The Commercial Real Estate Trends & Outlook Report discusses trends in the small commercial market (transactions that are typically less than $2.5 million) based on a survey of members of the National Association of Realtors® engaged in commercial real estate about their transactions in the second quarter of 2020.

Across the multifamily, industrial, office, retail, and hotel sectors, REALTORS® reported a decline in sales and leasing transactions, a decline in sales prices, and an increase in vacancy rates, with retail and hotel suffering the heaviest blow from the coronavirus pandemic. Industrial and multifamily remain as the strongest legs of the commercial real estate market, in both transactions for structures and land. The office market is also impacted, but it is in the middle-of-the-pack in terms of the impact. Commercial sales among REALTORS® fell 5% year-over-year in in 2020 Q2. Sales prices were also down by 3%. Leasing volume fell by 4%, and construction was down 5%.

Looking ahead in the next quarter, leasing volume in multifamily properties will likely remain unchanged or decline modestly in 2020 Q3 compared to the volume in the second quarter. Realtors® expect multifamily vacancy rates to hover at around 8% in the next three months. In metro areas where rental vacancy rates are low, rents will remain firm. In the office market, sales, leasing, and net absorption will likely contract mildly in 2020 Q3 given the massive loss in occupancy that has already occurred in the second quarter. Realtors® expect vacancy rates to continue to hover at 15% and will remain elevated until employment gets back to the pre-pandemic level. The industrial market is arguably the strongest leg of the commercial real estate market, and Industrial properties will remain in demand given the constant growth in e-commerce and as physical retail locations continue to attract and retain consumers via online shopping and delivery. REALTORS® expect vacancy rates in the warehouse spaces to average 8% in the coming quarter. Retail, after nearly coming to a complete stop, is starting to show signs of recovering, but some restrictions put in place to minimize human contact (i.e. operating at only 25%) will keep vacancy rates elevated. REALTORS® expect vacancy rates to remain elevated in the third quarter, at 20% among retail strip centers and free-standing stores, with much higher vacancy rates for malls, at 35%.

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Commercial Sales of REALTORS® Declined 5% in 2020 Q2

Sales transactions volume among REALTORS® fell on average by 5% year-over-year in the second quarter of 2020 according to members of the National Association of REALTORS® who responded to NAR’s 2020 Q1 Commercial Real Estate Quarterly Market Survey. NAR commercial members’ transactions are typically below $2.5 million (small commercial market). Sales transactions volume of properties or portfolios of at least $2.5 million (middle to large commercial market) plunged 68% year-over-year, according to Real Capital Analytics.

The largest pullback in sales of commercial REALTORS® were in the office real estate market (-7%), retail strip center and malls, and hotel/hospitality properties. Sales of apartment properties and industrial properties were down year-over-year by 4%. Land sales were down 3%.

Commercial Transactions of REALTORS® in 2020 Q2 by Property Type (YoY % Chg.)

Sources: National Association of REALTORS®, Real Capital Analytics
Commercial Prices Fell 4% in Small Commercial Real Estate Market

Commercial prices in markets where commercial members of the National Association of REALTORS® are engaged in declined 3% year-over-year in 2020 Q2. These markets are typically below $2.5 million (small commercial market). Among transactions of at least $2.5 million, commercial prices were still up nearly 4%, according to Real Capital Analytics, but this is a slower increase compared to pre-coronavirus period (6% y/y in January 2020). Commercial properties held by REITs declined in 9% year-over-year, according to the Green Street Commercial Property Price Index.

Commercial property prices in the small commercial market where REALTORS® typically engage in were down across all commercial property types, with the largest decline in hotel (-7%), retail (-6%), and office (-5%). Price for apartments were typically down by 2%. Industrial commercial real estate prices fell the least by about 1% year-over-year.

![Commercial Sales Prices (YoY % Chg.)](image)

![Commercial Sales Prices in 2020 Q2 by Property Type (YoY % Chg.)](image)
Residential and industrial land sales* up while office/retail/hotel land sales down

While sales of land for office/retail/hotel use have slumped, sales of residential and industrial land each rose about 3% year-over-year in 2020 Q2. Sales of cultivable, irrigated, agricultural and ranch lands were also about 1% to 2% year-over-year. However, recreation, timber, and brownfield land sales declined compared to one year ago.

