

The Cost of COVID – Recent Drops in Market Liquidity May Foreshadow Major Drops in US Commercial Real Estate Markets

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Real or Surreal? PDP Symposium, Preliminary results - subject to revision

Introduction

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PDP publishes 2 products, of which 1 is the “Liquidity Metric” for major US pvt commercial real estate markets

Here we quantify “Liquidity Metric” based on gap between buyer and seller reservation prices (Van Dijk, Geltner, and van de Minne, 2020)

Market liquidity is defined as the ease of selling a property at fair value

Due to buyer and seller behavior liquidity metric leads price movements

A white paper with an extra in depth-analysis of a regular update in wake of C19-crisis (recent update with data up to June 2020):

- Construct the method at a monthly scale for 8 MSAs and by 4 property type sectors

- Compare recent drops with Global Financial Crisis (GFC)

- Look at price implications based on historical lead-lag relationship

Based on private commercial real estate data only (RCA)

Poll questions

What do you think that will happen to prices in the short to medium-run in commercial real estate in major US cities related to COVID-19 and the inevitable economic downturn (GFC average drop in 7 major cities about 30%)?

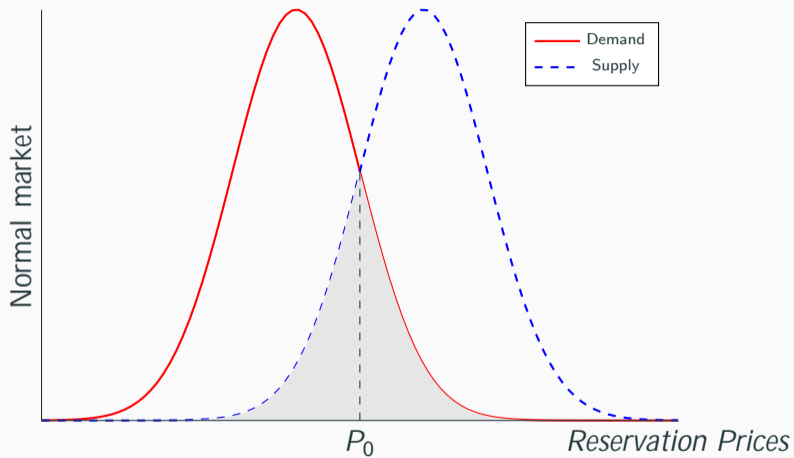
- (a) Increase or flatten
- (b) Decrease mildly (<10%)
- (c) Decrease moderately (10-20%)
- (d) Decrease substantially (20-30%)
- (e) Decrease extremely (>30%)

How long do you think it will take for prices to bounce back (GFC took about 2.5 years)?

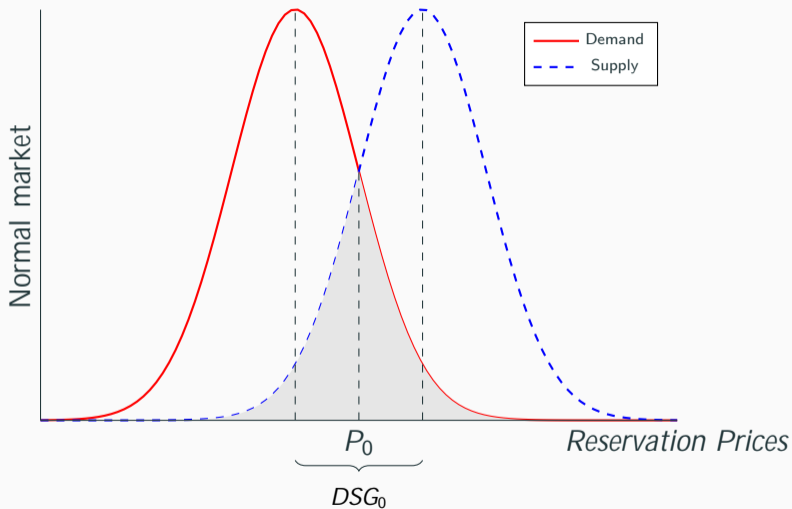
- (a) I didn't expect a price decrease in the first place
- (b) Within 1 year
- (c) Within 1 - 2.5 years
- (d) More than 2.5 years
- (e) Never

