BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

REGIONAL REPORT WEST COAST SUMMER 2020

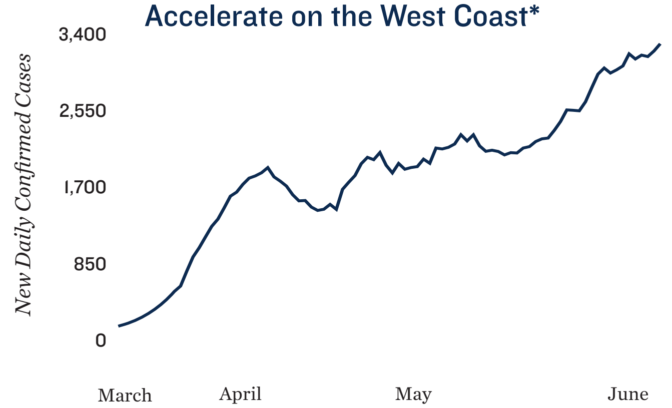
Health Crisis Presents Array of Challenges to West Coast Economies, Which Could Lead to Lasting Disruption for Property Markets

Economic resilience of multiple markets a bright spot for the recovery. The West Coast has taken a more pragmatic approach to managing the pandemic, staying under lockdown for longer durations than other states while also implementing statewide and local measures that support tenants and businesses. As the region starts to come out of the shutdown, the underlying strength of these markets will help in the recovery efforts, particularly due to the robust tech workforce. California, Oregon and Washington recorded a strong increase in tech and engineering jobs over the past decade, boosting the local economies and supporting robust gains in commercial real estate. Many asset classes in the region were some of the nation's best performers before the pandemic, helping to bolster markets during the economic downturn, while positioning them for a sound recovery.

New regulations to impact operations in some markets. Legislation and emergency orders being rolled out across the region may create additional challenges for landlords and investors as they navigate the crisis. Seattle and all of California have extended protections for tenants facing evictions that stretch beyond the expiration of the states of emergency, which could leave landlords with reduced revenue for a longer stretch, compounding the pandemic issues. A proposal will also be on the California ballot in November, known as the split-roll tax initiative, which could allow for higher property taxes on commercial properties if passed. Owners of retail space in San Francisco face another hurdle through the tax on vacant storefronts, which was approved by voters in early March, though the tax has been pushed back into 2022.

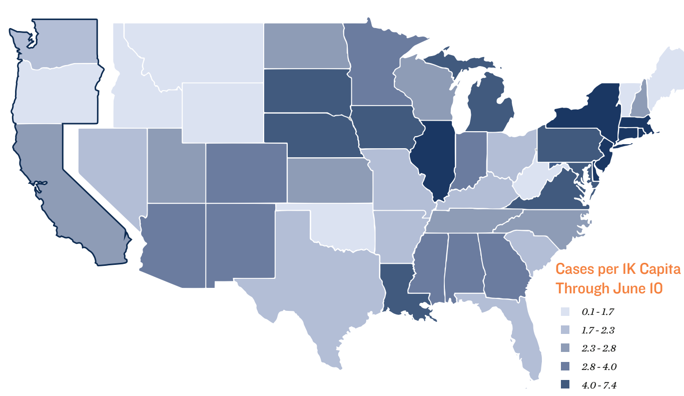
Long road to recovery lies ahead. A continued acceleration of coronavirus cases has occurred in recent weeks on the West Coast, presenting more potential problems for markets. California, Washington and Oregon already face substantial hurdles with unemployment at record levels, and they will contend with a long and choppy economic recovery. A return to lockdowns just as these economies begin to reopen creates more uncertainties, though the strong position before the pandemic may shore up property metrics. For the recovery to pick up greater steam in the months to come and have staying power, it will be vital that a treatment or vaccine become readily available.

COVID-19 Cases Continue To Accelerate on the West Coast*



Strength and Attractiveness Illustrated by Yield Profile

Market	Apartment	Multi-Tenant Retail	Office	Industrial
Los Angeles	4.3%	5.2%	5.1%	5.1%
Oakland	4.9%	5.1%	5.8%	5.4%
Orange County	4.3%	5.0%	5.7%	4.7%
Portland	5.5%	5.9%	5.8%	5.5%
Riverside-San Bernardino	5.3%	6.3%	6.7%	5.4%
Sacramento	5.2%	6.4%	6.7%	6.5%
San Diego	4.7%	5.4%	6.4%	6.0%
San Francisco	4.0%	5.0%	4.9%	5.0%
San Jose	4.1%	4.9%	5.2%	6.1%
Seattle-Tacoma	4.8%	6.2%	5.9%	5.5%



