

May 2020



CRE AMIDST COVID-19

Q1 2020 Overview

Market Update

In the wake of the coronavirus pandemic, there is no doubt that most commercial real estate brokers and their clients have become at least somewhat familiar with force majeure and other related legal terms and defenses that have suddenly become top-of-mind. For those that have arranged for—or are currently parties to—commercial leases or real estate purchase agreements, COVID-19 has probably triggered a passing understanding of force majeure and the like, and has no doubt raised all kinds of questions in terms of existing commercial leases and pending and future sales transactions.

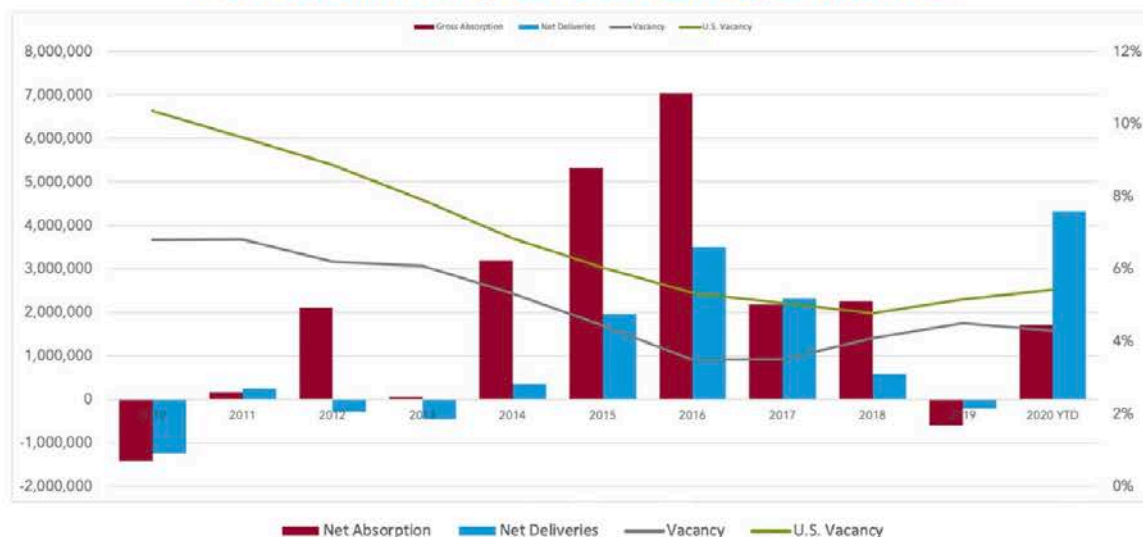


LEE &
ASSOCIATE

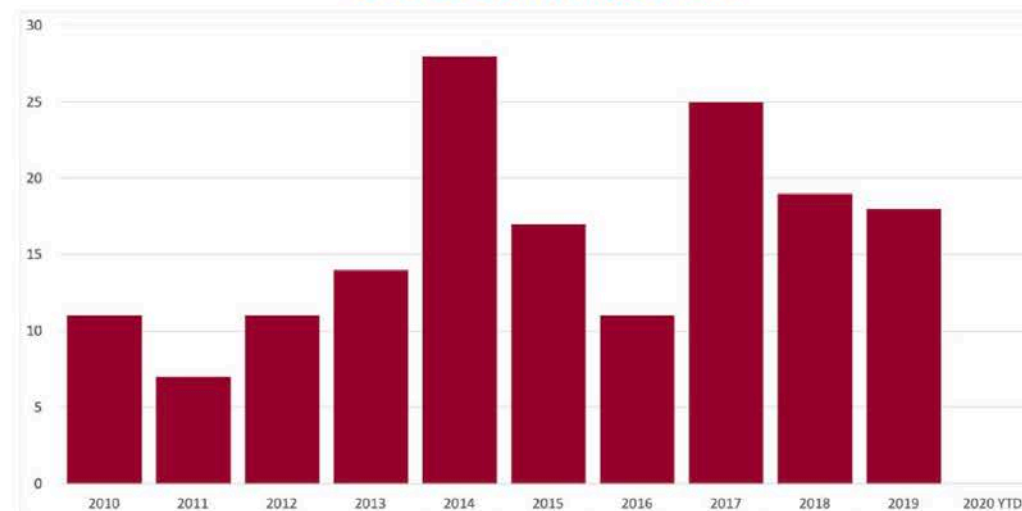
Q1 2020 Overview

MARKET INDICATORS	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019
▼ Net Absorption	554,976 SF	622,456 SF	612,000 SF	829,298 SF	758,371 SF
◀▶ Vacancy Rate	4.30%	4.30%	4.80%	4.80%	4.40%
▲ Avg NNN Asking Rate	\$5.25/SF	\$5.20/SF	\$5.18/SF	\$5.18/SF	\$5.16/SF
▼ Under Construction	3,000,500 SF	3,591,719 SF	3,609,206 SF	2,400,546 SF	1,472,266 SF
▲ Inventory	336,445,433 SF	336,396,033 SF	335,480,294 SF	335,055,426 SF	334,630,558 SF

NET ABSORPTION, NET DELIVERIES, & VACANCY



UNDER CONSTRUCTION



"STATISTICS ADJUSTED TO REPRESENT TWIN CITIES METRO FOR SINGLE AND MULTI-TENANT PROPERTIES ONLY"

Q4 2019 Overview

