Commercial Market Insights

August 2020

National Association of REALTORS®
Research Group

NATIONAL ASSOCIATION OF REALTORS®

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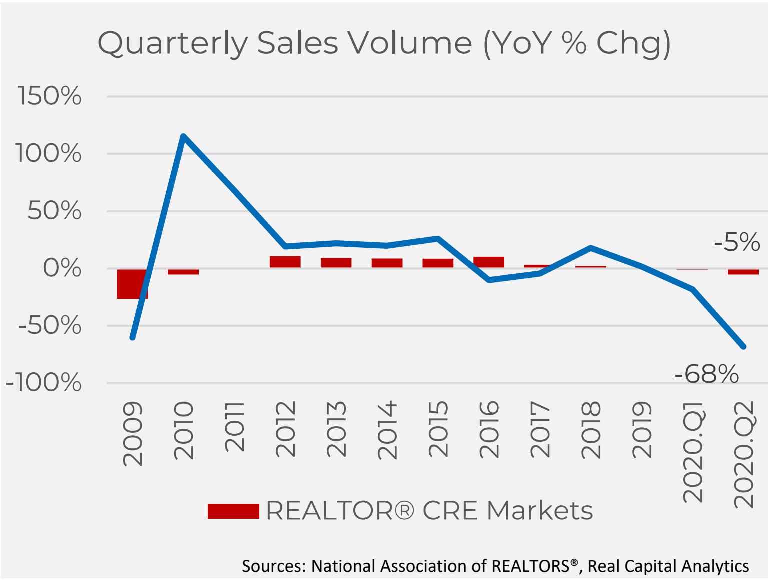
Commercial Real Estate Transactions Continues to Reel from Pandemic

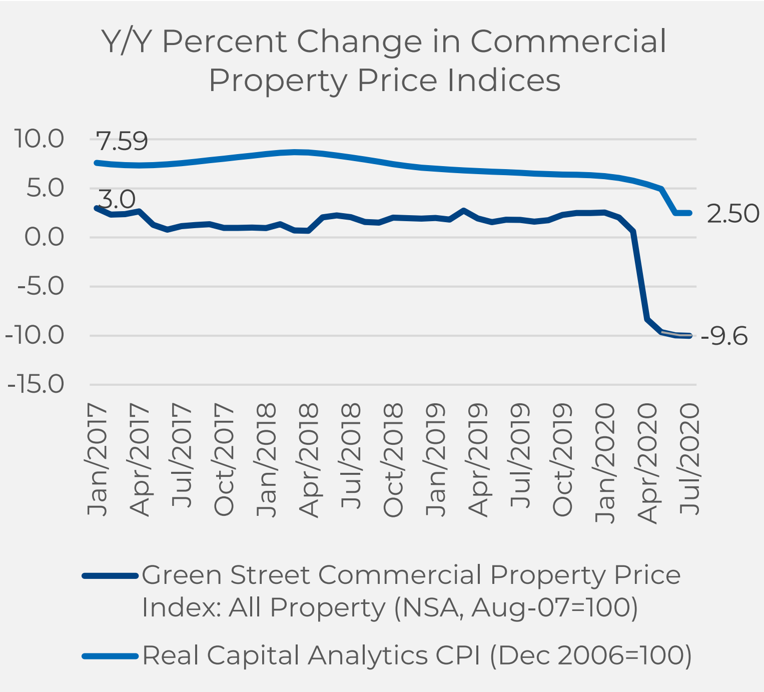
Commercial real estate sales and leasing contracted heavily in the second quarter. However, the worse may be over based on lower CMBS delinquency rates and with sustained job openings. The industrial property market is the least impacted, with demand for industrial properties supported by the continuing shift towards e-commerce while store sales decline.

This issue features a deeper dive into the data showing how the pandemic has accelerated the demand for industrial warehouses and e-commerce sales .



