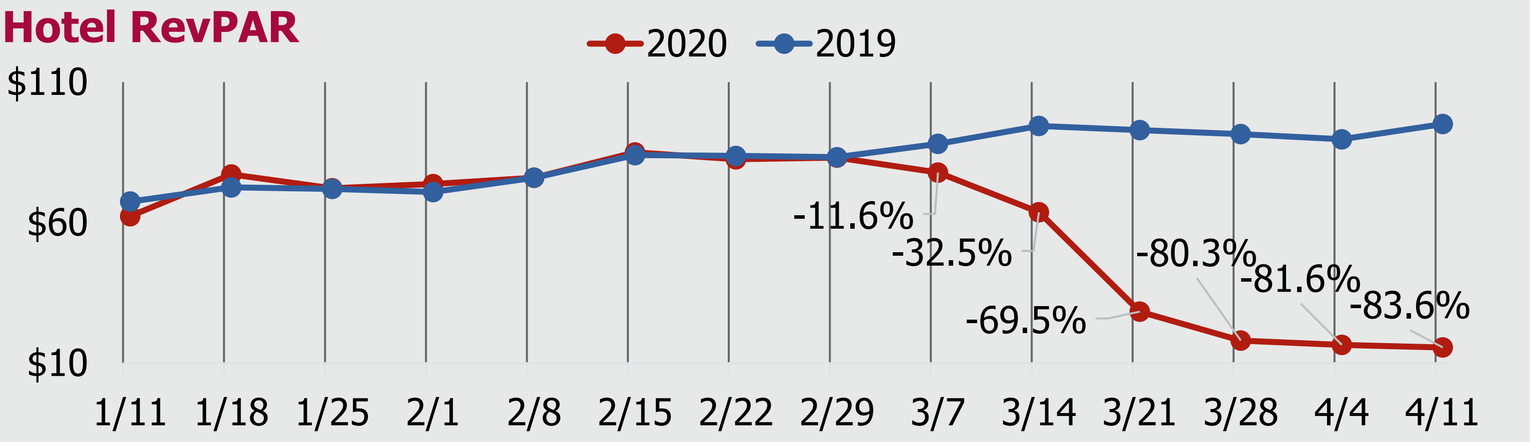
Anne R. Lloyd-Jones, MAI, CRE

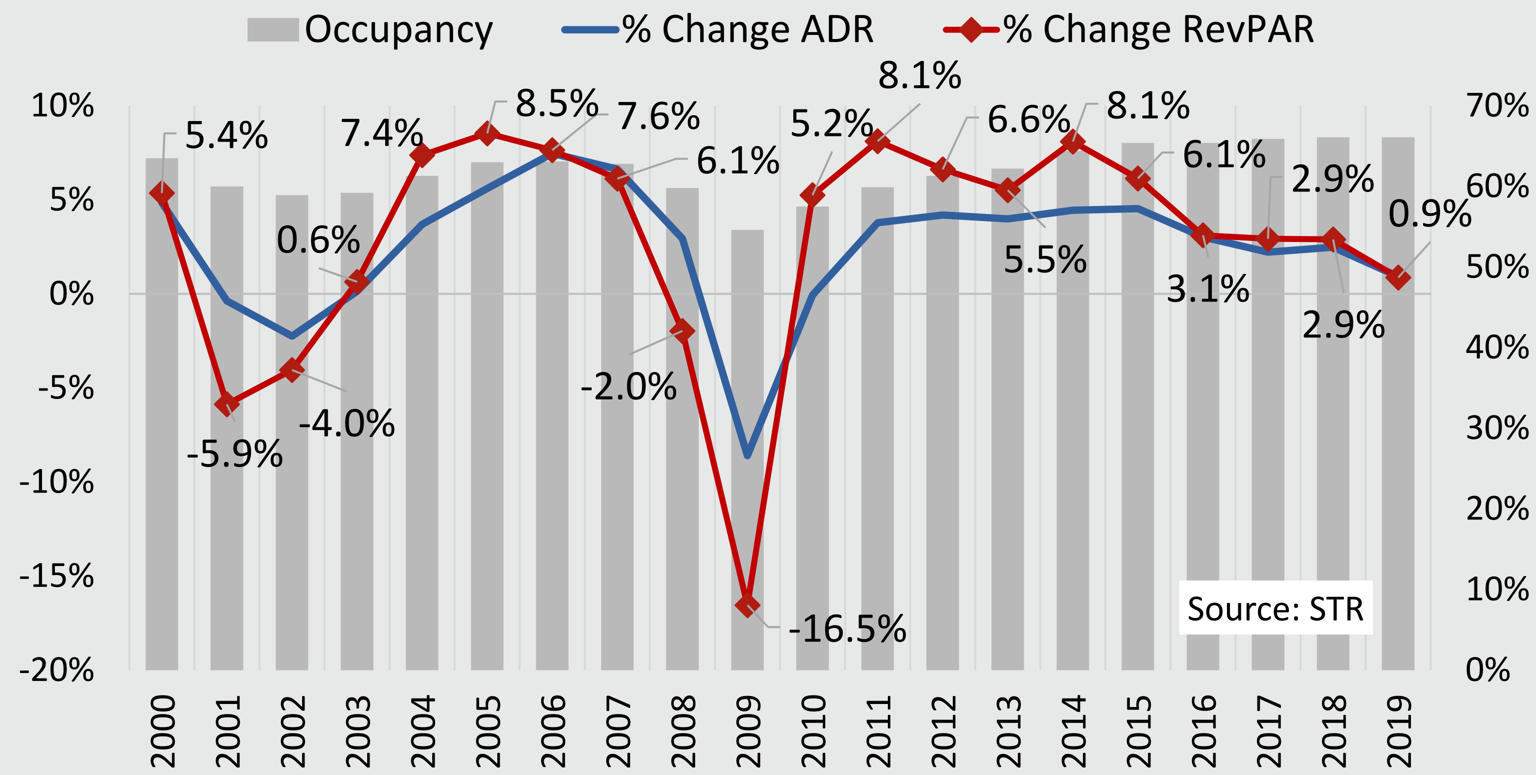
Senior Managing Director

HVS

Valuation Impacts Of COVID-19: **LODGING AND HOSPITALITY**

Hotel RevPAR



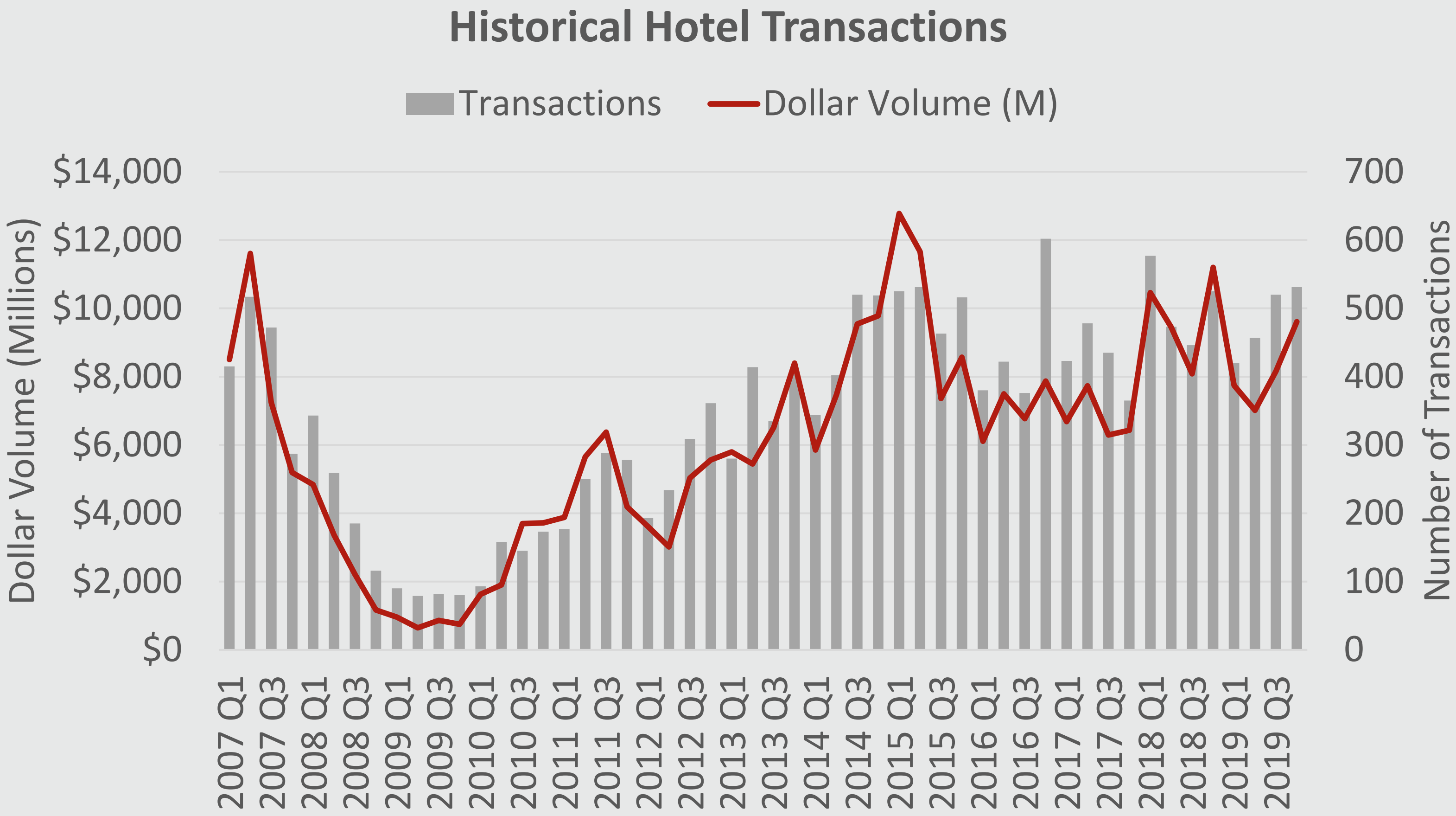


Source: STR

The Hotel Sector

- Unprecedented decline in all revenues, with some hotels suspending operations
- Even with suspended operations, necessary expenses comprise 20% to 25% of “normal” expenses
- Negative operating leverage – typically a 10% decline in revenues results in a 20% decline in EBITDA
- Many hotels will experience negative EBITDA in 2020

WHAT ABOUT THE TRANSACTION MARKET?



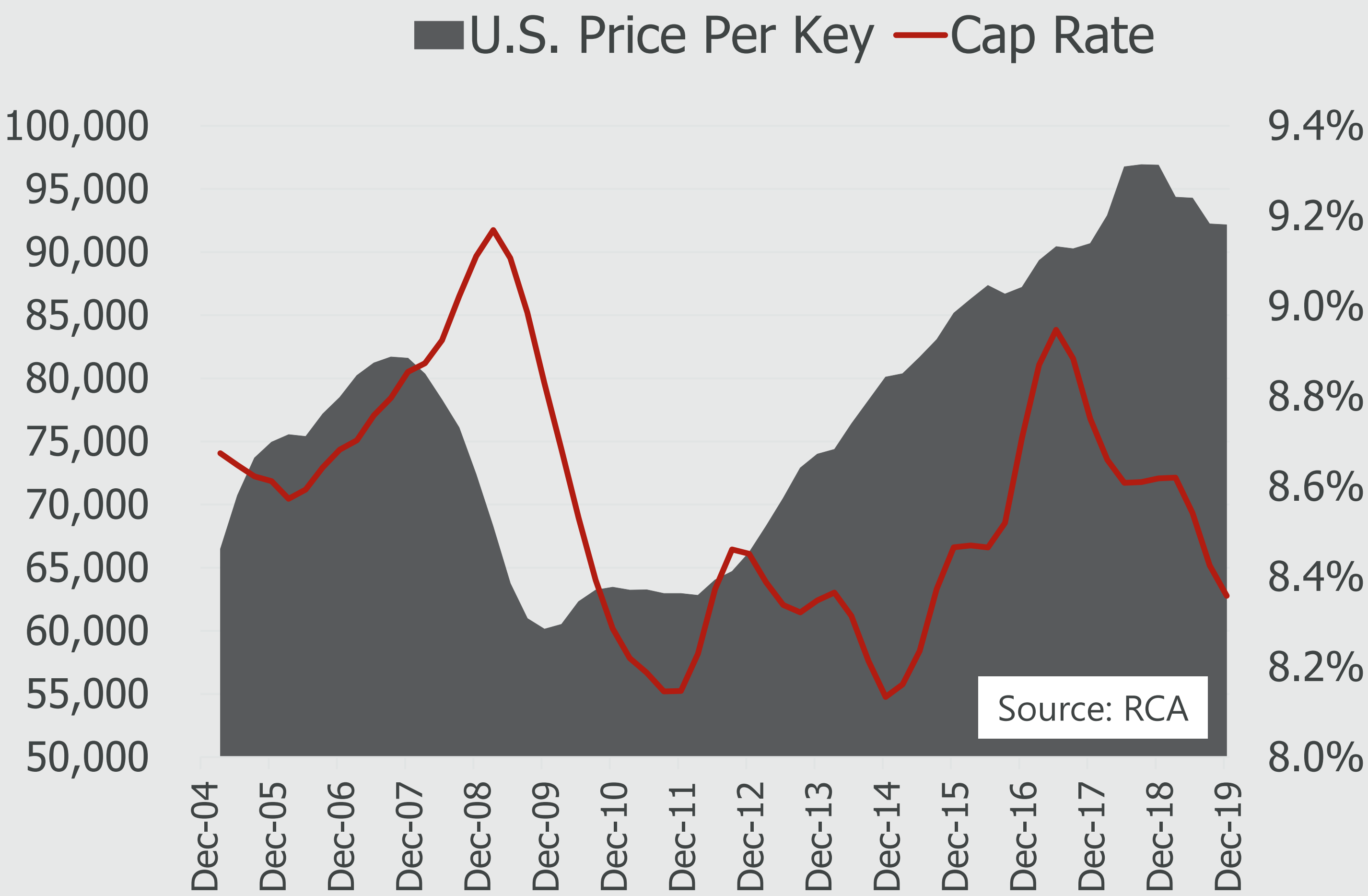
Source: RCA

- Transaction activity in this cycle is expected to mirror the 2008/09 downturn and recovery
- Volume of transactions will be low in 2020, as few owners are expected to sell in the current environment
- Deal volume is expected to accelerate in 2021, as opportunistic buyers enter the market. Low leverage, all-cash transactions, and seller financing will put downward pressure on values
- Pending deals are closing, but many have been re-traded

Valuation Impacts Of COVID-19: **LODGING AND HOSPITALITY**

Appraisal Institute

HISTORIC PRICE PER KEY AND CAP RATE TRENDS*



Source: RCA

* PPK and cap rate based on the RCA Hedonic Series (RCA HS), which reflects pricing for the average property rather than an average of the prices of properties that have transacted.