TOTAL OFFICE MARKET STATISTICS

	Vacancy Rate	Avg. SF Rental Rates GRS	Net SF Absorption	SF Inventory	SF Under Construction
Q4 2019	11.6%	\$25.08	282,112	127,978,186	2,910,306
Q3 2019	11.8%	\$25.02	145,085	125,867,649	2,901,293
Q2 2019	14.9%	\$24.29	175,045	124,050,542	2,789,729
Q1 2019	15.1%	\$23.85	344,205	124,238,409	1,881,985
Q4 2018	15.5%	\$23.88	157,460	123,394,066	2,233,654

LARGEST UNDER CONSTRUCTION

Address	Submarket/City	SF	Delivery Date
700 Nicollet Mall (Dayton's Proj)	Minneapolis CBD	850,000	Q2 2020
30 3rd St S (GatewayTower)	Minneapolis CBD	532,000	Q4 2021
10 West End	West	343,000	Q1 2021

SIGNIFICANT LEASE DEALS

Address	Submarket/City	Square Feet	Tenant
Flying Cloud Corp Bld C	Southwest	39,862	CH Robinson
Millwright Building	Downtown East	37,048	Probation
Millwright Building	Downtown East	25,573	Rally

Force Majeure

How does a force majeure provision impact the parties to a commercial lease agreement?

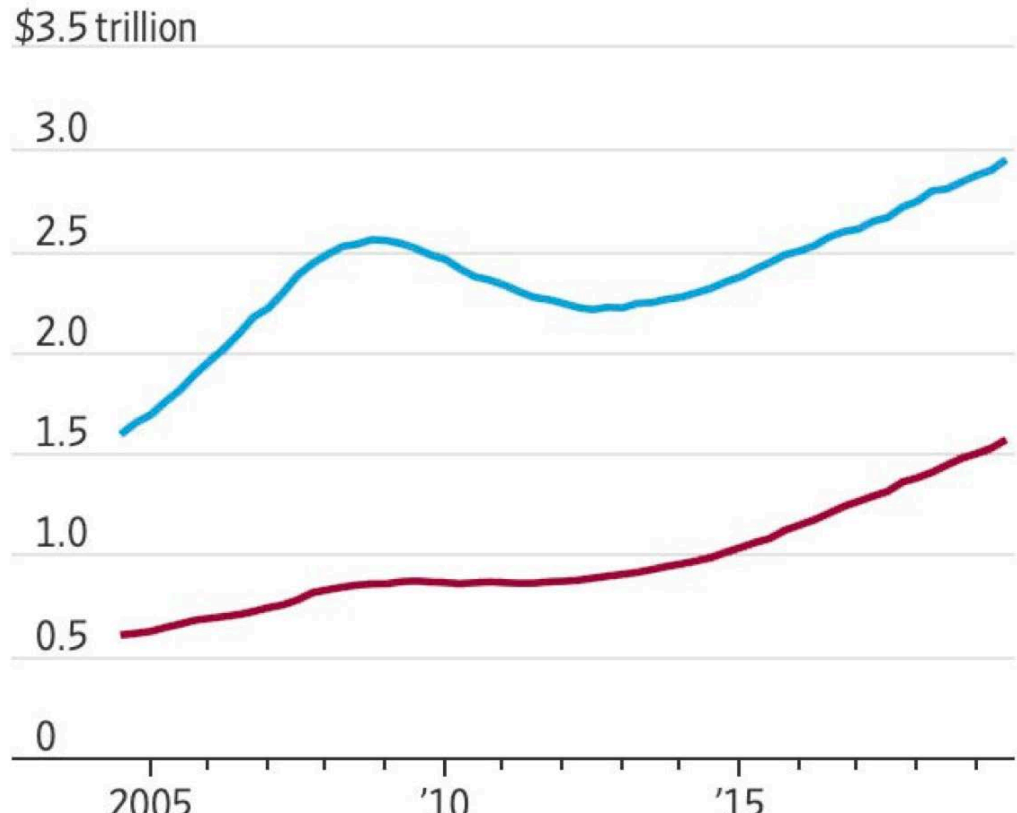
Force majeure language in any contract serves to suspend, postpone, and in some cases excuse performance obligations when certain circumstances outside the control of the parties occur. Clauses vary from contract-to-contract. Many agreements specifically list events that will trigger application of the provision, such as war, terrorism, an earthquake, a flood, government- mandated restrictions, or other “acts of God.”