With strong demand for residential land, prices also rose the strongest, at 3%. Prices of land for office/retail/hotel use were 1% below last year’s level.

* A land transaction is any transaction where the value of the land, including improvements that are agricultural in nature, accounts for at least 51% of the total sale of the transaction.
Cap Rate T-bond Spread Rose to 6% in 2020 Q2

Cap rates for transactions in the second quarter of 2020 reported by NAR commercial members averaged 6.9%. The average cap rate in the large commercial market ($2.5 million or more transactions) reported by Real Capital Analytics was 6.7%.

In the small commercial real estate market where most REALTORS® engage in, office properties had the highest cap rate, at 7 to 7.5%. Apartment Class A had the lowest cap rate, at 5.5%.

The risk spread (cap rate less 10-year T bond rate) increased to about 6% in the second quarter of 2020 from just 4% in the first quarter of 2019 in both the small and medium-to-large commercial real estate properties, an indication of the perceived riskiness of holding commercial real estate.

Lender Appraisal Values Fall Below REALTORS® Market Assessment

On average, REALTORS® reported that lenders had a lower appraisal value compared to their market assessment of the value of these properties. Retail and hotel appraised values were on average 5% below the market value assessment of REALTORS®, Industrial properties and apartments were appraised by lenders at about 1% on average below market values assessment of REALTORS®. The lower assessment values of lenders indicate a larger perception of the riskiness of the asset among lenders.
REALTORS® Leasing Volume Fell 4% in 2020 Q2

REALTORS® who responded to the survey reported that their gross leasing volume (renewals and new leases) declined by 4% year-over-year in 2020 Q2.

Leasing volume was down 7% to 10% at retail malls and down 1% to 2% for apartment and industrial properties. Industrial warehouses had the least decline in leasing volume of 1%, as e-commerce continues to make further inroads into the brick-and-mortar market.

Slightly more than half of respondents reported that they are not yet seeing any suburban/urban area shift, but 23% reported they are seeing more suburban development.
REALTORS® Reported 25% Vacancy Rate in 2020 Q2

REALTORS® reported that vacancy rates increased in all markets in 2020 Q2, to an average of 25%.

On average, the hotel vacancy rate spiked to 73%, retail vacancy rate to 20%, and office vacancy rate to 15%. The lowest vacancy rates were in multifamily, at 8%, and industrial properties, at 10%.

Vacancy rates have increased in the office market, with more workers working from home. Seventy-three percent of respondents reported observing an increase in co-working, alternating, or staggered job schedules.
REALTORS® Reported 5% Decline in Construction Activity in 2020 Q2

REALTORS® reported on average a 5% year-over-year decline in their construction activity (in square feet) in 2020 Q2.

Eighty-four percent of respondents reported that they expect their projects to be delayed, with 12% reporting more than six months.

Half of respondents reported that getting permits on time was the major cause of delay, followed by obtaining construction materials. Issues with hiring workers was cited by 39% of respondents. ‘Other’ causes of delay included work restrictions, sick workers, and physical constraints that made social distancing impossible on the construction site.
Leasing volume in multifamily properties will likely remain unchanged or decline only modestly in 2020 Q3 compared to the volume in the second quarter. Net absorption will also likely move sideways. Jobs have started to recover, but the recovery will face headwinds with the surge in coronavirus cases that will impact retail trade, food services, leisure and hospitality workers. Workers in these sectors tend to be renters than homeowners (51% of food service workers are homeowners and only 58% of housekeeping and personal care workers are homeowners, well below the national rate of 64%).

The $600 weekly benefit has also helped make up for lost wages, but this expires on July 31 and there is ongoing discussion in Congress on the extension of this funding for this program and the amount of the funding, which includes replacing the $600 weekly benefit with an amount that is a fraction of lost wages to incentivize people to go back to work.

The U.S. rental vacancy rate stood at 6.6% in 2020 Q2, but Realtors® reported on average an 8% vacancy rate on the properties they leased or managed. Realtors® expect multifamily vacancy rates to hover at around 8% in the next three months.