2008/09 Downturn and Recovery

- The price per key of an average hotel declined by 27% from peak to trough
- Cap Rates spiked in Q4 2008 and remained high for a year, but then fell dramatically

The Outlook for this Cycle

- Similar patterns/trends in value and cap rates are anticipated
- Value declines anticipated to range between 20% and 35%, with some variance based on property characteristics, location and market

HVS

Office

Brian Rapela, MAI, MRICS

Partner

Joseph J. Blake & Associates

Valuation Impacts Of COVID-19: **OFFICE**

OFFICE MARKET OVERVIEW

Transactions

- Like other sectors, deal velocity has slowed
- Some lenders have pulled out, and deals in progress are paused

Leasing

- Leases being signed when necessary but taking longer, using more resources
- Increased concessions, free rent, abatement until shelter lifted
- RE economists see flattening of rent in 2020, possible downturn in 2021

Medical Office

- Previously seen as recession-proof, sector now struggling
- REIT Healthcare/MOB collections down 15% in April

Other Considerations

- Change in behavior?
- WeWork
- CARES/PPP seen as only a moderate stopgap

OFFICE MARKET OVERVIEW

Appraisal Considerations

- Check collections and review tenancy risk
- Consider higher collection loss, and perhaps vacancy in near term CF
- Market participant interviews indicate anticipated value decreases from "a few percent" to 20%
- Insufficient market data to conclude an increase in OAR/IRR
- Be wary of 1031-related sales
- Consider a bifurcated market conditions adjustment in the Sales Comparison Approach
- Be confident in your value opinion

Recreation

James O’Neil, MAI

Practice Leader, Sports and Entertainment

Cushman & Wakefield

Valuation Impacts Of COVID-19: **RECREATION**

Movie Theaters/Cinemas

- **Current state of the market**
  - Digital's surge over Theatrical is further fueled by COVID-19
  - Three major operators have filed Ch. 11 with all eyes on AMC
- **What potential systematic changes lie ahead?**

  Will the final curtain fall on Theatrical's content release advantage?

Gyms/Fitness Centers

- **Current state of the market**

  Gym operators turn to virtual sessions and leasing their equipment to survive
- **What potential systematic changes lie ahead?**

  Will the home gym land the knock-out punch to a $30B industry?

What is the expected impact on the real estate going forward?

Valuation Impacts Of COVID-19: **RECREATION**

Amusement & Water Parks

- **Current state of the market**
  Time is of the essence for the majority of operators
- **What potential systematic changes lie ahead?**
  Limited outdoor ride openings, exclusion of water-related rides and reduced capacity
- **Impact on the real estate**
  Will a limited customer base allow financial feasibility?

Market Pulse on Development

- **What has started continues. What was an idea has been shelved.**
- **"The time is going to come, and we want to be ready."**

Esports:

Finding Opportunity (and Success) in Difficult Times

Self-Storage

Gary R. Free, MAI, SRA,
Senior Managing Director,
Valbridge Property Advisors

Valuation Impacts Of COVID-19: **SELF-STORAGE**

Size of the US Storage Market

There is an average of about 5.7 square feet of storage per person in the US.

17 April 2020

State of the Self-Storage Market prior to COVID

Looking back on the last recession can help us understand where we are today and how things may play out. On the graph to the right, you'll see the average national occupancy per year. At the beginning of trouble with the great recession of 2007-2008, you notice the occupancies for storage started to decline but they continued declining until 2011 with the trend reversing in 2012 and increasing until 2018.

Table 7.1 – Historical National Occupancy

Year	Occupancy
1987	78.4%
1988	80.4%
1989	85.9%
1990	81.5%
1991	86.4%
1992	85.0%
1993	88.3%
1994	89.9%
1995	88.5%
1996	88.3%
1997	85.1%
1998	82.9%
1999	86.9%
2000	83.7%
2001	86.1%
2002	85.4%
2003	84.6%
2004	84.2%
2005	83.0%
2006	83.0%
2007	81.4%
2008	80.3%
2009	76.7%
2010	75.7%
2011	79.7%
2012	85.0%
2013	87.8%
2014	89.1%
2015	90.2%
2016	91.2%
2017	92.8%
2018	91.7%
2019	91.0%

**Based on 2nd Quarter Numbers*
Sources: 2019 Almanac and Radius+

Valuation Impacts Of COVID-19: **SELF-STORAGE**

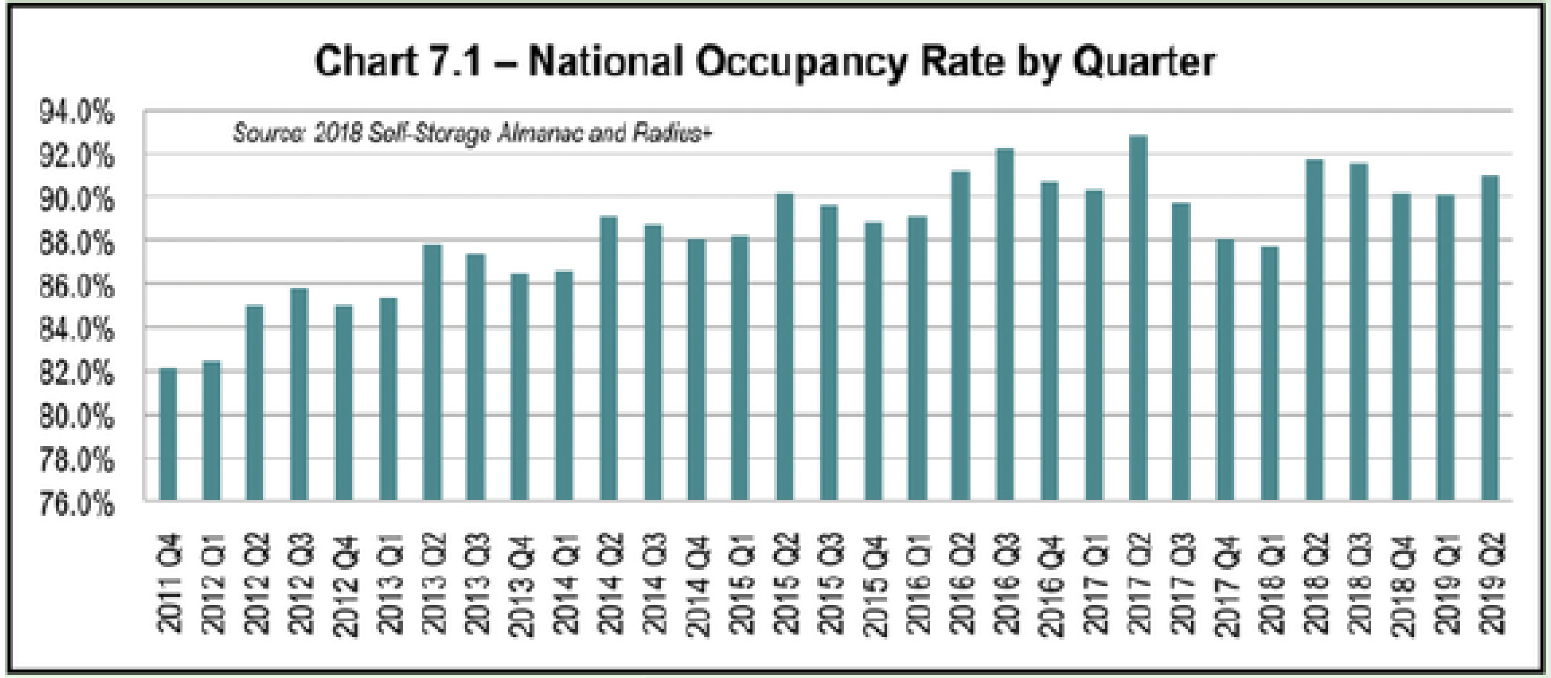


Chart 7.1 – National Occupancy Rate by Quarter

Source: 2018 Self-Storage Almanac and Radius+

Currently in 2020 pre-COVID period, some markets across the U.S. were beginning to see saturation levels and other markets seeing oversupply with lower occupancy rates year over. Weakening street rents were becoming more common, pre-COVID.