** Seven-day moving average; March 15-June 10*
*** Through April*
Sources: State and local health departments and hospitals; The New York Times

Shorter **Economic Downturn** *Longer*

Stronger **Economic Recovery** *Weaker*

Short Downturn/Strong Recovery

- V-shaped economic recovery
- Fewer new cases support phased reopening over the summer
- Government stimulus enables companies to rehire workers
- Commercial property construction projects suffer minor delays
- Investors and lenders resume activity after brief uncertainty period

Extended Downturn/Strong Recovery

- Extended U-shaped economic recovery
- Prolonged business closures accentuate economic costs
- Additional federal stimulus key to boosting consumer spending
- Health concerns extend delays of projects that have broken ground
- Liquidity constrained during shutdown, limiting investment activity

Short Downturn/Weak Recovery

- ✓-shaped economic recovery
- Economy reopens but people remain cautious of contagion
- Constrained corporate budgets limit rehiring, lower spending
- Projects in planning stages are reevaluated
- Investors focus on stabilized or resilient assets in populated areas

Extended Downturn/Weak Recovery

- L-shaped economic recovery
- Lack of health solution keeps some businesses closed late into year
- Extended period of high unemployment notably curbs spending
- Both active and planned development projects face delays
- Investors hold a long-term perspective, fewer listings come to market

Short Downturn/Strong Recovery

Tech hubs most likely to experience a rapid return to normal. The strong labor market bounce back in May along with substantial growth in retail sales may indicate the economy has weathered the worst of the pandemic, pointing to a strong recovery. All three West Coast states have entered a multiphase reopening process, allowing many businesses to welcome customers again, albeit at reduced capacities. These actions pave the way for a more expeditious return to pre-health crisis employment and consumption levels. Technology-focused markets including Seattle and those in the Bay Area are best suited for a rapid, V-shaped economic recovery, as the sector was less impacted by temporary shutdowns. Metros more geared toward tourism and entertainment, such as Los Angeles or San Diego, may be less likely to follow this path.

Short Downturn/Weak Recovery

Consumer sentiment may not follow reopened businesses. Even though more businesses are beginning to reopen across the West Coast, many temporary closures and job losses may prove to be permanent. Consumers, weighed down by financial losses and concerned by a lack of a widespread health solution, may be more reserved in spending, weakening the broader economic recovery. This scenario may be more likely in entertainment-oriented areas with a high cost of living and notable tax burdens, including Orange and Los Angeles counties.

Extended Downturn/Strong Recovery

Protracted reopening process may require additional fiscal aid. California, Oregon and Washington have been some of the most proactive states in the country in attempting to manage the pandemic. Their similarly more deliberate approach to reopening may exacerbate the short-term economic costs of the lockdowns on businesses and consumers, though. A second wave of infections could also arrive, especially as logistics hubs in Southern California and the Pacific Northwest necessitate people moving into and out of the region on a daily basis. If renewed health concerns were to extend, additional federal stimulus would be needed to jump-start the recovery.

Extended Downturn/Weak Recovery

A prolonged downturn could sway future of region. If many job losses in the shutdown become permanent and the region's most populated metros follow a protracted reopening timeline, then recovery may take time to manifest. The lack of tourism and major entertainment or corporate events would weigh on a vast array of local businesses across all three states. Substantial financial burdens to living in California may prompt some people to move to less costly parts of the region or outside of it entirely, further impairing the performance of commercial real estate in certain areas. Uncertainty around property performance and softening demographics could also limit investment sales activity in the near term.