Commercial sales transactions of $2.5M down 68% year-over-year as of June 2020

Commercial sales/acquisitions for properties or portfolios of $2.5 million or over contracted 68% in the second quarter, according to Real Capital Analytics. REALTORS® reported a 5% decline in sales transactions, which are mainly below $2.5 million.



Commercial property values down by 10% year-over-year as of July 2020

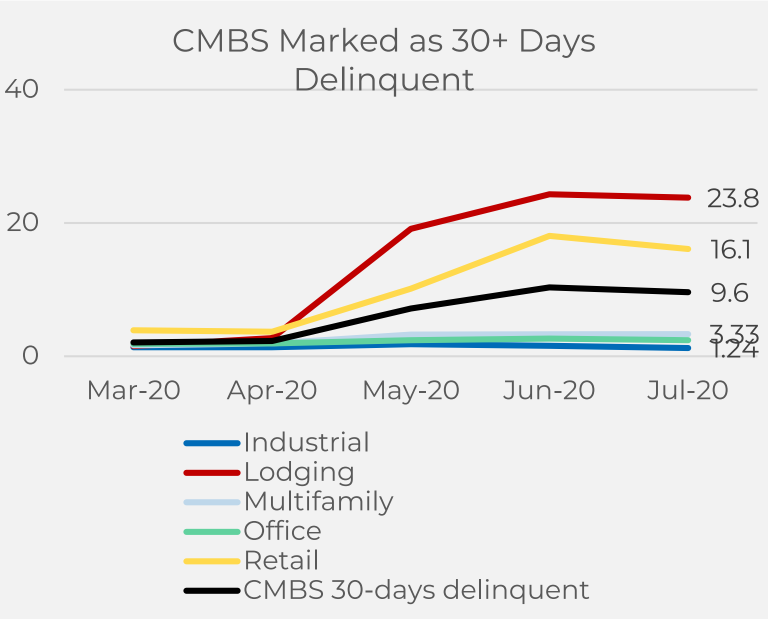
Green Street's appraisal based commercial price index of properties held by REITS values prices at 10% less I July compared to one year ago. However, only properties which are still selling above last year's value are coming into the market. Real Capital Analytics commercial price index, a transactions-based price, reported that a 2.5% year-over-year increase in its commercial property price index in the second quarter.

Overview

Commercial Real Estate Transactions Continues to Reel from Pandemic

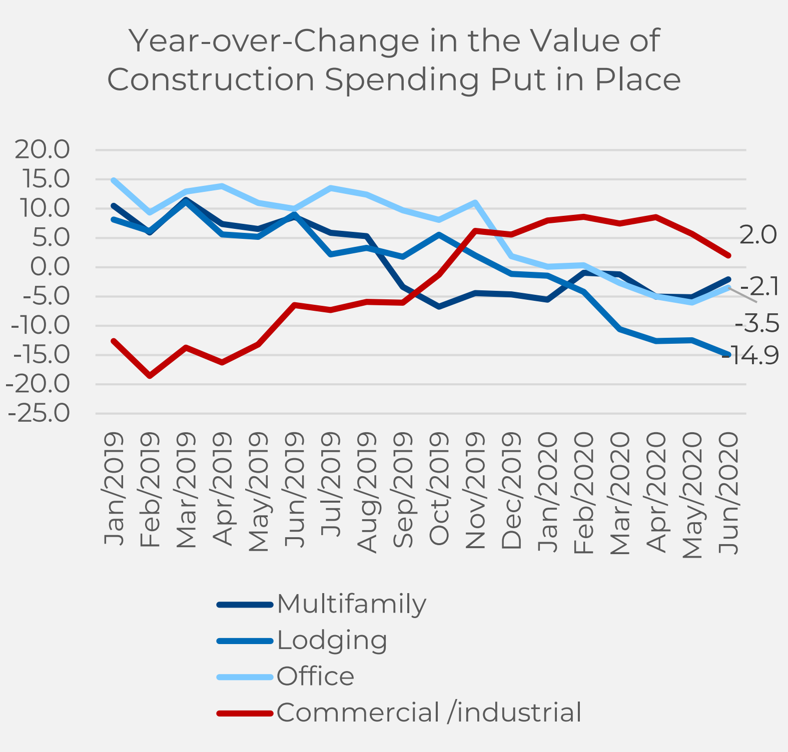
CMBS delinquency rates slightly decline to 9.6% in July