Valbridge
PROPERTY ADVISORS

Valuation Impacts Of COVID-19: **SELF-STORAGE**

PRIOR TO COVID

- Cap rates pre-COVID are presented in Table 13.1 from the Self-Storage Almanac, demonstrating the impact of age on the sample of comparable sales presented. You will notice the oldest property built in 1983 has the highest cap rate, while the newer properties are in the lower range. Table 13.2 gives the capitalization rate ranges up until 2019.
- Interviews with market participants I have had this week indicate no evidence of an immediate change in cap rates. Interest rates for long term money remain low despite an increase in the spread. Ten-year treasury rate remains very low.

Table 13.1 – Comparable Cap Rates

No.	Yr. Built	Sale Date	Rentable Area	Occ. %	Price SF	OAR
1	2001	Mar-2017	56,214	97%	$144.09	5.12%
2	2000	Jul-2018	56,780	80%	$138.96	5.00%
3	1983	Mar-2018	55,218	96%	$124.05	6.24%
4	2000	Jan-2017	112,640	92%	$170.45	5.75%
Low Cap Rate:						4.58%
High Cap Rate:						6.24%
Average (Mean) Cap Rate:						5.32%

Source: Compiled by NKF

Table 13.2 – Survey Research

Investment Type		Cap Rate Range	Average
PwC Real Estate Investor Survey:	3Q 2017	5.00% – 7.00%	5.78%
PwC Real Estate Investor Survey:	1Q 2018	4.50% – 7.00%	5.65%
PwC Real Estate Investor Survey:	3Q 2018	4.50% – 7.00%	5.66%
PwC Real Estate Investor Survey:	1Q 2019	4.50% – 7.00%	5.66%
NKF Self-storage Investor Survey:	3Q 2019	4.50% – 8.50%	5.60%

Source: Compiled by NKF

Valuation Impacts Of COVID-19: **SELF-STORAGE**

COVID ERA:

- Self-Storage is defined or implied to be an essential business
- In most states, Self-Storage is defined as an essential business. In other states it is not listed but the status is implied as essential, yet with a lack of concrete definition.
- In recent months, professionally managed properties are implementing encouragement to lease online.

Valbridge
PROPERTY ADVISORS

Valuation Impacts Of COVID-19: **SELF-STORAGE**

> ”We have seen minimal effect so far other than lower move-ins. New facilities in lease-up are the most effected as they are taking longer to reach optimal occupancies. We expect our Q2 2020 lease-up season will be affected, and new move-ins will continue to decline during shelter-in-place or stay-at-home policies. However, when the economy re-opens, we anticipate a pent-up demand that will help fill our vacant inventory.“

– MID-SIZED OPERATORS

Valbridge
PROPERTY ADVISORS

Self-Storage Investment Grade Valuation 2020

Self-Storage has counter cyclical properties. Valuation methodology will be dependent upon specific geographical and local economic situations. Past economic downturns show slower and milder impact on this real estate class. Valuation methods most likely.

- Direct capitalization of projected annualized going forward income, with back up DCF showing annual fluctuations.
- Proposed properties and properties still in lease-up must include any additional time for lease-up due to the economic impact of 2020.
- Severely impacted properties will need a stabilized valuation with a lease- up analysis for present value of lost income to reach stabilized NOI recovery.

Senior Housing

James A. Graber, MAI,

Practice Leader, Senior Housing & Healthcare

CBRE

Valuation Impacts Of COVID-19: **SENIOR HOUSING**

NEAR TERM CLIMATE

Operations:

- Seniors Housing Census Declining: Lack of ability to tour, communities closed to new admissions
- Skilled Nursing Census: Change in census is highly market/community specific
- Revenue Reduction: Census levels, ancillary, and limited care revenue adjustments
- Expense/Cost Increases: Staffing, sanitation and PPE
- Skilled Nursing: Coronavirus Stimulus Bill, $200M for Nursing Home infection-control efforts
- Skilled Nursing Facilities are tooled for dealing with communicable diseases

Capital Markets:

- Institutional groups are sidelined: REITs, Private Equity, and Life Co's
- Elevated cost of capital: Higher reserves, lower LTV, higher DSCR, and increased rate spread
- Lack of ability to perform physical due diligence impacting underwriting/closing

Investor Activity:

- Continuing to close deals that are through due diligence (few remaining) in most cases
- Developing methods to quantify perceived risk, seller-accepted "COVID" pricing adjustments
- Flight to quality: Highlighted operator performance and location

CBRE

Valuation Impacts Of COVID-19: **SENIOR HOUSING**

LONG TERM CLIMATE

Operations:

- Seniors Housing Census: Continued disruption, with consideration for lifestyle vs need-based
- Revenue: Pent-up demand for need-based care levels
- Expenses: Risk of increased regulations, liability insurance; consideration of property taxes
- Payroll: Challenge to revert back to pre-COVID hourly levels
- Government Intervention: Additional stimulus
- Skilled Nursing: Potential of Medicare reimbursement adjustment structure, PDPM, or alternative

Capital Markets:

- Institutional groups will return to the market
- As quarantine rules are lifted, seniors housing is in the last group to open
- Expectation of market liquidity and terms to return in the mid- to long-term

Investor Activity:

- Tempered interest from equity groups without prior seniors housing experience
- Seniors housing returns have historically out-paced other asset classes, expecting to continue
- Flight to quality will relax over time, consistent with recent trends
- Aging demographic story to be a positive influence in the recovery

CBRE

Valuation Impacts Of COVID-19: **SENIOR HOUSING**

VALUATION PRACTICES

Underwriting Revenue:

- Ancillary and limited care revenue adjustments in near term
- Census Disruption: Market and care specific, expectations in the 12 to 24-month range

Underwriting Expenses:

- Near term adjustments for increased sanitation, PPE, and other
- Staffing costs elevated in the near- to mid-term

Capitalization Rate Adjustments:

- Incorporation of increased cost of capital and elevated risk perception
- Typical capitalization rate increases of 25 to 75 bps

Diminution of Value:

- 5% to 10% for stabilized assets
- Up to 15% value-add, tertiary markets, "Hot Spot", in-community COVID, etc.

Marketing Periods:

Extended by 90 to 120 days

CBRE

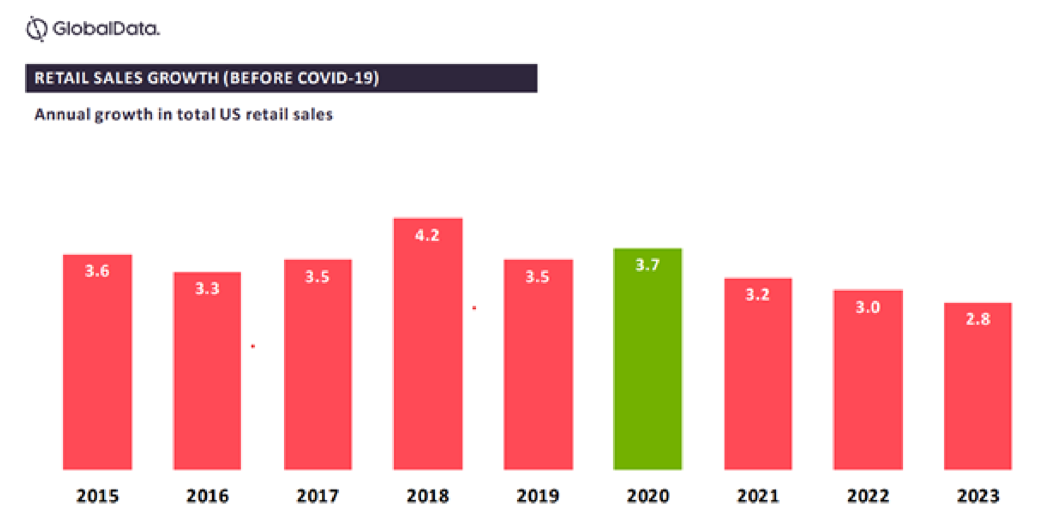
Shopping Centers

Jerry Gisclair, MAI, MRICS

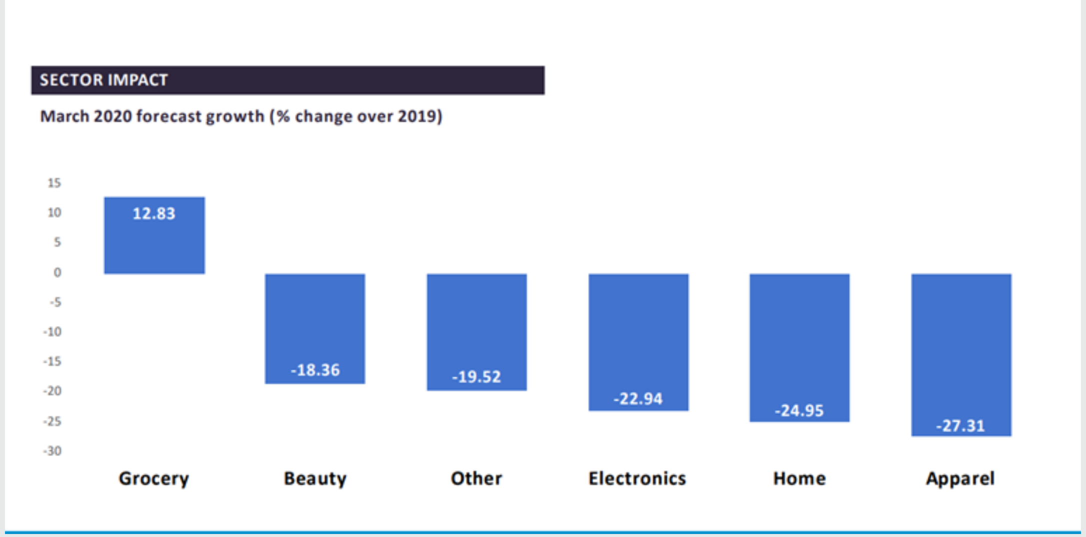
Executive Managing Director, National Client Services

Colliers International

Valuation Impacts Of COVID-19: **SHOPPING CENTERS**



Forecasted Impact (late March)



Consumer Behavior Change

Broader Retail Sales Pattern Forecast – all outlets

Valuation Impacts Of COVID-19: **SHOPPING CENTERS**

Store & Consumer Adaptation:

Rapid acceleration in adoption of E-Commerce

Year-over-year change in daily e-commerce spending

Data: Rakuten Intelligence

Broader Impacts:

- Disruption in existing tenant base (especially restaurants and experiential-oriented tenants)
- Increased Omni Channel Adoption Rate
- Retail will change at a faster rate than pre-COVID
  - Retail spaces will include more fulfillment-oriented design to accommodate both in-person and on-line purchase

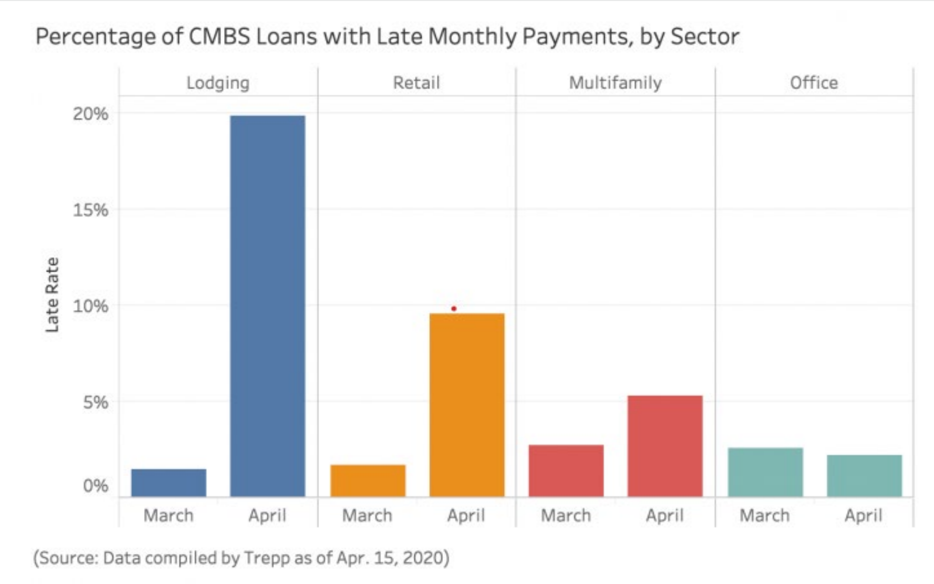
Valuation Impacts:

- Near-term income loss related to COVID shutdown
- Intermediate Income changes related to longer-term tenant changes
  - Likely changes in tenants and/or space design
  - Big Box tenancy concerns – Co-tenancy clauses a big factor
  - Do intermediate changes become more permanent
- Changes in Risk profiles related to income uncertainty and debt/capital structure changes

Valuation Impacts Of COVID-19: **SHOPPING CENTERS**

Increased Asset Class Credit Uncertainty

- **Transactions:** Many with locked debt terms proceeded; those whose debt terms were not secured prior to debt market volatility have generally fallen out, noting 2 recent examples involving Blackstone:
- **Blackstone** pulling out of Uptown Station in Oakland ($415M for 397K mixed use (retail & office), walking from $20M deposit). Additionally pulling out of Amazon (through 2028) occupied office building in Seattle. Sourced cited debt costs increase from sub-3% to mid-4% impacting along with other market
- Of note, **Taubman** under agreement to be acquired @ $52.50 per share by **Simon**, with stock trading near $41-42, with 6.6% Annual Dividend based on March 13 dividend date. Lots of chatter discussing whether this will proceed and the implications of if the purchase can be cancelled without significant legal ramifications. Clearly the market sees risk in the contract.


Percentage of CMBS Loans with Late Monthly Payments, by Sector

(Source: Data compiled by Trepp as of Apr. 15, 2020)

Special-Use Commercial Real Estate

Aaron Wright, MAI, MRICS, ASA

President

Specialty Valuation Group

Special-Use Commercial Real Estate

As Defined by The Appraisal Institute Property Use Classification System (PUCS)

- Cement, Rock, Gravel Plant
- **Death Related (Funeral Home, Crematory, Mortuary, Other Death Related)**
- **Kennel**
- **Marina**
- Movie Studio
- Pier
- Outdoor Sign
- Communications Tower
- **Veterinary Clinic**
- **Watercraft Repair & Storage**
- Other Special Purpose

Special-Use Commercial Real Estate

Death Related Properties - Operators are Reporting:

- The COVID-19 impact on operations can vary greatly by location. Some areas are seeing significant spikes and requesting volunteer funeral director help, while funeral home operations in other areas are reporting an 18%-25% decline in revenue over the past 30-45 days.
- Declines are largely attributed to restrictions on large gatherings, so families are delaying services.
- Many families intend to come back after restrictions are lifted for 'a celebration of life' and funeral receptions; however, the operators only project a fraction will do so.
- No real impact to cemetery properties, other than likely higher absorption rates than previously predicted.
- The operators interviewed have applied for the SBA loan programs and believe lost revenue can be offset by the government bailouts.
- Most funeral directors are projecting very little impact to business after 12-18 months.