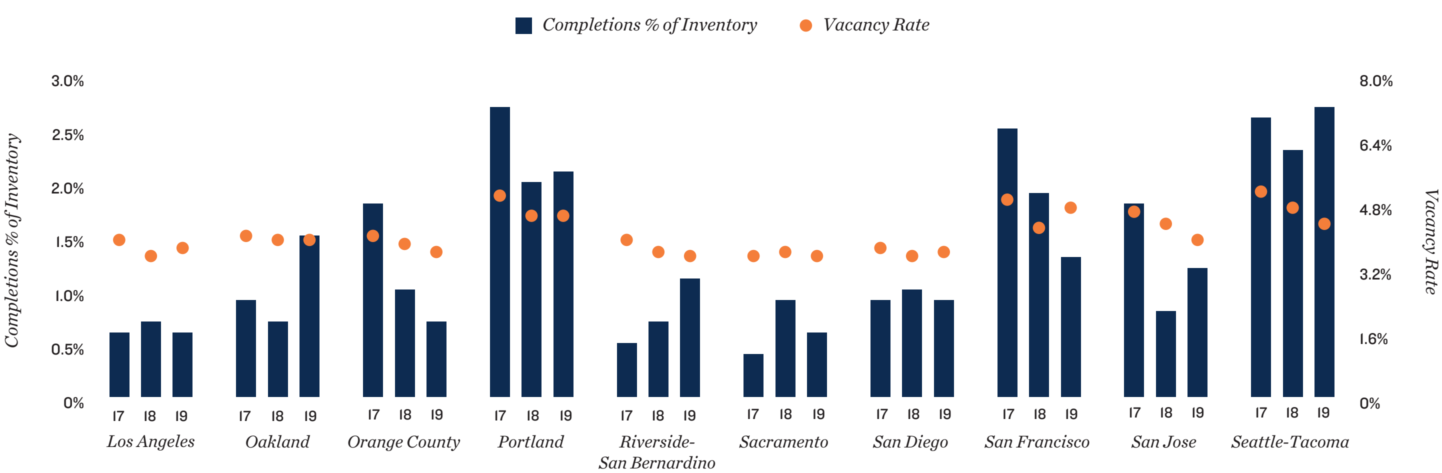
Apartments Prove to be More Resilient During the Downturn, Though Risks Remain as Clarity on the Crisis Emerges

Less-impacted employment sectors help stabilize rental housing. As the West Coast advances through the health crisis and states begin to reopen their economies in phases, the multifamily sector may prove to be a more durable asset class as long-term demand drivers remain intact. Over the near term the sector does face challenges from historic unemployment, which could push vacancy higher as state and local eviction moratoriums expire over the coming months. Despite the greater financial hardships faced by many, collections remained stable nationally, according to the National Multifamily Housing Council, as more than 90 percent of renters partially or fully made their rent payment in May. Markets with a robust tech, financial and government workforce could be more insulated from greater turmoil as these sectors have been less impacted by the crisis. This will benefit property performance in Sacramento, San Francisco, Portland and Seattle as many higher-paid workers have been able to adapt to a work-from-home environment more rapidly.

Eviction moratoriums create challenges. State and local jurisdictions have rolled out new public policy in an effort to keep tenants in their units, presenting numerous challenges for property owners. California has given local governments greater latitude in issuing eviction moratoriums and rent relief, leading to restrictive policies in San Francisco, Los Angeles and other metros. Tenants facing an eviction in California will have 60 days beyond the expiration of the state of emergency before any action is taken. Those impacted by the pandemic in San Francisco are currently allowed to forgo monthly rent payment during the state of emergency and cannot be evicted for overdue bills after the emergency orders expire. Enhanced tenant protections have been rolled out in Seattle as well, where renters are allowed forbearance on payments for an additional six months after the emergency orders are lifted, creating complications for owners. Similar laws apply to Oregon and the Portland metro, building uncertainty for private investors.

Construction shutdowns to taper supply growth. Delivery schedules will be extended as many projects were forced to hit pause or felt the brunt of a reduced workforce. As demand is anticipated to soften, this will provide welcome relief to many markets as the construction pipeline has swelled in recent years. Completions could still reach a new high across several markets this year, though many of those deliveries will be of Class A stock that will have little impact on the broader market. Rent growth will likely taper and could turn negative, though, as many of these new units will need to increase concessions to attract new residents. Headwinds and uncertainties will slow deal flow over the near term, but as more clarity emerges investors could quickly return, favoring the long-term growth prospects.

West Coast Apartment Supply and Demand



Source: RealPage, Inc.