Overall delinquency rates declined in July to 9.6%, down from 10.3% in June, as CMBS delinquency rates declines for securities backed industrial, office, retail, and lodging properties. CMBS backed by industrial properties had the lowest delinquency rate at 1.24% (1.57% in June. CBBS office-backed delinquency rates remain low at 2.4% (2.66% in June). Securities backed by lodging properties have highest delinquency rate, at 23.8%, followed by retail, at 9.6%. CMBS backed by multifamily properties slightly rose to 3.33% (3.29% in June). The multifamily sector is facing increased headwinds with the end of $600 weekly pandemic assistance to those unemployed.



Construction spending declined 3.5% in June

The value of construction spending declined for the fourth straight month in June, with the annualized level of construction down by 3. 5%. The value of construction put in place declined for multifamily (-3.5%), office (-2.1%), lodging (-14.9%), but it was up 2% in the construction of commercial buildings. The US Census Bureau defines commercial buildings to include automotive, retail, food service, warehouses, and other brick and mortar stores that provide a commercial service.



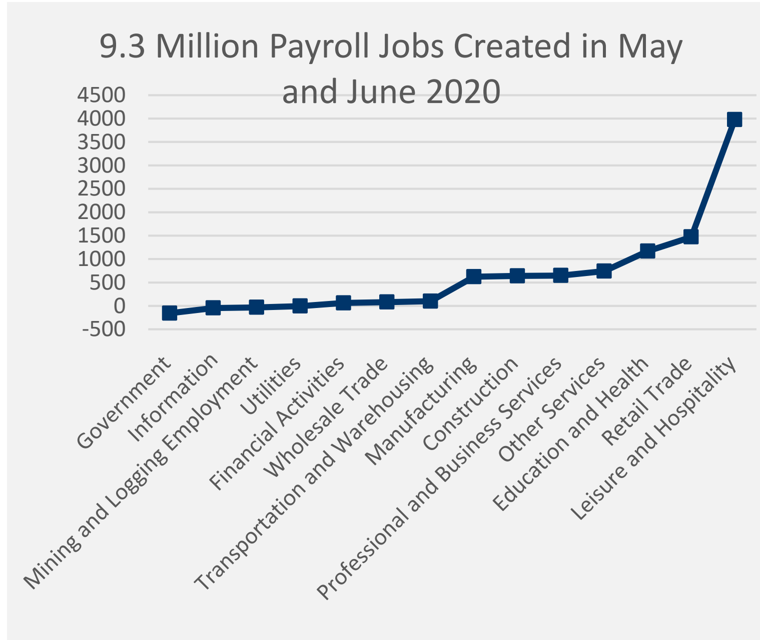
Overview

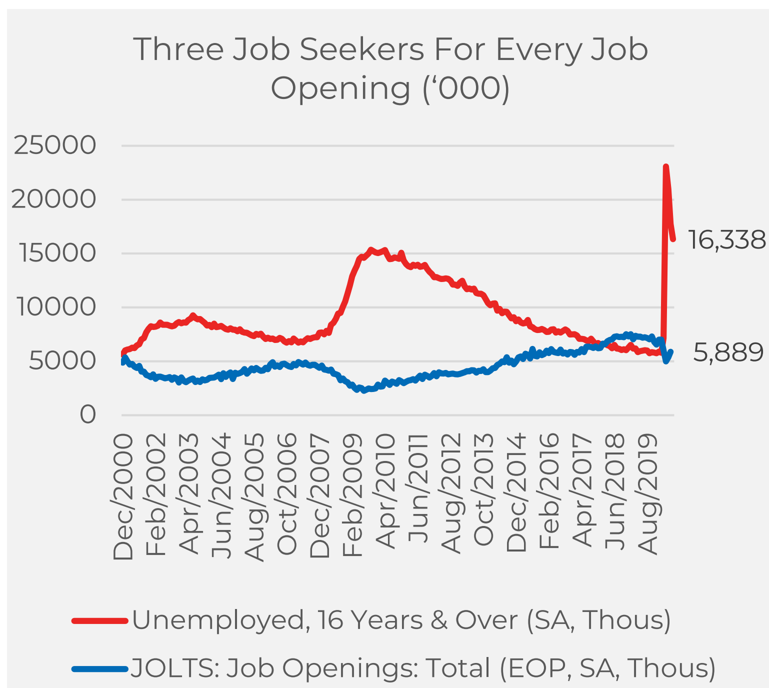
Commercial Real Estate Transactions Continues to Reel from Pandemic

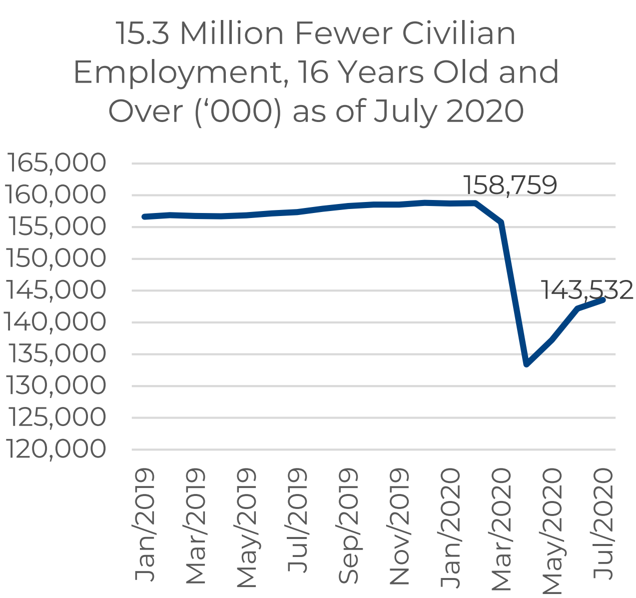
9.3 million net payroll jobs gains during May-July

A silver lining in the commercial market outlook is the strong job recovery in the industries that had lost those jobs, as many states started allowing more business re-openings. The economy created 9.3 million net new payroll jobs during May through July, with about half in leisure and hospitality ad retail trade. All private industries created net new payroll jobs, while the government sector lost 156,000 jobs, as well as information, -45,000; mining/logging, -32,000; and utilities, -4,500.