Stylized theory

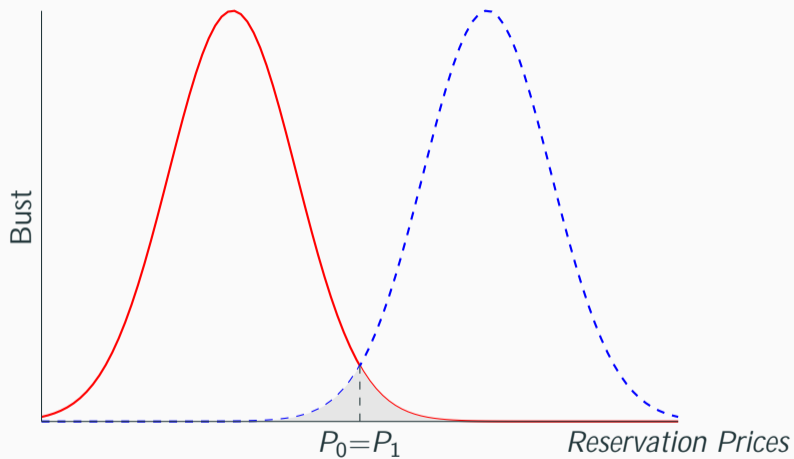
Measuring liquidity: reservation price and downturn



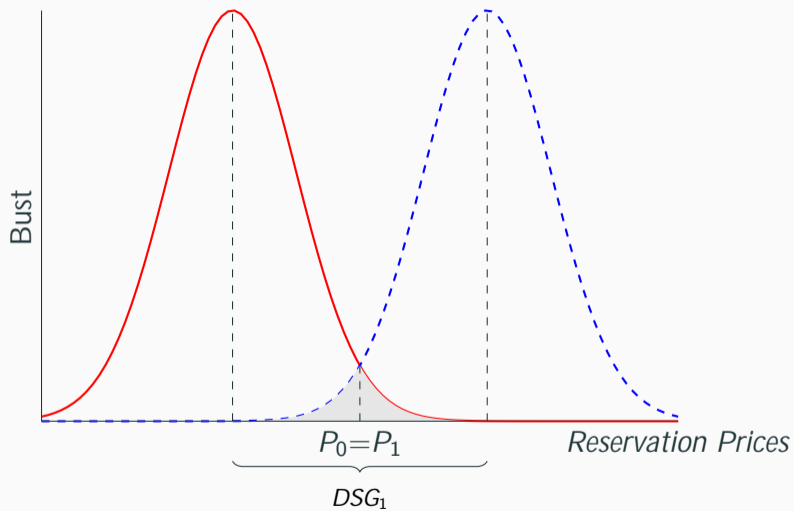
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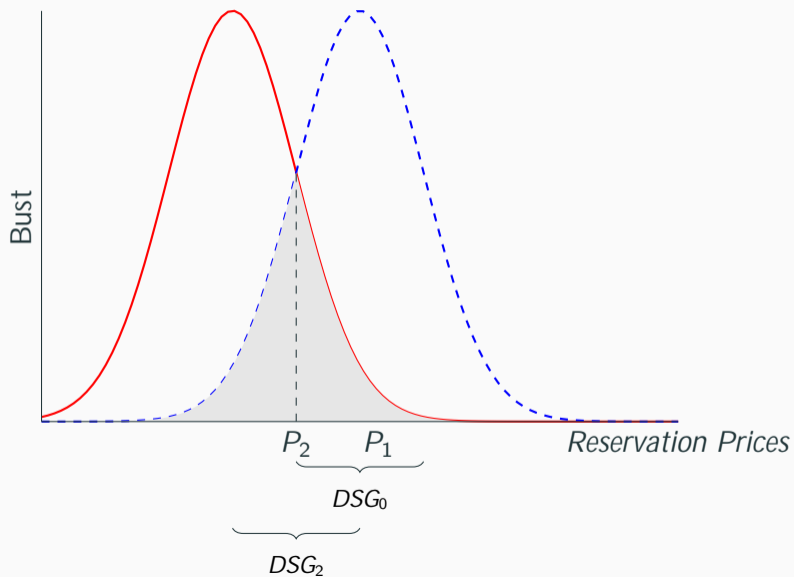
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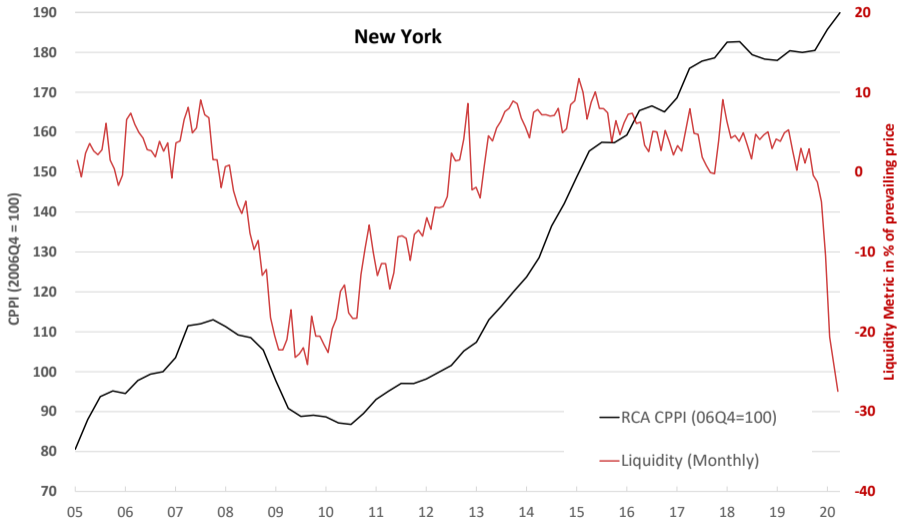