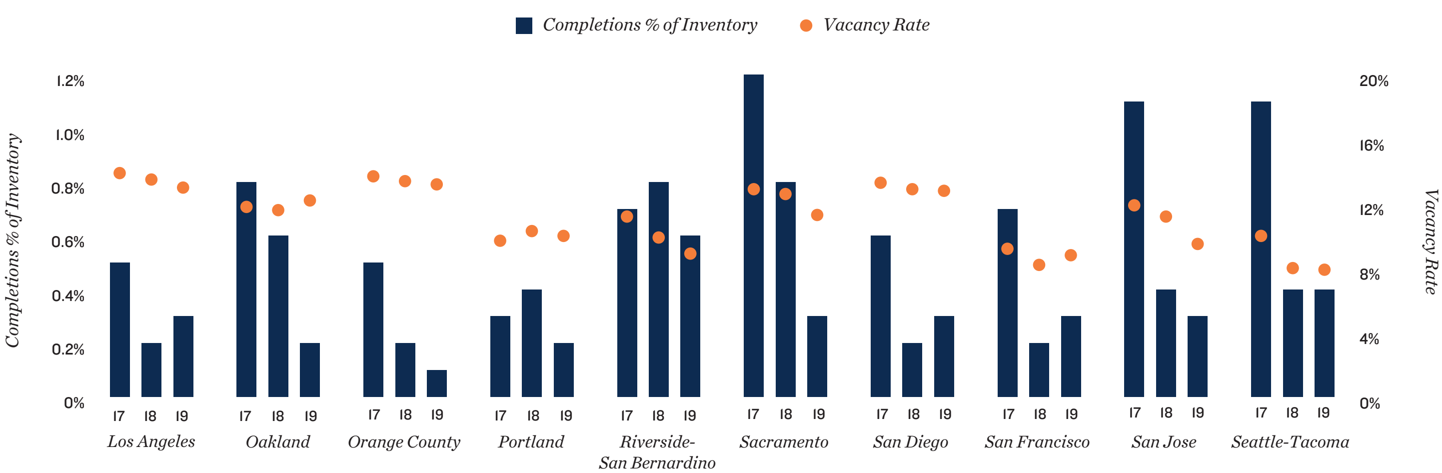
Pandemic Poses Many Challenges to Retailers and Property Owners; Strength of Local Economies Helps the Sector to Weather the Health Crisis

Industry to go through a reshuffling period. The pandemic has proved to be particularly difficult for the retail sector as states ordered the closure of nonessential businesses in March and consumers considerably curbed spending. As lockdowns gradually lift, shoppers are flocking to retailers faster than anticipated, though many hurdles remain in place for the industry. Social distancing measures present a challenge, particularly in the food and beverage category as some restaurants may not be able to continue under reduced capacity. This will weigh on experiential retailers as well, a segment that has grown rapidly in recent years as consumer preferences evolved. Heavy debt loads also present difficulties as bankruptcies over the coming months will soften property metrics, though the strength of the region's retail sector heading into the downturn will act as a buffer.

Gradual reopening to buoy the sector. With multiple tech centric markets on the West Coast and a relatively high percentage of affluent households, consumer spending will drive a stabilization of the retail sector. Nonessential businesses have begun to reopen across most markets, which will help to put local economies on a path toward recovery, supporting local retail. In contrast with other regions, supply growth was moderate over the past cycle on the West Coast, contributing to favorable property fundamentals before the pandemic. Markets that are prime tourist destinations including Orange County and San Diego could face a longer path to recovery as visitors account a substantial share of retail sales in these metros. Seattle, Portland and the Bay Area could see less of an impact with a healthy employment base and elevated median household income, though new laws present a risk for investors. In San Francisco, a retail vacancy tax was passed in March for storefronts that sit empty for more than six months, though implementation is now delayed until 2022. A temporary ban on commercial evictions is also in place in San Francisco, while other states and local jurisdictions have implemented measures that suspend evictions.

Investors to target certain segments. With numerous construction projects hitting pause along the West Coast, many delivery schedules are expected to be delayed until next year. The reduction in inventory growth will lessen the impact from shuttered storefronts. Vacated space creates opportunities for investors, with some choosing to redevelop dated assets for last-mile logistics space or into another asset class. A trend had been building in recent years, bringing more mixed-use development to the region, which has the benefit of generating more foot traffic for retailers. Investors will target these deals when available as they could fare better through economic turmoil. Buyers will also continue to gravitate to single-tenant net lease properties with a national credit retailer to hedge risks, as well as grocery-anchored plazas.

West Coast Retail Supply and Demand



Source: CoStar Group, Inc.

