REAL ESTATE

Here Are Real Estate's Winners and Losers In the New Normal

The recession and new health protocols are impacting tenants, landlords and developers.

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The pandemic is affecting certain areas of real estate differently.

Residential housing has stayed resilient throughout 2020. Commercial real estate (CRE), however, is severely impacted as lockdowns forced offices and shops to close. But there's a silver lining to Americans changing their shopping behavior: Online sales and work-from-home (WFH) are creating lucrative opportunities for cold-storage warehouses, distribution centers and remote working spaces.

We explore how the historic downturn and new health protocols are impacting tenants, landlords and developers.

Residential stays robust

Many renters are struggling but residential property owners are seeing a rise in asset values.

Between 30 and 40 million Americans are potentially facing an eviction, according to data from U.S. Census Bureau. Thus, up to 23 million workers intend to relocate away from major cities and move to cheaper places, according to Upwork's October 2020 study.

Despite these trends, the residential housing market remains robust due to low mortgage rates and a glut of supply. The current seller's market also means homeowners are likely to receive multiple bids if they sell.

In September, existing-home sales grew for the fourth consecutive month to 6.5 million nationwide. That's up 9.4 percent from August and 21 percent increase from one year ago, according to National Association of Realtors (NAR). The median price was $311,800 or 15 percent more than in September 2019.

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Commercial real estate saw a nosedive

In 2018, the U.S. commercial real estate (CRE) market was estimated at $16 trillion, according to Nareit, an industry association. It's undergoing a structural shift.

I recently spoke with industry veteran Paul Daneshrad about the pandemic's effect on CRE. "It typically takes between 6 and 9 months for the commercial real estate market to experience the negative impact of an economic downturn," says the CEO and founder of StarPoint Properties, a Beverly Hills, California-based real estate investment firm.

"CRE normally remains stable in the early periods of a recession. But during Covid-19, the consequences were immediate as offices closed, travel halted, and governments imposed shelter-at-home orders."

Office, retail and hospitality transactions dropped in only three of the past seven recessions, according to Daneshrad. The pandemic is obviously different: Just visit any mall or hotel.

A surge in economic growth in Q3 bodes well for the segment. Gross domestic product (GDP) rose by 33 percent on an annualized basis from July to September, according to October 2020 data from U.S. Commerce Department. Because businesses are gradually reopening.

Facilities that cater to the new normal see strong demand

Forty-five percent of senior real estate professionals and investors expect CRE assets to fall between 5 and 10 percent in value this year, according to October 2020 survey by valuation firm Duff & Phelps. But over 90 percent of respondents also think transaction levels may move back to pre-pandemic levels in 2021. And 36 percent believe the industrial and logistics sector will emerge the strongest from the crisis.

"Winners leading into 2021 are data centers, cold-storage warehouses and industrial manufacturing," says Daneshrad.

Cold-storage facilities are temperature-controlled warehouses that keep food cold. Investors find them appealing because of new safety considerations, last-mile delivery capabilities, and old age of existing infrastructure. Cold-storage warehouses are also in low supply with a national vacancy rate of 10 percent, and that was before Covid-19. They allow companies to improve delivery times and ensure food safety.

Key changes to consumer behavior include ecommerce, hyperlocal delivery, work-from-home and new health protocols. In September, online sales increased 43 percent year-over-year (reaching $60.4 billion), according to Adobe Analytics.

WFH gives rise to a tectonic shift in office demand.

What remote workers gain in convenience, landlords lose in tenants. A September 2020 report from Cushman & Wakefield predicts the U.S. office sector will lose 145 million square feet of occupancy in 2020 and 2021. That's driven by a 1.7 million reduction in on-site office jobs.

"Tenant uncertainty about the viability of centralized offices, as well as big shift towards teleworking is causing a major downturn in office-space demand," says Daneshrad.

“Covid-19 has the potential to alter the CRE office sector in the long-run since businesses are realizing cost savings from remote work. However, companies that return to the office will expand their space so that employees can maintain social distance.”

An economic cycle affects industries differently.

A McKinsey study a while back found that in a recession, some sectors contracted more quickly than others. For example, a downturn is foreshadowed by a decrease in consumer spending, which accounts for 70 percent of the economy. In contrast, the energy industry is among the last affected. (Shoppers can stop buying shoes but they’ll still need to pump gas.) In a recovery, consumer and IT showed the first signs of improvement, according to McKinsey’s authors.

Covid-19’s impact on real estate is extremely interesting. Because there are underlying structural transformations on how Americans study, work and buy food. Investors, developers and tenants will need to adapt to a permanently different landscape.