One year with COVID-19: The pandemic's temporary and permanent impacts on CRE

BY BRANDI SMITH

"American consumers' savings are up, and people are thirstier than ever to get back out and socialize, shop and see friends and colleagues for meals and drinks and concerts."


Terry Ohnmeis


Ian Anderson


Ken McCarthy


John Carr


Ben Fuller


Jeanette Rice


James Breeze

March 2021 marks one year since the World Health Organization declared the COVID-19 outbreak a global pandemic, triggering a domino effect that has had a profound impact on Americans' daily lives, as well as the commercial real estate industry. REJournals spoke to experts in the retail, office, multifamily and industrial fields to reflect on how each sector responded to the challenges posed by the pandemic and their expectations going forward.

RETAIL | "... everyone is so hungry ..."

"Retail, more than other sectors of commercial real estate, offers its share of volatility and requires those of us who work in the sector to react and evolve quickly," said Terry Ohnmeis, director at Cushman & Wakefield.

He describes the industry as being at a peak in terms of occupancy, rent growth and overall vibrancy in the first quarter of 2020. Retail being "more nuanced" than other property types, Ohnmeis acknowledges some locationally challenged malls, but generally, if Class A space became available in "A" and "A+" locations, he said it instantly had a dozen offers on it.

"This run actually extended longer than many thought it would and left us wondering when it would end and why," Ohnmeis said. "Still, no one thought it would be a pandemic until the reality of COVID-19 hit."

When it did, deals were completely sidelined for the first six to 12 months. Ohnmeis and his colleagues at Cushman & Wakefield worked with landlord and tenant clients on what to expect with reopening and how to reopen safely.

"With essential services that could not close like grocers and owners of grocery-anchored retail, we worked through how to operate safely in this environment, for both employees and customers, and maintain supply chains," said Ohnmeis. "It's an understatement to say that restaurants were—and still are—challenged, but quality operators who could pivot and heavily rely on delivery and carry out were in much better shape than those who could not."

Since the third quarter of 2020, activity has surged and Ohnmeis said Cushman & Wakefield's retail teams are as busy as they've ever been. Closing deals is more intensive and volatile, he said, but adds that there are a number of opportunistic retailers and investors active in the market.

"Well-capitalized retailers were able to take advantage of quality spaces left vacant as a result of the pandemic," Ohnmeis said. "Similarly, proven restaurants with successful menus, delivery and carry out operations are evaluating options and closing deals."

Continued on Page 20>

CRE

< Continued from Page 20

Looking ahead to life beyond the pandemic, he anticipates a retail boom.

"American consumers' savings are up, and people are thirstier than ever to get back out and socialize, shop and see friends and colleagues for meals and drinks and concerts," said Ohnmeis. "Pre-pandemic, the term 'experiential' was almost a cliché, but everyone is so hungry now for personal interaction and travel."

As successful retailers have always demonstrated, he adds, the optimism, resilience and adaptability inherent in retailers and investors leaves us well positioned for recovery.

OFFICE | "... only a matter of time ..."

"The pandemic has affected the U.S. office market like never before. It has caused a generational reassessment of both how we work and the existential need for office space," said Ian Anderson, CBRE head of Americas office research. "More concretely, it has emptied out offices of their occupants like we have never seen. Physical occupancy of offices is its lowest on record."

That's a stark difference from March 2020 when he said the U.S. office market was underpinned by a sense of optimism as it enjoyed an ongoing economic expansion and growth in office-using jobs.

"Leasing volumes in the first quarter of 2020 were on a par with previous years as was absorption," said Ken McCarthy, Cushman & Wakefield economist. "So, as the pandemic hit, the national office market was healthy, with some pockets of substantial construction."

That changed quickly as employers sent employees to work at home if possible or, in the worst-case scenarios, laid those workers off as revenue tanked.

"Unfortunately, there is little demand right now, and we are showing record-low levels of office-leasing activity across the country," Anderson said. "We can't overlook either that we're also in a recession, and the economic impact has caused severe distress in some industries. As a result, we are seeing rising vacancies of office space and downward pressure on rents. This will ultimately be one of the most severe office downturns on record."

If there's any silver lining, it's that Anderson predicts we are at or near the bottom of the trough in terms of office leasing activity and demand for office space.

"As COVID cases decline, more people become vaccinated, and warmer temperatures arrive, we expect more decisions to be made by clients based upon more certainty in the future," he said.

McCarthy echoed that, adding, "It's only a matter of time before the pace of growth accelerates again. We expect the recovery in the U.S. to continue through 2021, with strength backloaded in the second half of the year."

Both experts agree that, though the pandemic could have long-term effects on the office sector as a whole, it will not eliminate the need altogether.