Special-Use Commercial Real Estate

Veterinary Clinics and Kennels - Operators are Reporting:

- National year-over-year daily average revenue per practice was down 14% at the end of March. Daily average invoices per practice were down 16.5%. (Source: avma.org)
- Sharp decline in kenneling services, due to stay-at-home orders.
- Largest threats: stand-alone kennels who have also seen a sharp decline in revenue, with few other profit centers to offset losses.
- The operators interviewed have applied for the SBA loan programs and for the most part, believe lost revenue can be offset by the government bailouts.
- However, as many are still paying-off business loans, increasing debt to EBITDA ratios may become a threat to any over-leveraged businesses.
- Most participants interviewed project recovery will begin in Q3.

Special-Use Commercial Real Estate

Marinas - Operators are Reporting:

- Of note, responses can vary greatly based on individual state restrictions on boating.
- Very little impact on many northern seasonal Marinas (Summer), as many do not open until Memorial Day.
- Many marinas are reporting record gas sales for this time of year.
- Those marinas that include restaurants plan to offer carry-out for boaters.
- Most northern operators have had limited payroll exposure during the stay-at-home orders.
- Slip rentals showing little to no impact nationally (at least right now). Slip revenue is projected to increase in southern Florida during this time due to more boats staying in the US.
- Most southern and costal marinas have seen little impact to business operations, according to a MarineMax representative, with the exception of a decline in recreational boat sales.
- Boat sales in the northern markets are down, and many showrooms are by appointment only. No plans exist to replace sold inventory in the near term.
- Those offering watercraft repair and storage: Storage has not been impacted in the short-term. Boat repairs are still in demand, and staff is still working and are considered essential personnel in most states.
- Some operators are taking advantage of deferments on mortgage payments, and most are looking at SBA programs to offset any lost revenue that may be realized over time.

Special-Use Commercial Real Estate

Valuation Ongoing Considerations:

- Sales Approach – Monitoring very recent sales activity and broker interviews.
- Sellers expected to hold off on listing during this period, thus resulting in a slowdown of sales activity in the coming months.
- Cost Approach – Monitoring material and labor costs will become increasingly important.
- Market analysis – Market participant interviews, trade association statistics, market surveys, etc.
- Going Concern – Impact to intangible value vs Impact to real property.
- Were the SBA loan programs enough?
- Expect exposure and marketing periods to extend during this time.
- Overall, quantifiable impacts to special-use real estate is still yet to be determined and will vary between property types, locations, and will be very much dependent on the longevity of this pandemic.

Transportation

KC Conway, MAI, CRE

Director of Research and Corporate Engagement
Alabama Center for Real Estate

Valuation Impacts Of COVID-19: **TRANSPORTATION**

http://www.acre.culverhouse.ua.edu/research/logistics-infrastructure-research

CHANGING FROM A: "Shop & Take Home" to "Order Online & Deliver" Economy

Where we make things & Who owns the companies that make what we need?

The COVID-19 outbreak is revealing the "where" things are made (maybe too much in China – and not just auto parts and items that go into a WalMart store, but pharmaceuticals and paper products like diapers and toilet paper that are made possible by "fluff pulp" via the port of Mobile). **It's also unveiling how things connect and maybe enable rapid transmission of a coronavirus. For example, China bought several luxury retail brand companies in Italy in recent years and then moved their workers to Italy** to sustain a "made in Italy" manufacturing claim. That is now the hypothesis for how the coronavirus spread so quickly to Northern Italy - and then Spain and the rest of Europe.

Forbes

Port Laredo Again No. 1 as Coronavirus Sends Port Of Los Angeles Reeling

A stunning development the first time, the result of the impact of the U.S.-China trade war on the venerable California seaport, this time it's the one-two punch of the ongoing trade war and the coronavirus pandemic that has sent it, the U.S. economy, and the global economy reeling.

This time, unlike last time, it is not likely to be a one-month aberration.

That's because the most recent U.S. Census Bureau data is for February. **Port Laredo passed the Port of Los Angeles before the full brunt of the impact of coronavirus would have even hit the Los Angeles seaport.**

https://www-forbes-com.cdn.ampproject.org/c/s/www.forbes.com/sites/kenroberts/2020/04/07/port-laredo-again-no-1-as-coronavirus-sends-port-of-los-angeles-reeling/amp/

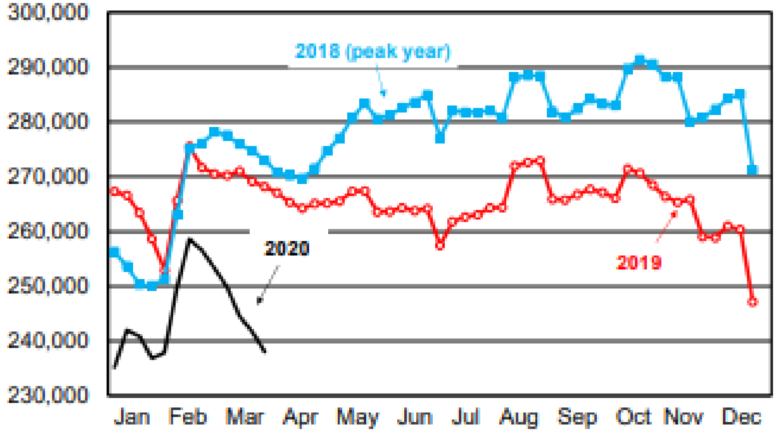
Forward Looking Transportation & Freight Measures

