

Overflowing Oil Supply to Reshape Energy Sector; Real Estate Faces Local Effects, but Some Benefits Will Emerge

Oil demand tumbles under quarantine, sending prices negative.

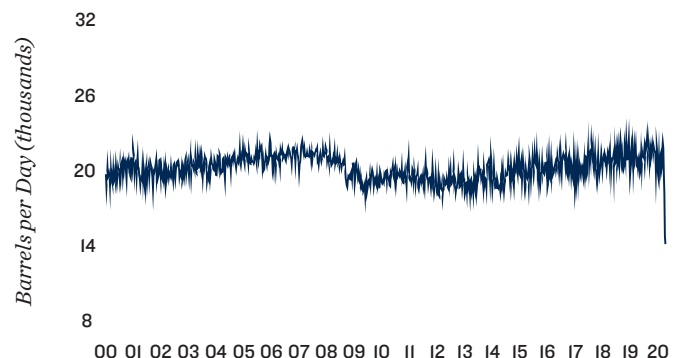
The global health crisis has idled factories and stalled businesses, leading to a historic fall in oil consumption at a time when production was at an all-time high. Petroleum consumption in the U.S. dropped to its lowest level in 30 years in early April, while demand for gasoline was cut by almost half from mid-March. Years of investment and high debt loads for U.S. producers left them reluctant to shut wells and stop pumping, while cuts made by OPEC were too little and too late to slow the oil rout. Demand has contracted much faster than supply has, leaving storage near capacity and driving prices to record lows. Western Texas Intermediate futures briefly dipped below zero on April 20 as oil demand significantly dropped due to lockdown measures. Pricing has since gained traction with the spot price pushing \$36 per barrel, still down from upward of \$60 per barrel at the start of the year. Lower prices typically trigger savings for U.S. consumers and fuel-burning businesses, though as quarantines continue across the nation, many are currently unable to benefit.

Oil imbalance to weigh on commercial real estate. In contrast with many of world's oil producers, production comprises a much smaller proportion of the U.S. economy, making the nation far less vulnerable to the shock. With businesses and jobs on the line, though, the president directed the Energy and Treasury departments to create a plan that provides the oil and gas industry with federal stimulus funds. In exchange for aid, the government is considering partial ownership in the struggling firms or their reserves. Even so, the energy industry faces an elevated risk of bankruptcies, consolidations and layoffs, all having broad impacts on commercial real estate. Markets with greater exposure to the industry will face the most challenging path, including Houston, Dallas/Fort Worth, Denver and Oklahoma City. While these markets are more economically diversified than during previous oil price drops, downsizing oil companies could push office vacancies higher, which could potentially spill over to multifamily demand. Industrial space could also be impacted, particularly near oil fields, if oil companies go out of business or significantly downsize operations.

HIGHLIGHTS

- Oil prices briefly fell into negative territory for the first time on April 20 as suppliers overshot storage capacity. The world's oil producers have been unable to shut wells fast enough to adapt to the pandemic-driven decline in consumption, now at its lowest level in 30 years.
- Plans are forthcoming for government funds to be directed at the embattled oil and gas industry, which may come at the cost of federal ownership of companies or their crude reserves.
- Houston's energy sector faces a challenging path forward, weighing on the local economy and commercial real estate. Office vacancies will climb higher over the short term for an already struggling sector.
- Lower fuel prices will likely remain in place until the economy ramps back up, benefiting downstream firms and consumers.

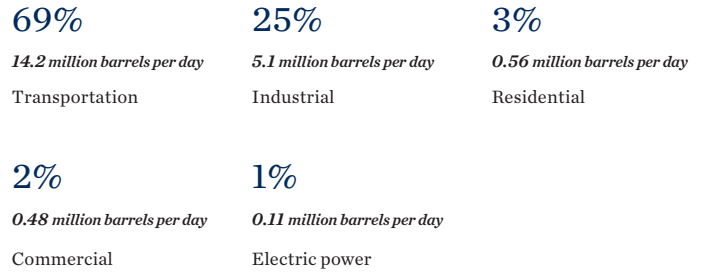
Weekly Petroleum Barrels



Houston faces dual threat of health crisis and oil downturn. Houston's oil and gas industry faces a significant headwind as companies cut their budgets and lay off or furlough employees. The impact will weigh on the office sector as approximately 40 percent of tenants are in the energy industry. The turmoil will largely be isolated to areas including the Energy Corridor as the tech and healthcare sectors remain comparatively healthy in other areas of the market. Houston's office sector has struggled to regain footing since the 2014 oil crash, closing out 2019 with North America's highest office vacancy rate as energy companies continued to tighten operations. While office construction was already near a standstill in Houston, apartment developers will face an increasingly difficult path ahead as renter demand could soften. The oil crisis will compound the impact of the health crisis, which is already weighing on the metro. While the state of Texas is preparing to reopen, which could help businesses and partially offset the economic impacts already felt, there are risks that a premature reopening could spark a second wave of health issues. Federal stimulus, particularly support targeted toward the oil sector, will help mitigate the pressure.

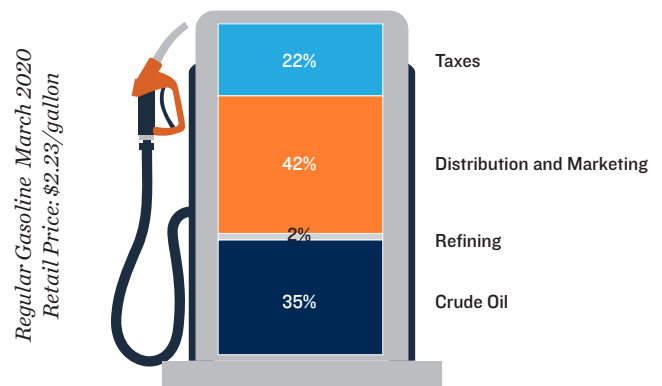
Fuel intensive industries to see lower prices in coming months. While upstream energy companies that focus on extraction and production will feel the brunt of the price drop, downstream sectors will benefit, including construction companies and logistics firms. With the oil imbalance anticipated to continue through the start of next year, shipping costs could trend lower, a windfall to retailers and the industrial sector. Logistics expenses can be a sizable component for businesses and have grown rapidly as e-commerce gains a stronghold and trucking firms contend with shortages. As the economy eventually moves toward recovery from the health crisis, construction activity will pick back up and firms may benefit from the lower pricing of oil-related products, including asphalt, roofing and siding materials. Heavy users of fuel and petroleum products will benefit as well, including manufacturers and factories, acting as a tailwind as activity ramps back up. Once quarantines are lifted, consumers will be able to pocket more cash at the pump, a much-needed savings for many Americans who have been affected by the financial fallout of the pandemic.

U.S. petroleum consumption by sector*



* 2018 market share
Source: U.S. Energy Information Administration

Consumer Cost For Gasoline



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Sources: Marcus & Millichap Research Services; Baker and Hughes; U.S. Energy Information Administration