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Bouwinvest Analysis:

Covid-19 and the implications for real estate markets

Introduction

Bouwinvest closely monitors local and global trends and conducts in-depth research at macro and micro level. The analyses of the Research & Strategic Advisory team, as well as the Portfolio and Asset Managers of individual teams, allow our management team to make informed strategic decisions. Objective analyses remain all the more necessary in these times that the Covid-19 virus is spreading so rapidly. Below is a summary of our current views on the impact of the Covid-19 virus on the six real estate sectors in which we are active. Forecasts are subject to change, especially given the speed of developments and the measures being taken by the Dutch government. In that case, we will of course adjust our strategy and decision-making.

General

The global economy and financial markets are currently in the grip of the impact of the coronavirus. How things develop depends to a large extent on how quickly a drug or vaccine can be found and how effective government measures are.
It is becoming clear that the economy in the Netherlands and large parts of the world will enter into recession this year, despite the emergency aid announced by various national governments. The main goal is to prevent large numbers of companies from going bankrupt and unemployment rising significantly. As a result of this intervention, yields on government bonds are rising due to fears that the creditworthiness of governments will decline. On 18 March, yields on government bonds immediately eased after the European Central Bank (ECB) announced it would buy €750 billion in bonds. The ECB has so far left monetary policy interest rates unchanged in the belief that other forms of financial stimulus are more effective. However, the Bank of England (BoE) and the Federal Reserve Board in the US (Fed) have used interest rates as an instrument to stimulate the economies of the UK and US respectively.
The financial markets are currently very volatile, resulting in a sharp cumulative fall in share prices of 30% to 40% in recent weeks. Real estate stocks have shown a similar pattern. Valuations of non-listed real estate generally react with a delay to such economic and financial events.

Residential

The Dutch housing market is currently experiencing a limited impact. One of the main reasons for this is the structural housing shortage which currently amounts to approximately 300,000 homes.
According to market players, the number of mortgage applications in the owner-occupier market is still at a high level, although ABN AMRO Bank expects mortgage interest rates will now rise. Households may run into problems in case of lost income and this also applies to tenants in rental homes. The government is trying to limit the effects through a financial emergency package. In the short term, there is uncertainty about when new housing schemes under development will be completed; relocation is also more difficult due to the closing of businesses such as interior designers, painters and house movers.
Our expectation is that developments under construction will be delayed due to the current circumstances. Initial signs indicate that foreign workers are going back to their home countries and the supply of materials is also declining. The start of many new building developments will likely be postponed. Currently, construction is one of the least affected sectors in terms of the impact of Covid-19.
As for house purchases and rental price development, no effects have emerged as yet, but these are closely linked to economic development and consumer confidence. Since these will deteriorate, it is conceivable that price developments in the owner-occupier market will level off compared to earlier forecasts.

Retail

A significant difference exists between shopping areas for daily groceries and non-convenience goods. In the largest inner cities, the number of passers-by, or footfall, has fallen by 45-65%. Several retail chains have decided to close their doors in the coming weeks, others have restricted their opening hours. All retail chains have indicated they will focus more on the online market.
Neighbourhood shopping centres, on the other hand, are seeing an increase in their footfall, particularly in supermarkets where sales have risen. This is due to the closure of restaurants, cafes, bars and other hospitality venues, the increased number of people working from home and large-scale stockpiling purchases by some customers. Stores selling fresh produce and other fast-moving goods will also benefit from this trend for the time being. Other stores focusing on non-convenience goods, services and catering will be negatively affected.
We expect the impact on inner cities will be significant in 2020, resulting in rising vacancy levels and falling rents. In neighbourhood shopping centres, the same will apply to the non-convenience sector. Demand may, however, recover quickly provided a deep recession does not take hold. The retail sector is dependent on aid provided by the Dutch and international governments. They cannot eliminate the heavy blow to the sector, but they can mitigate it.

Offices

Because so many companies are encouraging employees to work from home, many office floors are currently empty. These companies generally have long-term contracts with office landlords so the direct effects in the regular rental market will be limited. On the other hand, the impact on the most flexible area of the office rental market, the coworking segment, will be huge. However, this is a relatively small part of the total office market.
The general uncertainty regarding economic developments is likely to result in a temporary fall in demand which will possibly also have a stabilising effect on rents after the significant increases of recent years. A broader impact will only become visible in the event of a recession (with bankruptcies, rising unemployment and a permanent decline in demand). That impact is expected to be less than during the global financial crisis of 2007-08 when the market was characterised by high levels of vacancy. On the investment side, we see that the office market is being less affected than other commercial sectors.

Hotels

The hotel market has been hit directly and severely. Occupancy rates are falling by double-digit percentage figures (currently up to 20% for many hotels). As a result, room prices are also falling. Several hotels in the Netherlands have closed their doors for the time being, including Postillion and Stayokay. Many hotels are making use of shorter working-hour schemes.
Hotel chains with low levels of capital are being hit hard. This applies especially to hotel chains with a large presence in countries that are officially in lock-down. In addition, hotels are seeing alternative sources of income, especially events and restaurants, dry up. Most events have been moved to the autumn while restaurants had to close their doors on Sunday, 15 March due to a government decree.
In 2020, therefore, hotels will have a worse year in turnover terms than when the financial crisis broke out and any recovery in 2021 will depend on whether conditions improve or not. Further consolidation in the hotel sector is likely.

Healthcare real estate

The structural trend of an ageing population in the Netherlands means the intrinsic need for healthcare real estate will remain strong. Due to the coronavirus, we expect a temporary fall in supply and that some institutions will run into payment problems.
The pressure is particularly high in the 'cure' healthcare sector. At the same time, care for coronavirus patients is covered under basic health insurance. As a result, the financial risk is low and patients in cure-focused healthcare institutions will continue to be able to pay their fees. In the event of a peak in the number of infections, healthcare providers may face liquidity problems as a result of rising prices for equipment and medicine. We expect governments to provide financial aid under that scenario.
In the care sector, the key challenges are staff shortages, the reduced well-being of residents due to quarantine measures and higher mortality rates due to patients contracting the virus. Although many care homes have waiting lists, it is possible that no, or very few, new admissions will be made. As a result, some nursing homes may run into liquidity problems.
Independent care apartments house elderly people, who are the main risk group for the coronavirus. As a result, vacancy levels in these complexes may increase over time and will last longer due to quarantine measures now in place. Payment problems will be limited, however, given that most older people have sufficient income via private capital and pension benefits.

Logistics

International trade has practically ground to a halt since the end of January as a direct result of the outbreak of Covid-19 and the current pandemic. An increasing number of countries around the globe are entering a total 'lockdown'. We expect that after normalisation, the logistics market will prove resilient.
A direct result of the Covid-19 pandemic is that logistics supply chains are under pressure. Production processes have come to a standstill and there is a real risk of redundancies. As a result, logistics companies may end up with empty distribution centres while rental obligations continue. Bouwinvest expects the share of e-commerce will continue to grow and (urban) logistics centres, located in densely populated agglomerations, will remain attractive. In addition, there is still a shortage of modern distribution centres built in line with the latest standards.