ASSOCIATION OF AMERICAN RAILROADS

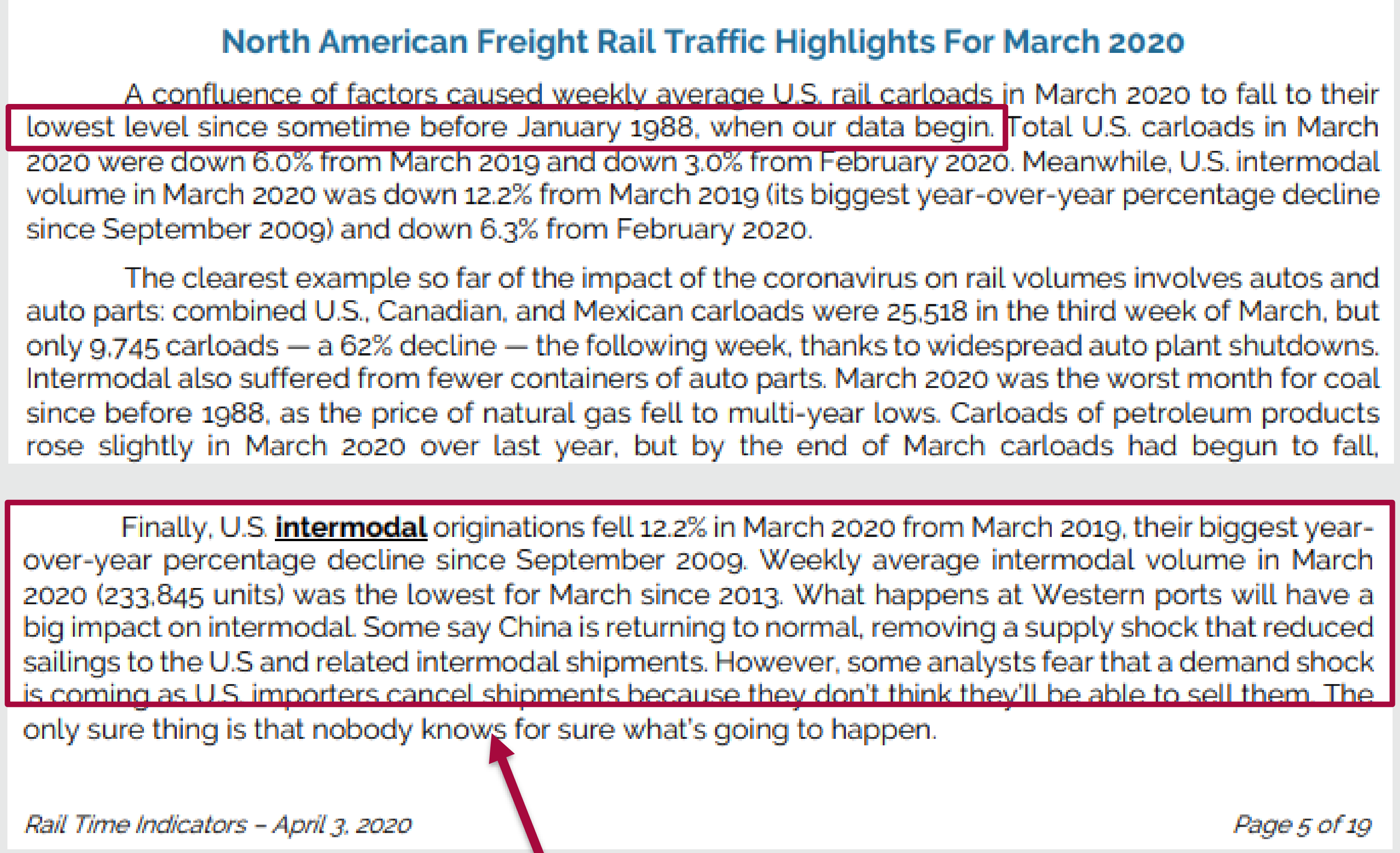
https://www.aar.org/

U.S. Rail Intermodal Units

(6-week moving average)



Data are 6-week moving average originations and do not include the U.S. operations of CN, CP, and GMXT. Source: AAR *Rail Time Indicators*



North American Freight Rail Traffic Highlights For March 2020

A confluence of factors caused weekly average U.S. rail carloads in March 2020 to fall to their lowest level since sometime before January 1988, when our data begin. Total U.S. carloads in March 2020 were down 6.0% from March 2019 and down 3.0% from February 2020. Meanwhile, U.S. intermodal volume in March 2020 was down 12.2% from March 2019 (its biggest year-over-year percentage decline since September 2009) and down 6.3% from February 2020.

The clearest example so far of the impact of the coronavirus on rail volumes involves autos and auto parts: combined U.S., Canadian, and Mexican carloads were 25,518 in the third week of March, but only 9,745 carloads — a 62% decline — the following week, thanks to widespread auto plant shutdowns. Intermodal also suffered from fewer containers of auto parts. March 2020 was the worst month for coal since before 1988, as the price of natural gas fell to multi-year lows. Carloads of petroleum products rose slightly in March 2020 over last year, but by the end of March carloads had begun to fall,

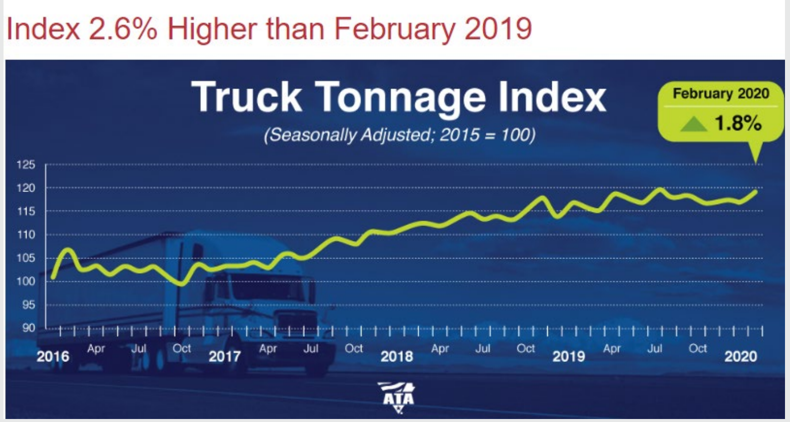
Finally, U.S. **intermodal** originations fell 12.2% in March 2020 from March 2019, their biggest year-over-year percentage decline since September 2009. Weekly average intermodal volume in March 2020 (233,845 units) was the lowest for March since 2013. What happens at Western ports will have a big impact on intermodal. Some say China is returning to normal, removing a supply shock that reduced sailings to the U.S and related intermodal shipments. However, some analysts fear that a demand shock is coming as U.S. importers cancel shipments because they don't think they'll be able to sell them. The only sure thing is that nobody knows for sure what's going to happen.

Rail Time Indicators – April 3, 2020 *Page 5 of 19*

Beware of a **"Demand-Shock"** – orders canceled as businesses not confident they can stay open or even sell new inventory.

Forward Looking Transportation & Freight Measures

Am. Trucking Assoc & Trucking Tonnage Index


Index 2.6% Higher than February 2019

Truck Tonnage Index

(Seasonally Adjusted; 2015 = 100)

February 2020 ▲ 1.8%

https://www.trucking.org/news-insights/ata-truck-tonnage-index-rose-18-february

Cass Freight Index

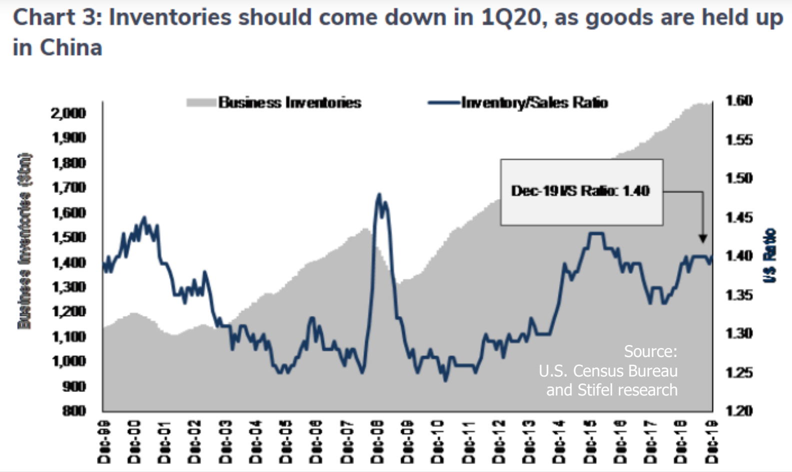


Chart 3: Inventories should come down in 1Q20, as goods are held up in China

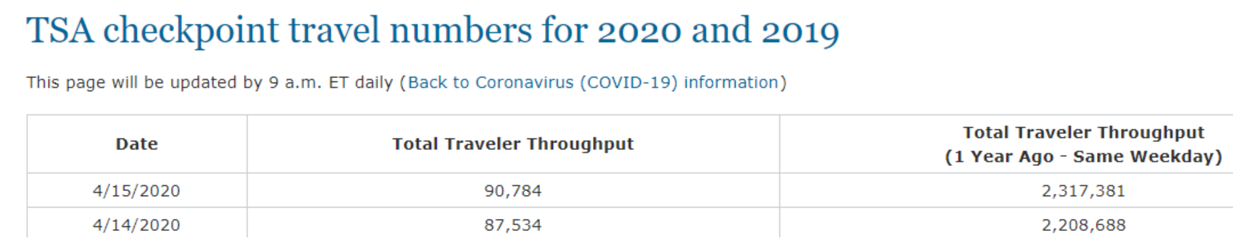
Source: U.S. Census Bureau and Stifel research

https://www.cassinfo.com/freight-audit-payment/cass-transportation-indexes/cass-freight-index

When exports do bounce back again, we're looking to the airfreight market for the first signs of the demand rebound, as retailers and manufacturers need to play catch-up. The airfreight market has been hurting for some time, but we expect at least a short period of large yield spikes for cargo capacity, especially with belly space limited. Today, though, we're hearing airfreight yields spiking due more to the lack of available capacity rather than any surge in demand.