Tenants, Landlords and Lenders are Reacting

OUTSTANDING MORTGAGE DEBT IN THE U.S.

■ COMMERCIAL ■ MULTIFAMILY



- **TENANTS HAVE LEARNED THAT FORCE MAJEURE PROVISIONS IN THEIR COMMERCIAL LEASES DO NOT NECESSARILY OBTAIN THEIR OBLIGATION TO PAY RENT TO THEIR LANDLORDS.**

- **ALTHOUGH THE LAW IS IN THEIR FAVOR, MOST LANDLORDS ARE SEEKING TO PROVIDE SOME KIND OF RELIEF TO THEIR TENANTS, PARTICULARLY TO SMALL AND MID-SIZE FIRMS.**

- **WHILE TENANTS HAVE RECEIVED LEGISLATIVE RELIEF, LANDLORDS THUS FAR HAVE NOT YET RECEIVED SIMILAR PROTECTIONS FROM BANKS AND OTHER LENDING INSTITUTIONS.**

OFFICE LEASES: Virtually all office leases require tenants to pay rent even in the event of a force majeure. Likewise, this category of commercial lease also requires landlords to provide services and access, but arguably, a force majeure would protect the landlord from doing so, sometimes for several months. It is important to mention that rent is sometimes abated during periods of disruption due to a force majeure. In addition, many institutional landlords are currently keeping their buildings open (as they do on weekends or holidays) and not restricting tenant access.

RETAIL LEASES: The retail sector had already experienced a downturn and has been hit hard by the pandemic. To the extent retailers can establish a causal connection between the COVID-19 crisis and their inability to perform under their leases, they could possibly leverage force majeure clauses in their retail leases to alleviate non-monetary obligations (e.g., continuous operations and similar provisions). We are seeing some landlords amenable to working with tenants and offering coronavirus-related rental abatements.

INDUSTRIAL LEASES: A common industry form (the AIR form of commercial leases) does not contain a force majeure clause. One reason for this is because the document as pre-written requires tenants to carry business interruption coverage (discussed below). However, the absence of a force majeure provision does not necessarily mean landlords and tenants are without protection from or remedies for injuries due to COVID-19.

Acquisitions and Dispositions

FOR BUYERS:

- Request updated Estoppel Certificates to ensure tenants are not in default (ask for a landlord/seller estoppel too concerning any recent notices from a tenant)
- Think about updating financial due diligence
- Work with lenders early
- Consult tax or financial professionals given the stimulus and relief packages now available to borrowers

FOR SELLERS:

- Inquire about the buyer's ability to perform (e.g., confirmation of down payment)
- Seek lender confirmation (e.g., loan term sheets often contain "MAC" provisions ensuring that there is no "material adverse change" or "material adverse effect" before a lender will make the loan)

FOR BUYERS AND SELLERS:

- Document extensions through formal written agreements
- Consider whether the coronavirus crisis constitutes a "MAC" in the purchase agreement (this may impact where deposits are paid in purchase and sale agreements that are past the due diligence period and have liquidated damage clauses tied to the deposit)
- Be sure all agreements are equipped for DocuSign PDF signatures, and check with title companies about lead time or "work-arounds" for documents that need to be notarized for recording

Hotels Through COVID-19

Due to the loss of their traditional sources of revenue, hotels have had to look elsewhere for income and occupancy. Most people aren't staying at hotels, but rooms, up to a point, are continuing to get filled. Hoteliers have been quite creative in this regard.