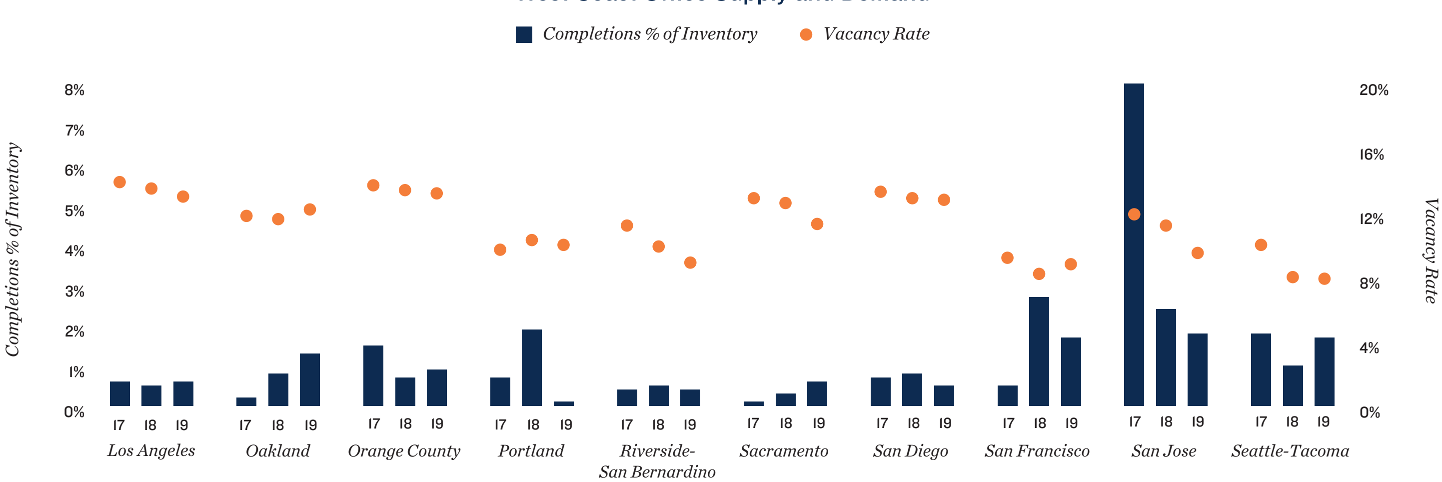
Working Remotely Quickly Becomes the Norm During Stay-at-Home Orders, Though Will Be a Temporary Fix for Majority of Companies

Remote-working options grow in popularity. The pandemic forced office closures and drove workers to quickly transition to working from home, testing companies' capabilities of adapting quickly to managing a digital workforce. Major tech companies have transitioned seamlessly, with some reconsidering their space requirements moving forward. Facebook, with a presence across all three states, announced that over the next decade as much as half of its workforce will transition to working remotely. Twitter has also developed new policies that allow much of its staff to permanently work from home. Other firms could follow suit, though this will not be a structural shift for office/work models. Many companies are likely to offer a hybrid working model that still maintains an office footprint while providing the flexibility that workers are demanding. As economies begin to reopen and companies attempt to bring back workers, firms will likely reconfigure their floor plans and limit occupancy over the coming months. In Seattle, office occupancy will be restricted to 25 percent of the building's capacity per King County's reopening plans.

Suburban office movement gaining steam. The tech-centric economies of the West Coast helped to reshape multiple metros and carried those markets out of the financial crisis at a faster rate than the nation. Across the West Coast, the office outlook remains positive with a robust mix of strong companies that continue to hire highly skilled talent. Of the 10 lowest vacancy rates in the nation for the major markets in the first quarter, five were on the West Coast, headlined by Seattle, which has the tightest operations. San Francisco and Portland registered low vacancy rates in the first quarter as well at 10 percent and 10.3 percent, respectively. Los Angeles also came in near a decadelong low in the first quarter with large leases in place by tech titans and major entertainment firms, which as in other markets contributes to downstream growth in other asset classes.

Challenges ahead for fundamentals and investors. Over the near term, office leasing will slow across the West Coast as businesses hold off on making long-term commitments. Vacancies are likely to drift upward as a result. The pre-leasing of projects under development has been strong, though, which could help property metrics in some markets as roughly two-thirds of space that was scheduled for delivery this year has been signed for. A slowdown in completions will also bode well for property metrics, particularly as speculative office developments, which were on the rise, are put on hold in San Francisco, Portland and other markets. Sales activity will also pul back as it has become increasingly difficult to underwrite deals in the current economic environment. Many investors are on the sidelines as cash flows are uncertain, and they will closely watch rent growth over the coming months to gauge performance as the buyer/seller gap widens.

West Coast Office Supply and Demand



Source: CoStar Group, Inc.