TSA Passenger Count & Air-Cargo Piece of L&T

https://www.tsa.gov/coronavirus/passenger-throughput


TSA checkpoint travel numbers for 2020 and 2019

This page will be updated by 9 a.m. ET daily (Back to Coronavirus (COVID-19) information)

Date	Total Traveler Throughput	Total Traveler Throughput (1 Year Ago - Same Weekday)
4/15/2020	90,784	2,317,381
4/14/2020	87,534	2,208,688

What Would it Take to See Asset Prices Fall?

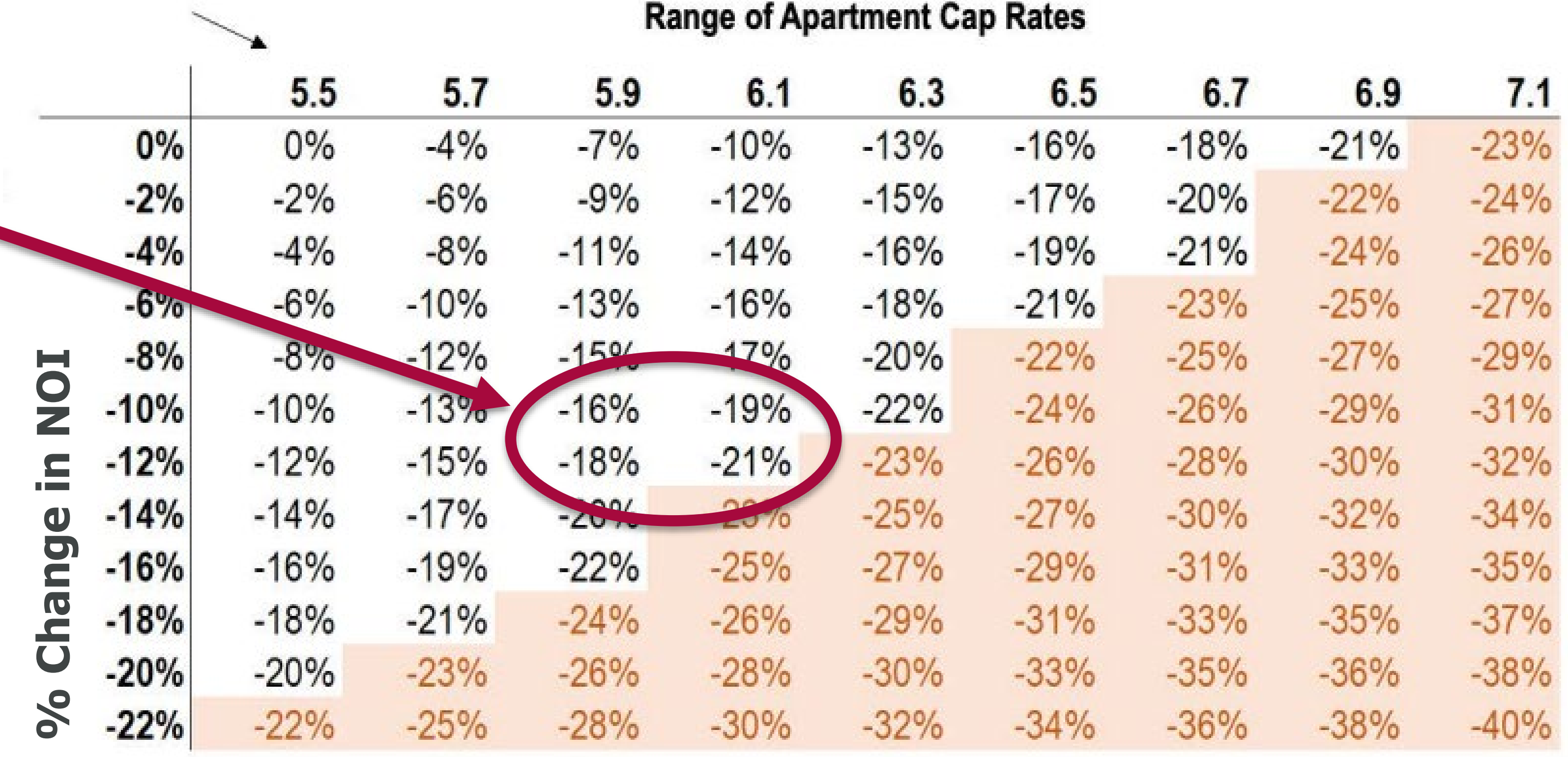
The "Red-Shoe Economist" outlook for Industrial/ Transportation CRE **is -20%** due to:

- **1-part rise in Cap Rates** (100-150 basis points); and
- **1-part decline in NOI on expense vs rent side** due to higher costs (fogging, spacing, insurance, etc.)

Source: RealPage & RCA/Jim Costello

The Combination of Cap Rate and Income Changes That Would Drive a 22% Price Drop

Average US apartment cap rate in Feb '20



Range of Apartment Cap Rates

% Change in NOI	5.5	5.7	5.9	6.1	6.3	6.5	6.7	6.9	7.1
0%	0%	-4%	-7%	-10%	-13%	-16%	-18%	-21%	-23%
-2%	-2%	-6%	-9%	-12%	-15%	-17%	-20%	-22%	-24%
-4%	-4%	-8%	-11%	-14%	-16%	-19%	-21%	-24%	-26%
-6%	-6%	-10%	-13%	-16%	-18%	-21%	-23%	-25%	-27%
-8%	-8%	-12%	-15%	-17%	-20%	-22%	-25%	-27%	-29%
-10%	-10%	-13%	-16%	-19%	-22%	-24%	-26%	-29%	-31%
-12%	-12%	-15%	-18%	-21%	-23%	-26%	-28%	-30%	-32%
-14%	-14%	-17%	-20%	-23%	-25%	-27%	-30%	-32%	-34%
-16%	-16%	-19%	-22%	-25%	-27%	-29%	-31%	-33%	-35%
-18%	-18%	-21%	-24%	-26%	-29%	-31%	-33%	-35%	-37%
-20%	-20%	-23%	-26%	-28%	-30%	-33%	-35%	-36%	-38%
-22%	-22%	-25%	-28%	-30%	-32%	-34%	-36%	-38%	-40%

☐ **Combinations Needed to Drive a 22% Decline in Asset Values**

What would these changes look like historically?

Valuation Impacts Of COVID-19: **CLOSING REMARKS**

Jefferson L. Sherman, MAI, AI-GRS,
2020 President,
Appraisal Institute

Why What We Do Matters

We definitely face many business uncertainties because of this most unusual medical/economic situation. However, it has been my observation of the severe economic downturns I've seen during my 36-year career as an appraiser that our high-quality services are needed then and now more than ever.

We need to untangle this web of uncertainty for our clients. We can because we are trained to the highest level, have the best education, and have a tremendous bank of experience from which to draw our conclusions. We also have relationships with colleagues and can share thoughts with them.

Valuation Impacts Of COVID-19: **QUESTIONS**

Handouts / Recording

This webinar presentation is being recorded.

The recording will be posted on our coronavirus page:

www.appraisalinstitute.org/news/coronavirus/

Evaluation

Please complete the brief survey that will appear on your screen immediately following this webinar.

We appreciate your feedback in helping us improve the quality of our webinars.

Appraisal Institute®

Thank you!