Moreover, hotels such as Hilton offer discounted rates for health care, law enforcement, and other essential workers who might need to self-quarantine. Hotels are now also contracting with counties to house medically vulnerable homeless persons. A small percentage have always used hotels as workspaces, but many hoteliers are now making themselves into an alternative to WeWork. They are now day workspaces, aka flex rooms. Hostmark's Lafayette Hotel, for instance, gives guests private workspaces in its poolside rooms for a day rate. With golf being a \$84 billion industry, and because it is still viewed as a safe activity even during the current COVID-19 era, hotels have continued to use their courses as alternative sources of revenue.

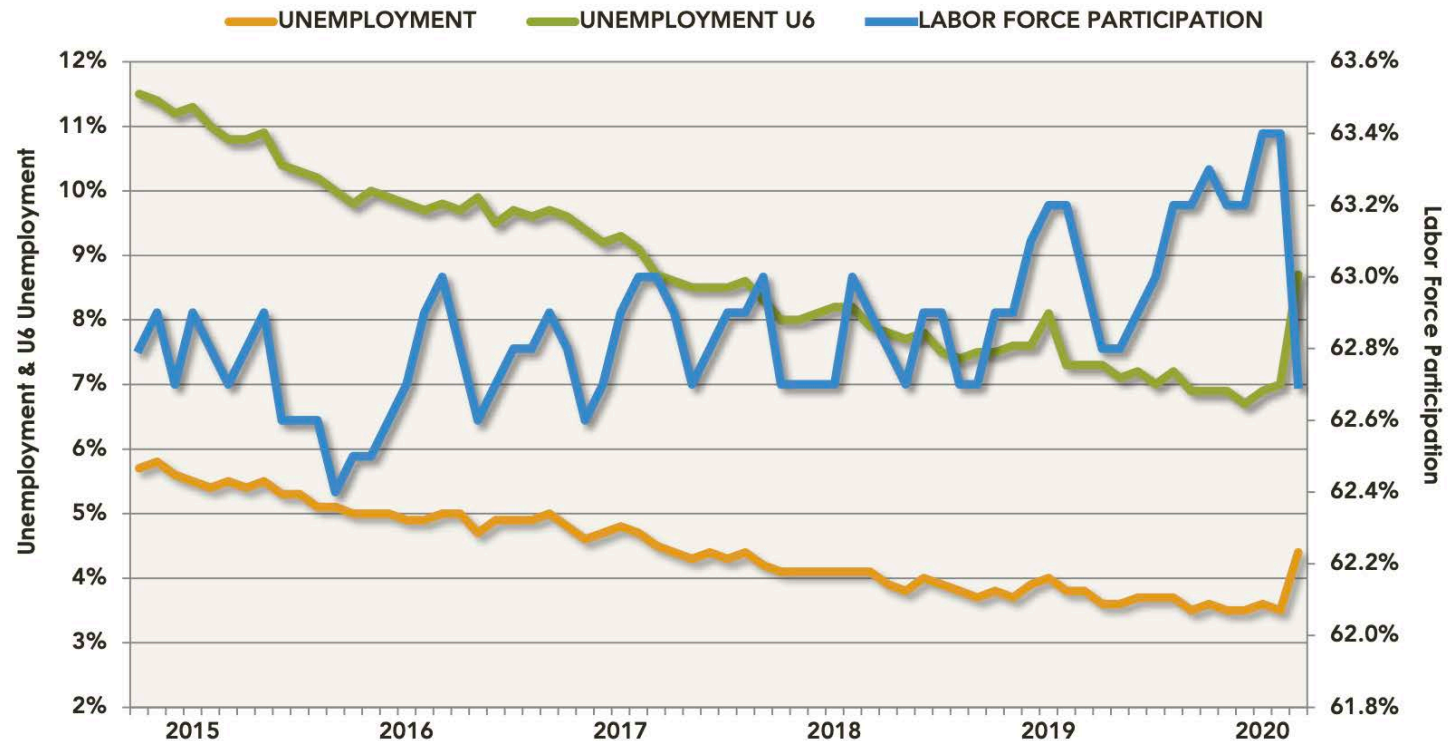
Hotels Through COVID-19

In preparation for a reopening economy, hotels have had to acclimate themselves to new customer and employee expectations regarding cleanliness, hygiene, and safety. Prior practices—such as face to face check-ins or food buffets-- might not exist in the near term.