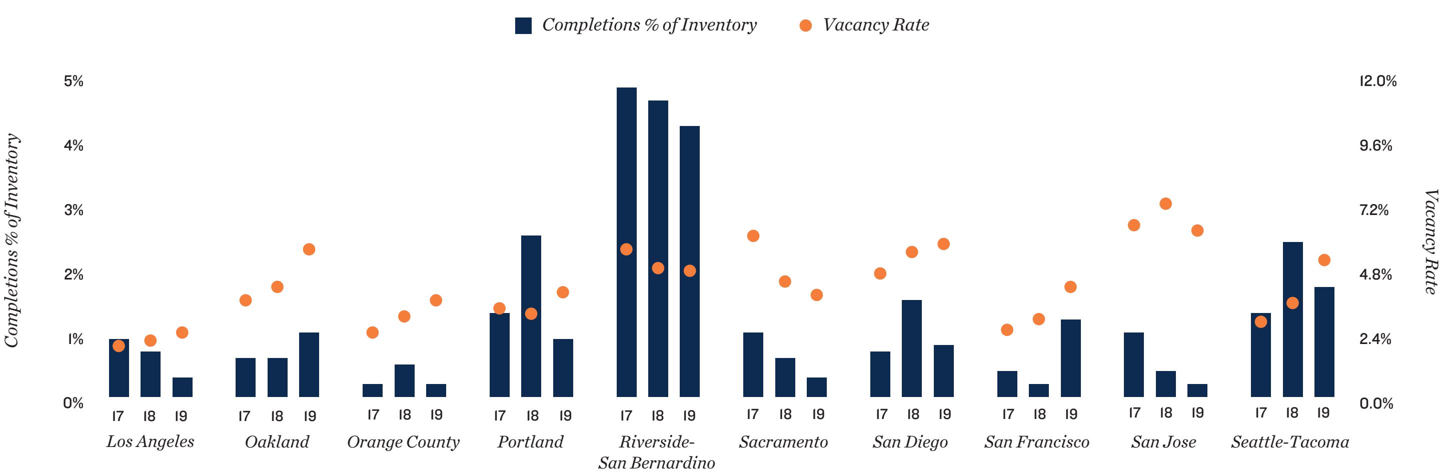
Lockdowns Push Consumers to Online Shopping at Faster Pace, Supporting Long-Term Demand for Industrial Space

Reopening factories and trade routes bolster coastal metros. Trade flows have declined nationally by roughly one-quarter since the start of the pandemic, weighing on West Coast industrial markets more connected to global commerce. Imports and exports will pick up over the summer months as more factories reopen, putting more people back to work in San Diego, Portland and the Bay Area. A return to more normal levels of production and shipping will also benefit industrial space in inland metros that serve as important linkages to the rest of the country, namely Riverside-San Bernardino. While domestic production is reactivating, global shipping companies have reduced the number of vessels at sea. An accumulation of exports could raise the short-term need for industrial storage space in and around the ports of Los Angeles and Seattle-Tacoma.

E-commerce perseverance underscores demand for certain industrial assets. As shelter-in-place orders stretched on since March and a consumer preference to avoid public places has climbed, e-commerce adoption has accelerated rapidly, bolstering a range of logistics and online shopping tenants. Home delivery of groceries from services including Amazon, Target, Walmart, and Instacart has been vital to providing residents under lockdown with essential goods and will continue to be widely used long after the pandemic ends. The move to home delivery of pharmaceuticals and other perishables on top of groceries has also raised the need for refrigerated space. These trends will power demand for both urban infill space that can serve as last-mile logistics facilities as well as for cold-storage assets. To support these digital services, firms also require a robust online infrastructure. The pandemic has emphasized the importance of a digitally connected world, not just because more people are shopping online but also from the widespread adoption of remote working, fueling demand for data centers. All three of these industrial property subtypes are garnering greater investor interest at a time when the income prospects for other real estate assets have been disrupted.

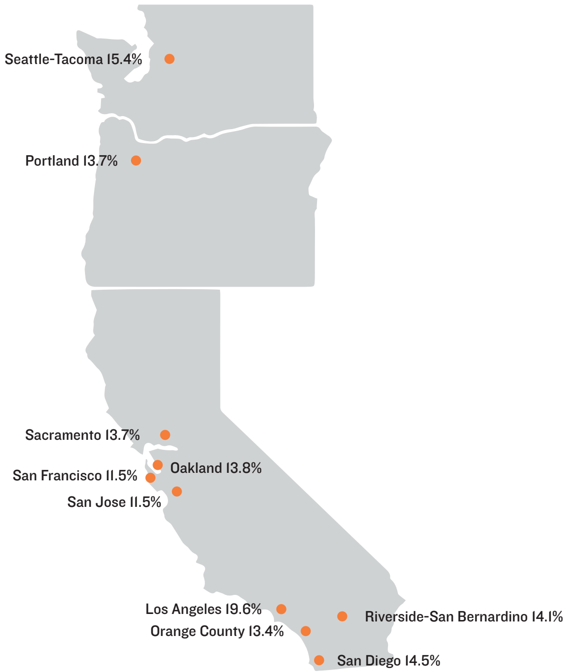
Region's industrial markets some of the nation's strongest. Through the health crisis the industrial sector overall has exhibited strength and resiliency as space demand remains healthy and the outlook continues to be positive. Many of the West Coast metros had exceptionally tight vacancy heading into the crisis, which positioned markets favorably as headwinds mounted. Prior to the current economic situation, strong supply growth across many markets this year was anticipated to push vacancy rates higher. Much of this was from developers adding more speculative space than in recent years. However, health precautions and interruptions to supply lines will delay some projects while others may be adjusted. Nonetheless, tenant demand continues to be robust, taking updated and modern space off the market quickly.

