Coronavirus' Impacts On
Real Estate in 2020

The real estate industry is being clobbered by the coronavirus, and it's going to get worse before it gets better. The effects on real estate will vary by sector and market, and the extent of the effects will depend upon the duration of the economic shutdown.

The sectors of real estate that have been hit hardest so far are hotels, restaurants, bars and other entertainment retail (particularly in tourist-driven areas) followed closely by retail and housing (particularly second-home and luxury homes).

Supplies that the builders and developers need are being interrupted more and more as workers stay home, and due to business shutdowns, quarantines and curfews. Huge numbers of layoffs will lead to further contraction in consumer spending, starting a downward spiral of economic activity. Together, these forces are already pushing the economy into recession.

China's factories and businesses are now restarting, which could be cause for optimism regarding a fairly rapid return to normal economic activity and strong real estate markets. That said, China took swift steps that the United States is only slowly and begrudgingly taking now. There are a lot of moving parts, so let's dig deeper.

Impact Will Be Different Regionally

The impact of the economic disruption in real estate varies, and is going to continue to vary, from one state or metro area to another.

The Impact on Housing and Homebuilding

Homebuilders are feeling not only the demand pullback from home shoppers staying home in droves, but also the supply impact of materials that they normally import from China (supplying more than 30% of the materials). In a new survey by NAHB, 81% of respondents said the coronavirus has have an adverse effect on traffic of prospective home buyers, and it’s probably closer to 100% now with the escalating lockdowns. Another 54% reported issues getting the building materials they need to finish homes.

Builders are seeing a large drop in sales now. There is also growing concern about tighter lending conditions for non-conforming mortgage loans. Buyers who have a debt-to-income ratios higher than 43%-45% or those who are self-employed are now having a lot of difficulty getting mortgages.

With all of this going on, builders are saying that their land acquisition and development spending will slow in the near term.

Even more worrisome is the impact that the stock market crash will have on consumer spending. People who have lost a lot of their “paper” wealth will spend less on discretionary items, and those who are retired, or close to retirement, may be drastically changing their spending plans. Those who had been planning to buy a home in an active adult community may have to shift their plans, and that could impact absorption rates at those developments.

Needless to say, there could be a serious impact on nursing homes and assisted-living facilities as well, at least in the near term.

The **rental apartment** industry is now preparing to deal with tenants who have lost their income and are unable to make the current month's rent. A large number of tenants will ask for forbearance in April, and even more will in May. Landlords will seek to emphasize retention, which will mean giving tenants some leniency in the near term. There will be downward pressure on effective rents in the next few months, and property owners will be asking their lenders for forbearance as well.

The long-term outlook for rentals is still bright, however, in light of demographic shifts that are still unfolding. Lease renewal rates were strong before the crisis, and apartment construction was running at more than 500,000 units annually right before the crisis, so it has some ground to give. Class "B" properties will likely fare better than expensive "A" properties or Class "C" developments that may be more susceptible to job losses and lost income among tenants. Some renters will "double up" and we may see some "boomerang kids" moving back in with parents in the near term. Underlying positive long-term rental trends will re-assert themselves after the crisis passes.

What Lies Ahead For Real Estate?

One thing that makes this economic disruption especially problematic is that it is affecting both demand and supply.

On the demand side, the answer to "what lies ahead" depends on how quickly the outbreak will be contained, meaning when the rate of growth in new cases flattens out and begins to fall off. At that time consumers will start spending again, and the economic engine will start humming once more. The disruption to the supply side this time may take longer to restore, particularly if the outbreak is not contained evenly across the globe, and thus may lag the bounce back in demand, which may in itself have some negative consequences.

The optimistic scenario is that unlike in the Great Recession, once the virus is contained and immunity starts to take hold in the population, even though supply chains will take some time to re-engage, it may not feel like the cold start that followed the housing and mortgage crash. The cycle could look like a “V,” or possibly more of a narrow “U,” with a sharp drop but also a strong upswing, coming at some time in the second half of this year. There will be a return at some point of pent-up demand, from people who were unable during the lockdown to go out and buy furniture for their home, get their house painted or plumbing fixed, or, on the industrial side, build structures and install equipment needed for business. And vacations that were put on hold will finally happen, boosting the hotels and theme parks.

The number of confirmed virus cases flattened out in China, and China is starting to see a resumption of normal business activity. Italy and other countries have yet to see a sustained flattening or drop. Data from companies like Federal Express and Uber in their operations in China indicate that 65% to 70% of small businesses there are open again, and 90% to 95% of large manufacturers are operating again. This implies that the economic “restart” could be quicker than after the housing and financial collapse. The first quarter GDP growth number for China is expected to be zero or negative, but the second or third quarter may show improvement. In the U.S., it is clear that the second quarter will be negative, but growth could resume some time in the second half of the year. That however assumes that we are successful with social distancing.

The problem too is that once the virus subsides in the population, it is likely to surge back again later this year, meaning that social distancing may have to be practiced off and on for the next 18 months. A sophisticated study utilizing epidemiological modeling, undertaken by the Imperial College in London, was just released, finding:

This is clearly a serious threat to commerce, profits, jobs, and, ultimately, real estate. The duration of the downturn will be the key determinant of how long and in what ways the real estate markets suffer.

The silver lining for real estate companies?

As happened at the bottom of the housing crash, real estate investors with a long view will find opportunities to pick up assets at distressed prices, and with financing rates lower than most of us have seen in our careers. Just as large funds stepped in to buy land and homes when values were depressed, we will likely see similar moves among the distress that is now taking shape. Such investors should be sure to make any such purchases with a studious eye, a measure of patience, and careful due diligence.