Metro areas with low vacancy rates will see firm rent growth. Many areas have vacancy rates below 4%, such as Raleigh, Los Angeles, Phoenix, San Francisco, San Diego, Riverside, Worcester, New Haven, Providence, Seattle, Knoxville, Dayton, and New York.

Realpage reported that among the nation’s 50 largest apartment markets, 34 recorded more new lease signings in June 2020 than in June 2019, such as in Atlanta, Boston, Chicago, Denver, Houston, Las Vegas, Los Angeles, Miami, New York, Orlando, Phoenix, San Diego and Washington, DC.

Bottomline: the multifamily market will remain one of the strong legs of commercial real estate, along with industrial real estate.
Sales, leasing, and net absorption will likely contract mildly in 2020 Q3 given the massive loss in occupancy that has already occurred in the second quarter, with negative net absorption of 8.4 million square feet from January to May 2020\(^1\) (roughly the size of 200 football fields, or 4 football fields, per state). In 2020 Q2 alone, the net occupancy loss was 14 million square feet. Nearly 5 million square foot of space for sublease became available. These subleases are for co-working spaces, with about a third of the loss arising from the loss of technology occupiers in the metro areas of New York, San Francisco, Orlando, Charlotte, Denver, and Pittsburgh.\(^1\)

Office-using jobs have come back, but about half are in the day-to-day operations of maintaining office buildings, while jobs in computer systems design and related services have not recovered. Moreover, jobs that are created won’t necessarily be office-using if workers work from home. A Gartner survey revealed that 74% of employers plan to shift at least 5% of their workforce to permanently remote positions.

REALTORS\(^\circledast\) expect vacancy rates to continue to hover at 15%, unchanged from the level in the second quarter.

In the short-term (no vaccine has been discovered), suburban office spaces are likely to be more in demand than CBD office spaces, due to the price differential (office CBD is nearly twice as expensive as suburban CBD), and the increasing preference for the suburban living. Suburban office spaces have increasingly taken a larger share of the market since 2014, with CBD sales now accounting for just 36%.

Bottomline: Vacancy rates will remain elevated until jobs fully recover and depending on how much of newly created jobs will be occupying office space. Demand for suburban office space is likely to be stronger than demand for CBD office space, sustaining a trend even before the pandemic.

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1 JLL Research 2020 Q2 Outlook
Industrial properties may remain in demand given the constant growth in e-commerce and as physical retail locations continue to attract and retain consumers via online shopping and delivery. The acceleration towards e-commerce via the coronavirus may be a permanent shift that can only be a benefit to e-commerce sales which underpins the demand for warehousing space and employment. The industrial sector displayed its durability and importance as it was not affected as much as other sectors and was one of the strongest sectors throughout the pandemic. As the economy traverses the coronavirus pandemic en route to an eventual complete recovery, the industrial sector’s growth should continue.

REALTORS® expect vacancy rates in the warehouse spaces to average 8% in the coming quarter.
Retail, after nearly coming to a complete stop is starting to show signs of recovering as the economy begins to reopen, albeit in phases according to various state guidelines. As retail reopens in phases, there are some restrictions put in place to minimize human contact i.e. operating at only 25%, 50%, etc. capacity. As states go deeper into various state reopening phases, retail foot traffic may increase. But, the retail sales lost during the pandemic will not be recovered anytime soon. When retail does recover it may not look the same as consumer spending habits changed through the pandemic. This coupled with permanent retail closures, we could see vacant retail being repurposed as apartments, warehousing or another use.

The increasingly popular food delivery sector, especially throughout the coronavirus pandemic, is facing consolidation as Uber offered to purchase Postmates for $2.6 billion in June. This came off of the heels of Uber’s failed attempt to acquire Grubhub for whom was acquired by Europe’s Just Eat Takeaway for $7.3 billion in June as well. Should the deal be executed, it would add to Uber’s current delivery business, Uber Eats which grew throughout the coronavirus pandemic.