Measuring liquidity: reservation price and downturn

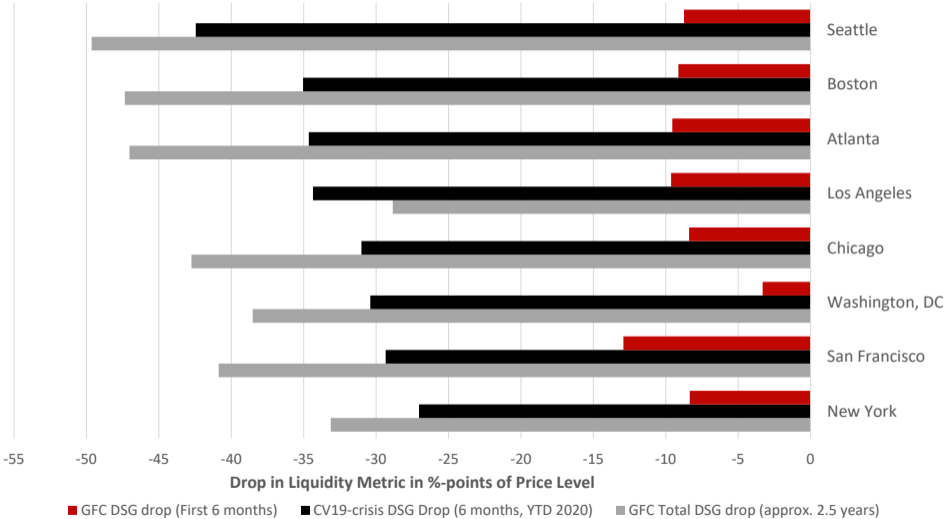


Empirical results

Indices: New York



Comparison with GFC for different MSAs



Comparison with GFC for industry subtypes

Calculate historical Price-to-Liquidity ratio (PL-ratio) which is the elasticity of price growth to the Liquidity Metric based on GFC relationship and panel regression models (4 models in total)

Back-of-the-envelope calculation to infer price effects of recent liquidity drops

This requires (at least) 3 assumptions:

- Historical price-liquidity relationship is indicative for current elasticity

- We have seen the full drop in market liquidity related to C19 in Jan - Jun 2020

- There are no feedback effects

Conclusions

We document substantial drops in market liquidity in major US commercial real estate markets in first half of 2020

Drops are happening much quicker than during the GFC

Drops are almost as big as the total GFC drop

Retail and Office markets are hit hardest

Prices are still stable/increase in 2020Q2 (except for West Coast cities)

Simple framework to infer effects on prices based on historical lead-lag relationship

Price drops of 20%-35% are predicted

Special report update expected in August

(<http://pricedynamicsplatform.mit.edu/> and SSRN)

References

- Van Dijk, D., D. Geltner, and A. van de Minne (2020). The dynamics of liquidity in commercial property markets: Revisiting supply and demand indexes in real estate. *The Journal of Real Estate Finance and Economics* Forthcoming
- Van Dijk, D., A. Kinsella Thompson, and D. Geltner (2020). Recent drops in market liquidity may foreshadow major drops in US commercial real estate markets. Available at SSRN 3604606

