

RESEARCH NOTE

COVID-19: GLOBAL LOGISTICS INFRASTRUCTURE ALSO UNDER SIEGE

Following weeks of headlines rightly focused on infection and fatality rates, equity and debt markets are now demonstrating a better understanding of the myriad ways coronavirus, or COVID-19, is impacting – and will continue to impact – supply chains, gross domestic productivity, and corporate profits in the world’s largest economies.

Similarly, equity and fixed-income property investors are awakening to the realities of the interruption. Many will gauge the impacts through a few means: changes in cost of capital, the financial performance of existing tenants, a continued deceleration of tenant demand and, in some cases, reduction in lofty valuations and returns from property in an increasingly uncertain financial and political environment.

CONTRACTION IN JAPAN

The world’s third-largest economy announced a significant contraction in the fourth quarter of 2019. The -6.3% annualized drop in Japan’s GDP pre-dates the COVID-19 outbreak and represents the largest decline in nearly six years, noticeably impacting foreign trade with China, its third-largest trade partner, as well as Japanese tourism ahead of the summer Olympics.

The \$120-billion stimulus package the country enacted in 2019 to avoid a recession has now demonstrably failed; furthermore, should Japan record a second consecutive quarter of GDP growth decline, the nation will formally enter a recession.

Japanese sovereign debt yields are already producing negative returns out to 10 years, limiting the Bank of Japan’s ability to respond with further accommodative monetary policy measures.

DISTURBANCES AT HOME

After providing forward first-quarter 2020 revenue guidance with an abnormally large range, Apple announced it would miss guidance entirely, due to mobile device production impacts across Asia slowing supply of device sales globally.

Numerous automobile manufacturers and airlines, as well as brands representing myriad soft good industries ranging from cosmetics to textiles to electronics, have also admitted disturbances in normal conditions.

Apple’s announcement should surprise even the most attuned investors, given the company’s soft stance only weeks ago in response to its then-understanding of COVID-19’s impact on its modernized supply chain, heralded globally by investors. Foxconn, Apple’s largest supplier, aims to resume 50% of its mainland-China production by the end of February, and 80% by mid-March.

It is no small matter that Apple, one of the largest U.S.-based corporate contributors to global GDP, won’t have a major supplier fully online until the end of the first quarter.

IMPLICATIONS FOR RETAILERS

Interestingly, the disruption in supply chains many retailers and logistics providers have been planning for has come to fruition – just not in the manner anticipated, leaving many flat-footed. Shipping concerns are experiencing immediate drawdowns on capacity utilization, resulting in loss of shipping volume and related revenue.

While U.S. retailers depend on imports to replenish inventories heading into the spring, the National Retail Federation is predicting sharply diminished shipping volumes over the next few months.

February U.S. port volumes are projected to be nearly 13% lower in February when compared to the same period last year, and 9.5% lower in March.

For comparison, the forecasts prior to the COVID-19 outbreak reflected only a 3.4% decrease year-over-year in February, and a 5.6% increase year-over-year in March.

Normalization of container shipping will only be the start of the industrial and retail property recovery. Delayed or canceled shipments will inhibit the usual spring stocking of inventories, resulting in potential congestion at air cargo and shipping

terminals, as well as disarray in delivery services. It has been reported that Amazon, which represents nearly half of the U.S. e-commerce market, is stockpiling product made in China due to the risks it poses to its supply chain. Delays ultimately lead to increased storage costs and frustrated customers. And with more than 15,000 commercial airlines flights into China canceled, the impact on airline profitability could also prove substantial.

CENTRAL BANK RESPONSE

Markets have grown increasingly dependent on guidance and action from central banks across the world. In China, Bloomberg reports median economist expectations for Chinese GDP growth will be the slowest in more than three decades, as its central bank, The People's Bank of China, offered \$29 billion of one-year notes at a 10-basis-point-cut interest rate of 3.15%. An additional funding of seven-day repos, in an amount equal to approximately \$13 billion, also was made available. While the injections are relatively small, they encourage the notion liquidity is not a concern. China's monetary toolkit was already under strain as more than half of its provinces expected slower growth in 2020, even ahead of the COVID-19 outbreak.

The U.S. Federal Reserve's Federal Open Market Committee may need to cut its target federal funds rate should China's economic deceleration infect global economies and undermine the U.S. pace of growth.

President Trump's previous predilection to try to influence Federal Reserve Chairman Jerome Powell via Twitter, combined with the pending election, make this possibility look more like a probability.

PROPERTY FUNDAMENTALS, COST OF CAPITAL & VALUATIONS

Many commercial real estate market participants have been riding a proverbial wave of e-commerce growth in the logistics space, as retail remains challenged by weaknesses in certain property subtypes. COVID-19's impacts are therefore undercutting one of the few secular shifts supporting commercial real estate investment.

ABOUT US

Transwestern advises clients on real estate strategy, site selection, lease-up and disposition of commercial assets, property and project management, portfolio strategy, debt and equity financing, and development.

While net absorption was already slowing in logistics, in some cases due to lack of availability of modernized space, it will surely be undercut by shaken confidence in supply-chain capacity utilization, at least for the short-term.

Additionally, retailers may face a financial squeeze on already-thin operating margins if they are unable to fulfill sales orders, creating higher levels of scrutiny on tenant financial performance.

ADAPTING TO CIRCUMSTANCES

While COVID-19 has been a health tragedy for many and wreaked havoc on supply chains, some upside may emerge. For more than 12 months, many logistics and retail businesses have been forced to consider and mobilize alternative supply-chain systems due to volatility in China-based manufacturing.

Now U.S. firms may more seriously consider onshoring manufacturing capacity in order to limit further disruption from global supply unpredictability.

Moreover, retailer strategy may tilt to over-stocking products, improving both capacity utilization of warehousing space and potentially increasing demand for related space across strategic logistics-driven markets.

As investors face volatile cost of capital swings in the coming months, property capitalizations may be disrupted. In instances where properties and markets are heavily dependent on foreign trade, underwriting standards will likely prove more cautious. In some cases, transaction velocity may slow and valuations could slip relative to recent sales comparables, impacting development, acquisition and refinance/recapitalization transactions.

To be sure, the long-term health of the asset class is not in question, especially in the U.S.; however, investors should be mindful of current and future conditions, and monitoring symptoms will be vital to sound decision-making.

Sources: Transwestern, The World Bank, International Monetary Fund, National Bureau of Statistics of China, Japan Association of Travel Agents, Bloomberg, Sea-Intelligence, Wall Street Journal, The New York Times, Business Insider and various company filings

RESEARCH & INVESTMENT ANALYTICS

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