West Coast Industrial Supply and Demand

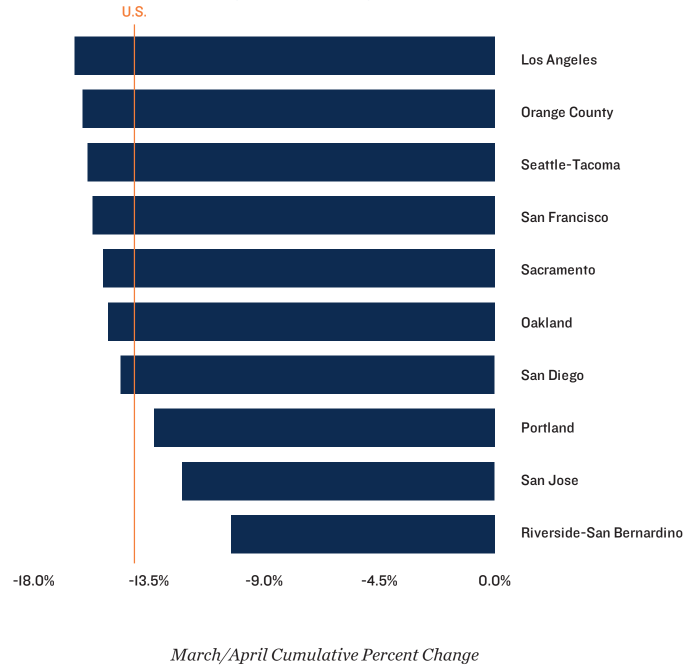


Source: CoStar Group, Inc.