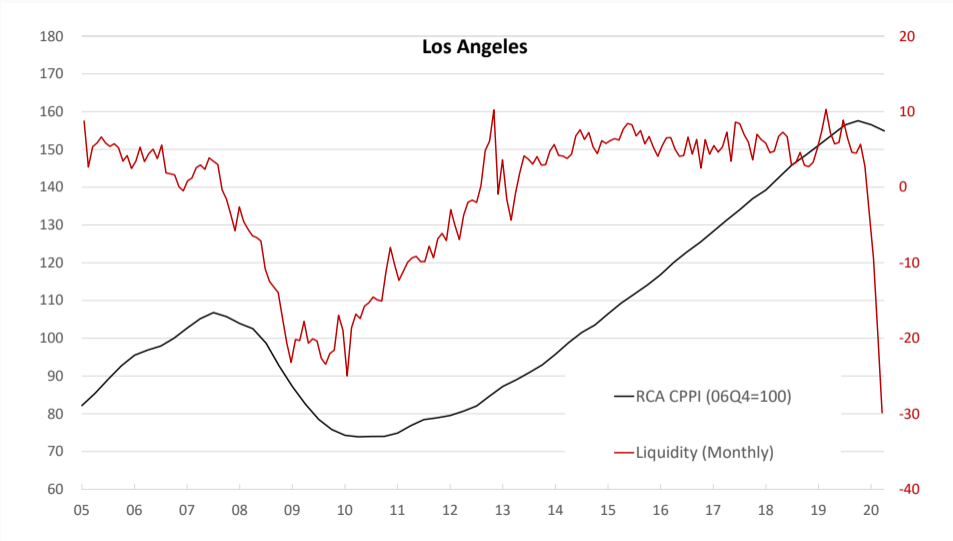
Extra Figure: Regional drops in industry types

Extra Indices: Atlanta

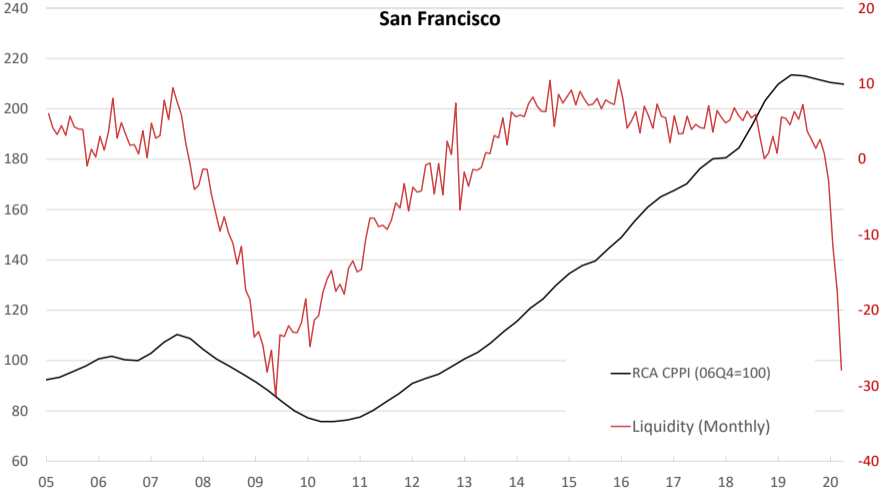
Extra Indices: Boston

Extra Indices: Chicago

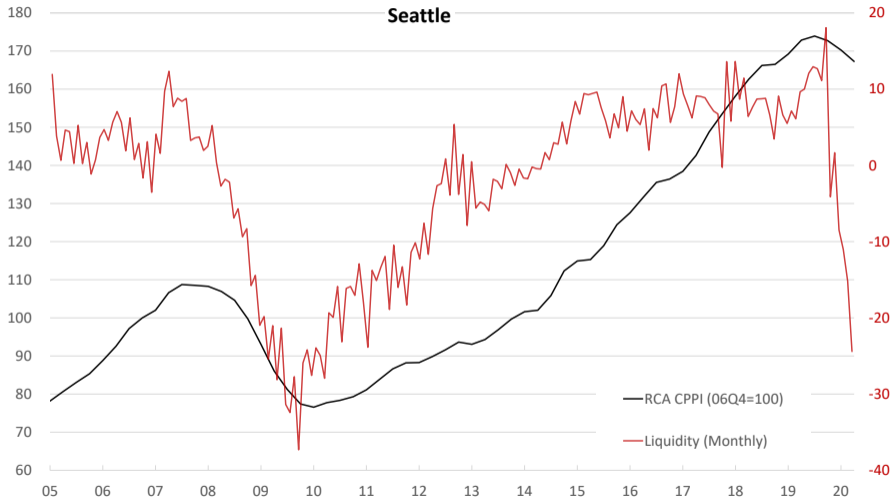
Extra Indices: Los Angeles



Extra Indices: San Francisco



Extra Indices: Seattle



Extra Indices: Washington D.C.