"What we will see is a new workplace ecosystem with a number of roles. The workplace will no longer be a single site but an ecosystem of different locations and experiences to support convenience, functionality and well-being," said McCarthy. "Balancing social distancing and density with lower office-based headcount will likely not affect current footprint sizes, and offices will continue to thrive but in new ways."

He expects the purpose of the office will be to provide inspiring destinations that strengthen cultural connection, learning, and bonding with customers and colleagues and foster creativity, collaboration and innovation.

MULTIFAMILY | "... cities will have to work hard ..."

Though retail and office have taken considerable hits during the pandemic, the multifamily sector exhibited resiliency, according to John Carr and Ben Fuller, directors of Cushman & Wakefield's Sunbelt Multifamily Advisory Group.

"Agencies stayed active, providing debt for new transactions. While lenders required increased reserve requirements for new loans, investors also began underwriting more conservatively from March to May," said Fuller, adding that underwriting started to loosen up, as did lenders, allowing the marginal price dip to bounce back.

“Cities will have to work harder to rebuild and maintain the kind of vibrant, exciting urban centers to keep attracting business and residents to the urban cores.”

Additionally, while demand typically falls dramatically as vacancy quickly rises during a recession, Jeanette Rice, CBRE Americas head of multifamily research, said this time was different in part due to the federal stimulus including enhanced unemployment, eviction moratoriums, the nature of job losses and the healthy market conditions prior to COVID.

“Vacancy rates have risen only by 50 basis points year-over-year as of Q4. Rents are down—4.2 percent nationally,” said Rice. “If San Francisco, San Jose and New York were taken out of the equation, the year-over-year decline would be only -1.3 percent.”

She said Class B and C product held up the best, but suburban product also sustained well. Rice attributes that to many urban residents, working from home or moving in with families or friends or to lower-cost suburbs.

“Many of the renters who left the urban core for the suburbs (for reasons of cost, lifestyle, space) will stay. Millennials continue to age and move into life stages that are better suited for suburban living,” said Rice, suggesting that could be a lasting impact of the pandemic on the multifamily sector.

She also anticipates increased focus on excellent Internet service, flexible coworking space and larger units as more people work from home.

“For 15 to 20 years, the renaissance of America’s urban cores was a key theme to the multifamily sector—and indeed for the entire commercial real estate industry,” Rice said. “While our research indicates that COVID is a temporary challenge to this theme, it has exposed more fully some of the issues that need to be better addressed such as aging infrastructure, cost, homelessness. Cities will have to work harder to rebuild and maintain the kind of vibrant, exciting urban centers to keep attracting business and residents to the urban cores.”

The city-to-suburb population shift happened on a broader scale, too, as populations migrated from states such as New York to the Sunbelt region driven by COVID regulations and job opportunities.

“Companies expanded relocation efforts and appreciate the lower cost of living, as regulatory issues burdened the coastal markets. The urban core will outperform over the next five to seven years, as America’s youth will want to spend their early careers in the urban core,” said Fuller. “Single-family rentals will survive post-pandemic, as millennials want more space and autonomy but lack the ability to purchase a home. This is reflected by development equity and sponsors flocking to the space.”

“The Sunbelt will permanently benefit as jobs and capital continue to migrate aggressively into the region,” Carr said.

INDUSTRIAL | “... robust demand for space ...”

The pandemic that created so many challenges within other property types generated the best possible scenario for industrial: massive demand that led to the highest rental rate annual growth ever posted, 8.3 percent.

“The U.S. industrial market was on solid ground in March 2020 with steady (although not record-breaking) transaction volume, 39 consecutive quarters of positive absorption, historically on-average rental rate growth and a record low vacancy rate of 3.9 percent,” said James Breeze, CBRE global Head of industrial and logistics research.

For a brief slowdown in March and April, it looked as though industrial’s streak of positive net absorption might have come to an end, but—in Breeze’s words—“the market roared back with massive transaction volume that created a record amount of positive net absorption in Q4 of 105 million square feet.”

Developers, he said, became bullish on the long-term positive effects of COVID-19 on e-commerce sales and completed 264 million square feet of new development. At year-end, a record 327 million square feet was under construction.

“Despite massive development, the overall vacancy rate is only 4.6 percent, which is 30 basis points higher than the all-time record low,” said Breeze. “We are seeing robust demand for space in all size ranges, but most so in warehouse/distribution centers of 100,000 square feet and larger. Occupiers are moving into larger facilities to better service the growing online consumer base and to ensure that inventory levels do not deplete like they did at the onset of COVID-19.”

He anticipates occupiers will need to expand their distribution capabilities to catch up as consumers continue to buy goods online post-pandemic.

“This, along with holding safety stock onshore, will be long-term drivers that came from the effects of COVID-19 on the American consumer,” Breeze said.