Early data from China's reopening shows the challenges and opportunities awaiting the hospitality industry. While the profitability numbers from China demonstrate the difficulties hoteliers will face for the rest of 2020, there is a reason for optimism. ADARA, the respected travel provider, reports a rebound in bookings for flights to and within China. They are now at about 30% of the volume that was booked in early January. Also, the latest data from STR shows the increasing recovery of the hotel market in China, with 89% of hotels being open again. While it took four weeks for average hotel occupancy level to increase from 10% to 20%, it took just two weeks to rise to 30%. Some sub-markets, such as midscale and economy hotels in Chengdu, are already running at about 50% occupancy.

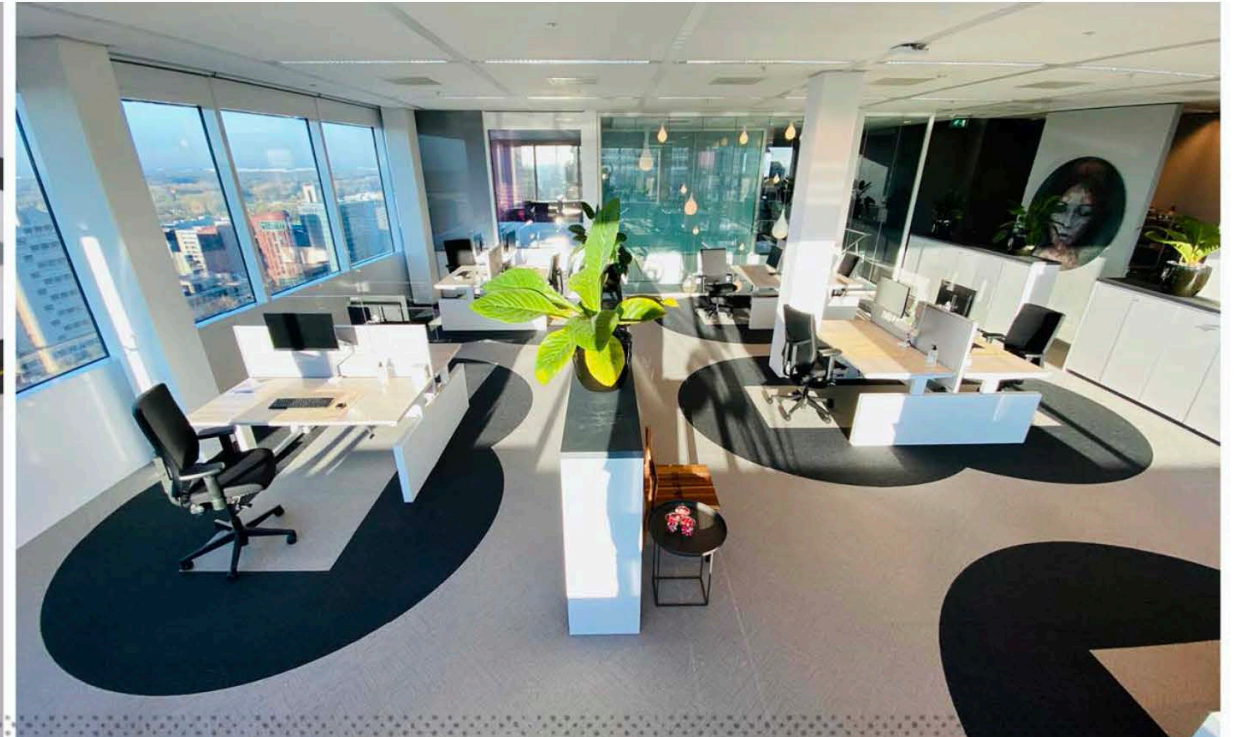
Employment

More than 26 million U.S. workers have sought unemployment benefits in the five weeks since states instituted coronavirus lockdowns in mid-March, and the Federal Reserve of St. Louis said the crisis may cost 47 million jobs, a rough early estimate made prior to the March 27 initial \$2.2 trillion rescue package. That number of furloughs, however, would push the unemployment rate to 32%, well above the 24.9% of the 2008-09 recession. Already, the tsunami of recent layoffs has wiped out all the employment gains created since the recession, when 9 million jobs were cut.



Outlook

- Industrial
- Retail
- Office
- Rents
- Cap Rates



QUESTIONS OR COMMENTS

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