However, job creation needs to be sustained. There are still 3 job seekers for every open job. There were 15.3 million fewer employed people compared to February 2020. This means that demand for commercial real estate properties will continue to remain low until economic activity and employment return to pre-pandemic levels.







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COVID-19: E-Commerce Accelerator and Retail Filter

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Demand for Retail and Industrial Properties: The Big Picture

As a result of the coronavirus pandemic and measures to contain it, the global economic landscape has been dramatically altered. The pandemic has hammered the economy and disrupted the sense of normalcy in all aspects of work and how people live. It has been the most disheveling event to the economy in decades, interrupting supply chains and causing large shifts in consumer demand and retail channels, among others.

While covid-19 has wrecked havoc on the hotel, office, and retail property assets, it brought out the durability of the industrial property market and accelerated e-commerce and warehousing employment. The increases in warehousing and storage employment reflect a rebound in demand for warehouse space as retailers re-evaluate supply chains originating from the impact of the coronavirus pandemic.

While the industrial property market has benefitted from the current environment, the brick-and-mortar retail market has been on the opposite end, being pummeled. The retail sector was already struggling prior to the pandemic, and the lockdown applied even more adverse pressure. Having lost a significant amount of foot traffic with respect to social distancing measures and lockdowns, store fronts and companies were forced to close or file bankruptcy as both shopping centers and shops realized substantial revenue losses. Additionally, as a result of the pandemic, quarantine, and shift in consumer spending habits, retail employment was significantly adversely effected.

