OAK INVESTMENT MANAGEMENT GROUP

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Reading the Tea Leaves

During times of crisis there is an irrepressible appetite for information and analysis for one's own sector of focus. During this time of government mandated homestay, appetite for information and analysis on commercial real estate is insatiable. The problem is that supply of 'new' information cannot keep up with demand. As a result, conjecture, hyperbole and generalisations make up the deficit. Therefore, it is important for the discerning observer to distinguish between what we know, what we don't know, and the honest limits of what we can learn given what we know and what we don't.

The occupational market is clearly under siege from all sides. This is driven by global governments' stricture to restrict all but essential work. The built environment and commercial real estate are only a reflection (with a certain time-lag) of what is going on in the real economy. As a result, commercial real estate is suffering as a result of people not using this economic resource. Whether or not rents are being paid, whether or not tenants are going bust – there will be short term as well as long term consequences of this unprecedented state of affairs.

In the short term the market is frozen. Nothing yet can be called as to whether the market will go up or go down in any generalised or meaningful way – because put quite simply there are no quantity of willing buyers and sellers to give validation to any price level. As elaborated above, a big downward draw will be the decreased use of commercial real estate but this situation is not without upward support. This consists of 1) economic stimulus provided by governments around the world 2) interest rate cuts 3) strangulation of all new supply to the market. **The irony of this situation is that the upward draw may not be more potent in the short term, but it certainly will be in the long term**.

The main question – are there any long living structural consequences of what is going on? First, as should be obvious by now there will be a large section of the retail, food, beverage and entertainment businesses that will go bankrupt. They rely on tight margins, high volume and high annuity rates. Their business model is ill equipped to deal with the working capital required to stay afloat during the lock down and the slow emergence back to a semblance of normality. Second, the tide has gone out for covenant-lite workspaces / co-working spaces that don't have the capital to sustain their model through this turbulence. Thirdly, non-discretionary secure leases, covenants and buildings will become even more sought after. Finally there will be window to act now when risk *premia* will be greatly enhanced – and strategic alpha can be captured. This period will not last forever, because in the long term governments will pay for this economic disruption not with assets or their honest labour but with their own printed cash and debasement.

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