Just as food delivery demand grew, the ghost kitchen concept gained further traction as well. Already on the rise in deal amount and transactions in recent years, ghost kitchens offered operators a revenue stream when traditional dine-in operations ceased as a result of the pandemic and as such, expansions were realized. Ghost kitchen investment is increasing such as investment in Zuul, whom raised $9 million to expand operations in NYC or Wingstop, whom recently opened their first ghost kitchen in Dallas, Texas as they pivoted from 80% to 100% off-premise operations originating from closing its dining rooms in March 2020 which was at the beginning of COVID-19. In consideration of the realized and expected growth of food delivery services, ghost kitchen investment shall continue provided the demand for on-demand food delivery continues.

REALTORS® expect vacancy rates to remain elevated in the third quarter, at 20% among retail strip centers and free-standing stores, with much higher vacancy rates for malls, at 35%.

![2020 Total Monthly Sales for Retail and Food Services](chart.png)
REaltors® Expect Land, Industrial, and Apartment Real Estate Market to Perform Better than Office, Retail, and Hotel

3-Month Sales Outlook (Y/Y Change)

- Land: 1%
- Industrial: Warehouse
- Apartment Class B/C
- Industrial: Flex
- Apartment Class A
- Senior housing
- Office Class B/C
- Retail: Free-standing
- Office Class A
- Hotel/Hospitality
- Retail: Strip Center
- Retail: Mall

3-Month Commercial Price Outlook (Y/Y Change)

- Industrial: Warehouse
- Industrial: Flex
- Land
- Apartment Class B/C
- Apartment Class A
- Senior housing
- Retail: Free-standing
- Office Class B/C
- Office Class A
- Retail: Strip Center
- Hotel/Hospitality
- Retail: Mall

Expected Vacancy Rates in 2020 Q3

- Apartment Class B/C: 7%
- Industrial: Warehouse: 8%
- Apartment Class A: 9%
- Industrial: Flex: 10%
- Office Class B/C: 15%
- Office Class A: 15%
- Retail: Free-standing: 20%
- Retail: Strip Center Class A: 20%
- Retail: Mall: 35%
- Hotel: 50%

3-Month Construction Outlook (Y/Y Change)

- Industrial: Warehouse: 7%
- Industrial: Flex: 7%
- Retail: Free-standing: 1%
- Apartment Class A: 1%
- Retail: Strip Center: -2%
- Apartment Class B/C: -2%
- Office Class A: -5%
- Office Class B/C: -7%
- Retail: Mall: -10%
NAR’s Quarterly Market Survey gathers information about the commercial transactions of REALTORS® and members of affiliate organizations (CCIM, SIOR, RLI, IREM, and the Counselors of Real Estate) and the opportunities and challenges facing commercial practitioners.

The 2020 Q2 survey was sent to approximately 76,000 commercial REALTORS® and members of affiliate organizations during July 5–16, 2020, of which 1,056 responded to the survey. A Leasing Conditions Survey was also sent out to all 76,000 commercial REALTORS® and members of affiliate organizations during July 1-13, of which 1,613 were engaged in leasing and property management and filled out the survey.
The NAR Research Group acknowledges the I/S/Cs for reaching out to their members to respond to the survey and developing the survey: Aubrie Kobernus, CEO, Realtors® Land Institute; Denise LeDuc-Froemming, CEO/EVP, IREM; Alexis Fermanis, Communications Director, SIOR; and Greg Fine, CEO/EVP, CCIM Institute. The Research Group also acknowledges Charlie Dawson, Vice-President, Engagement, and Rodney Gansho, Director of Engagement, in reaching out to CCIM, CRE, IREM, SIOR, and RLI designees to respond to the survey.
The National Association of REALTORS® is America’s largest trade association, representing more than 1.4 million members, including NAR’s institutes, societies and councils, involved in all aspects of the real estate industry. NAR membership includes brokers, salespeople, property managers, appraisers, counselors and others engaged in both residential and commercial real estate. The term REALTOR® is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of REALTORS® and subscribes to its strict Code of Ethics. Working for America’s property owners, the National Association provides a facility for professional development, research and exchange of information among its members and to the public and government for the purpose of preserving the free enterprise system and the right to own real property.

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500 New Jersey Avenue, NW
Washington, DC 20001
202.383.1000