Retail trade employment is making a recovery as it added 258,000 jobs in July. But retail employment is still down 913,000 jobs from February figures. Advanced monthly retail sales for July, which include non-store sales, are above pre-pandemic levels.

The shift in consumer spending habits may be a permanent shift as many consumers may continue to avoid brick-and-mortar retail entirely, alternatively ordering their groceries, apparel, electronics, etc. online. Retailers that were struggling to stay in business pre-covid19 are unlikely to remain open, as the temporary closure of nonessential stores seems to have accelerated the transition to e-commerce. Should the shift to consumer online expenditures become permanent, some retailers may aim to significantly reduce their retail square footage.

While the coronavirus pandemic functioned as a filter for retail markets, it was a catalyst for the acceleration and expedited growth of data centers and e-commerce. Nevertheless, although some consumers may decide to go back to making purchases in brick-and-mortar locations in the current and in a post-coronavirus pandemic environment, it remains apparent that e-commerce is indeed the future.

E-Commerce Accelerates

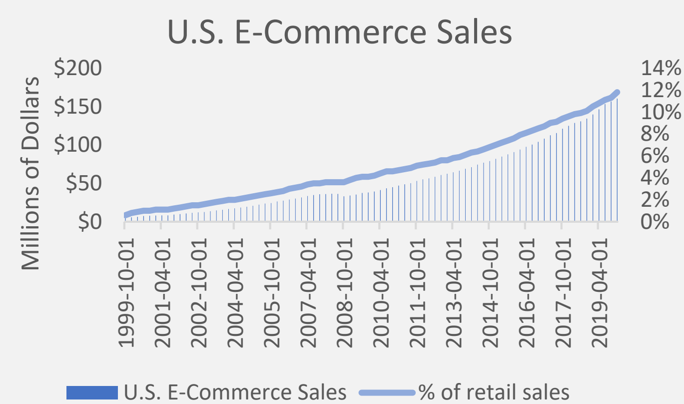
Going into the coronavirus pandemic, global e-commerce saw its market share increasing as it reached more than $3.5 trillion in 2019 according to eMarketer Global eCommerce report and should continue to grow throughout 2020.

U.S. retail e-commerce total sales and sales as a percent of overall retail sales was increasing headed into the pandemic. Total retail sales was estimated at $1,363.5 billion for Q1 of 2020, a decrease of 1.3% from Q4 2019. E-commerce sales represents 11.8% or $160.3 billion of total retail sales for Q1 2020. Q1 2020 E-commerce sales show an increase of 2.4% from Q4 2019 figures and a 14.8% increase from Q1 2019.

Q2 2020 e-commerce sales is anticipated to reflect a sizeable increase as it will capture consumers shift in spending from physical brick-and-mortar stores to online throughout the pandemic, lockdowns, social distancing measures and the reopening of the economy in phases. Food and beverage and health, personal care and beauty were ecommerce categories that were rapidly growing prior to the pandemic and grew throughout the pandemic while household essentials will establish the rate for ecommerce growth for the remainder of 2020.