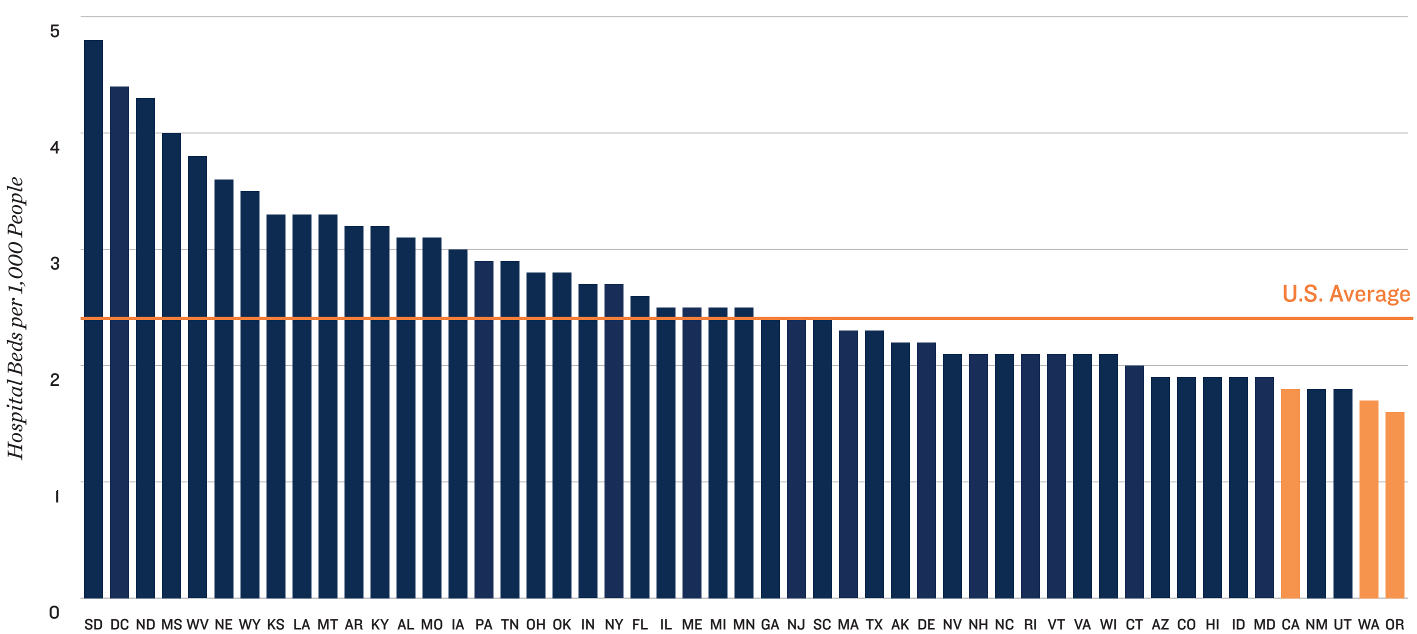
April Unemployment Rate



Share of Jobs Lost in March and April On the West Coast



Healthcare Capacity Key to Managing Crisis



Sources: American Hospital Association; Bureau of Labor Statistics

New Eviction Protections Impacting Investors

CALIFORNIA

Executive Order N-28-20

Removed restrictions on local governments' ability to impose commercial evictions through July 28, allowing cities and counties to enact moratoriums and provide rent relief.

OREGON

Executive Order 20-13

On April 1, a 90-day moratorium was issued for residential and commercial lease evictions statewide relating to nonpayment of rent. The order is currently set to expire on June 30.

WASHINGTON

Moratorium on Evictions

Washington's statewide moratorium prohibits residential evictions through August 1 and prevents rental rates from increasing on commercial rental properties impacted financially.

SAN FRANCISCO

Moratorium on Evictions

Residential evictions are suspended beyond July, in addition to a ban on commercial evictions for businesses with less than $25 million in annual gross receipts.

PORTLAND

Moratorium on Evictions

Residential evictions are prohibited in the city of Portland and Multnomah County during the state of emergency. Clackamas County placed a moratorium on commercial lease evictions as well.

SEATTLE

Ordinance 126066

Rent-related evictions of residential and certain commercial tenants are prohibited for six months after the civil emergency expires. It allows for the payment of overdue rent in installments.

Long Beach Office:
Damon Wyler| *Vice President, Regional Manager*
Tel: (562) 257-1200 | damon.wyler@marcusmillichap.com

Los Angeles Office:
Enrique Wong | *First Vice President, Regional Manager*
Tel: (213) 943-1800| enrique.wong@marcusmillichap.com

Newport Beach Office:
Jonathan Giannola| *Regional Manager*
Tel: (949) 419-3200 | jonathan.giannola@marcusmillichap.com

Oakland Office:
David C. Nelson | *Regional Manager*
Tel: (510) 379-1200 | david.nelson@marcusmillichap.com

Ontario Office:
Matthew Luchs | *Regional Manager*
Tel: (909) 456-3400 | matthew.luchs@marcusmillichap.com

Palo Alto Office:
Steven J. Seligman| *First Vice President, Regional Manager*
Tel: (650) 391-1700 | steve.seligman@marcusmillichap.com

Portland Office:
Adam A. Lewis | *Vice President, Regional Manager*
Tel: (503) 200-2000 | adam.lewis@marcusmillichap.com

Sacramento Office:
Daniel A. Kapic| *Regional Manager*
Tel: (916) 724-1400 | danny.kapic@marcusmillichap.com

San Diego Office:
John Vorsheck | *Senior Vice President, Division Manager*
Tel: (858) 373-3100 | john.vorsheck@marcusmillichap.com

San Francisco Office:
Ramon Kochavi | *First Vice President, Regional Manager*
Tel: (415) 963-3000 | ramon.kochavi@marcusmillichap.com

Seattle Office:
Joel Deis | *Vice President, Regional Manager*
Tel: (206) 826-5700 | joel.deis@marcusmillichap.com

South Bay Office:
Damon Wyler| *Vice President, Regional Manager*
Tel: (424) 405-3900 | damon.wyler@marcusmillichap.com

Ventura Office:
Jim Markel| *Vice President, Regional Manager*
Tel: (805) 351-7200 | jim.markel@marcusmillichap.com

West Los Angeles Office:
Tony Solomon| *Senior Vice President, National Director | MMCC*
Tel: (310) 909-5500 | tony.solomon@marcusmillichap.com

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Federal Reserve; RealPage, Inc.; Small Business Administration