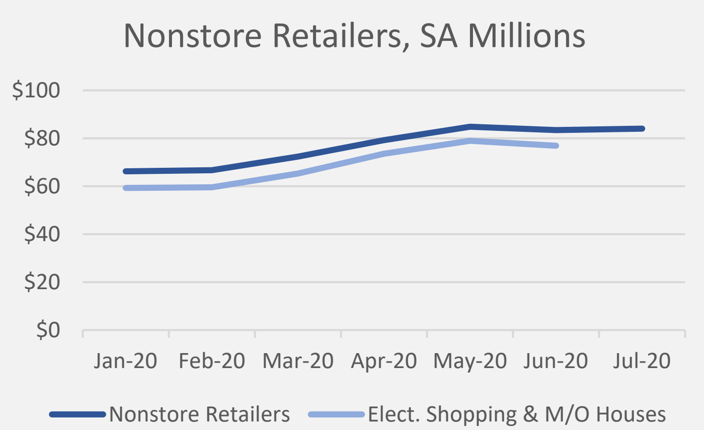
As a proxy for e-commerce sales and to understand what transpired on a monthly level, utilizing non-store retailer and electronic shopping & mail-order houses figures, we see continued growth throughout the pandemic. Non-store retailers, which are primarily online but include other sales such as call centers, catalogs, door-to-door visits and vending machines was up 24.7% year-over-year and up 6% from April to July. While non-store retailers doesn't wholly align with the spending captured in the pure e-commerce figures released in the quarterly report, the figures do provide early insights of movements in online purchases.

Source: eMarketer 2019 Global eCommerce



Source: U.S Census

Note: Quarterly Observation Date



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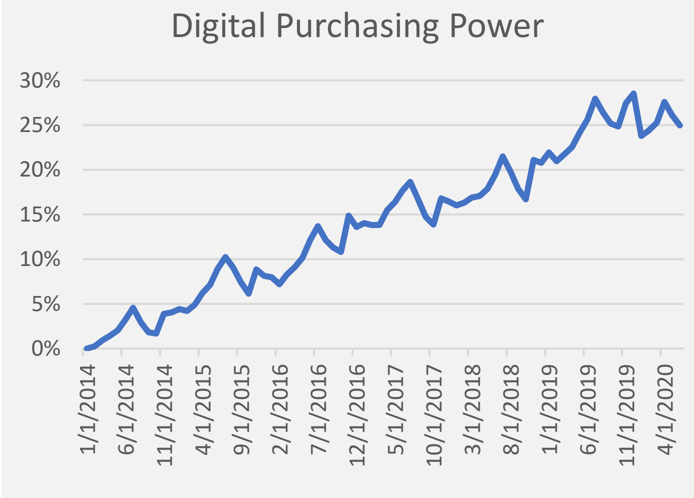
E-Commerce Accelerates

The electronic shopping & mail-order houses subsector increased as well by 4.5% from April to June as consumers conveniently made online purchases from the safety of their homes.

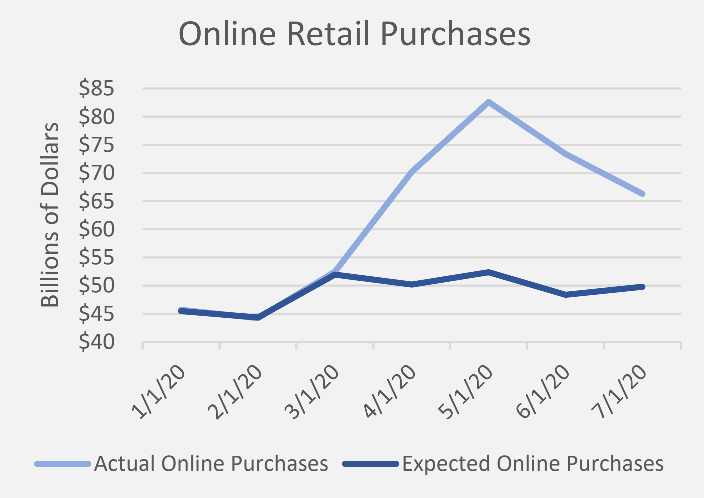
To further illustrate the growth of e-commerce throughout the pandemic, as opposed to relying entirely on survey data, Adobe, a computer software company, supplements the survey data with its Adobe Digital Economy Index (DEI). The DEI measures changes in consumer purchases made digitally since 2014 and is based on an analysis of aggregate and anonymous Adobe Analytics data that analyzes more than 1 trillion processed transactions and more than 100 million SKUs from 80 of the top 100 U.S. online retailers.

The DEI indicated a March increase in digital purchasing power of nearly 25% to 28% in April where April purchasing power grew 4.1% year-over-year. Digital purchasing power as of July 2020 has reversed to March figures and still represents an increase of 25% in digital purchasing power since 2014. This means that consumers money goes further when making purchases online overall but, in July it was down 1% year-over-year. So, according to the DEI, consumers are now purchasing online goods for $1.01 that was worth $1.00 . However, as a result of the coronavirus and stay-at-home orders, there has been more online purchasing activity than ever and as more people shop online, price differences between online and brick-and-mortar will eventually converge thus reducing purchasing power. Currently, that is not the case and with having more online purchasing power, consumers spent more.

Adode's DEI revealed consumers were more willing to shop in brick-and-mortar locations in July which slowed growth to 55% from June's 76%. July registered $66.3 billion and represents typical retail slowdown at this time of year. Despite the slowdown, e-commerce has generated more than $434.5 billion since January according to the DEI.



Source: Adobe Analytics



Source: Adobe Analytics

As the pandemic drove traditionally offline economic activity online, at the current growth levels, Adobe's DEI indicates that U.S. e-commerce may surpass all 2019 online expenditures before the 2020 holiday season.

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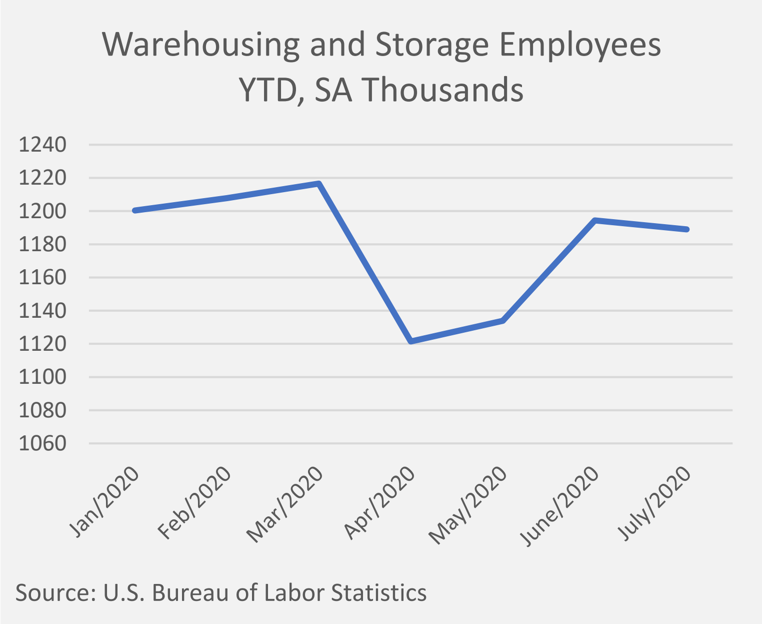
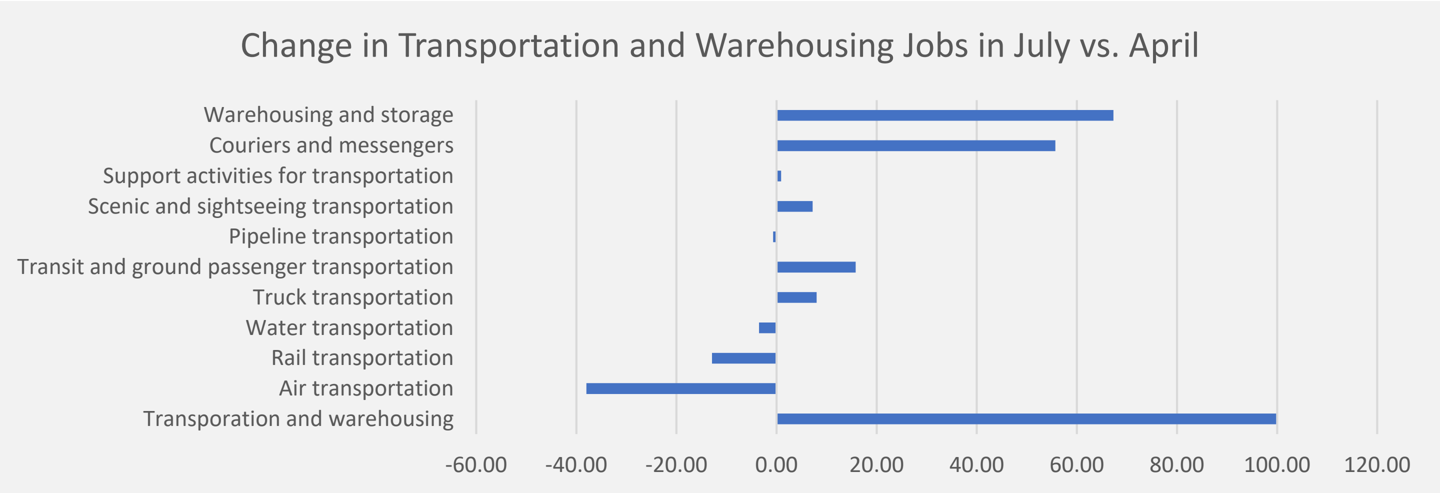
E-Commerce Accelerates

With many consumers now working remotely, consumer options such as online grocery shopping and click-to-collect will significantly aid in the growth rate of e-commerce. Some sizable e-commerce categories such as online CPG have experienced more than three years of penetration growth in the span of three or four months and remains at elevated levels post lockdown despite the reopening of physical stores.

As a result of the pandemic increasing e-commerce's ratio of total retail sales, the demand for warehouse and distribution space increased as well. According to CBRE, Q2 industrial net absorption was 19.2 million sq. ft. with year-to-date total equaling 54.2 million sq. ft. despite the slowdown in global economic activity.
Furthermore, demand amongst the industrial sector was highest for warehouse and distribution space for which CBRE estimates year-to-date net absorption to be nearly 70 million sq. ft.



As the demand for warehousing space increased, warehousing and storage saw employment increase from the bottom experienced in April 2020. The change in warehousing and storage jobs in July with respect to April shows warehousing employment is 67,300 jobs above its low in April.



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Retail Filtered

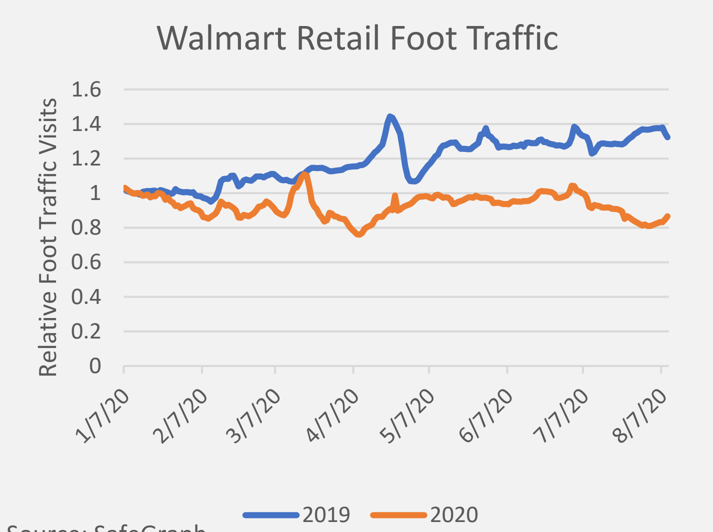
As e-commerce activity picked up throughout the pandemic, retail employment was reduced. Retail employment saw significant reductions as the quarantine, reduced hours of operation or closures based upon being a non-essential or essential business and social distancing measures were put into effect. The combination of the above led to a significant reduction in retail foot traffic.

SafeGraph, a data company who analyzes millions of aggregated, anonymized samples of location data obtained from mobile phones to understand how foot traffic has changed for businesses and consumer points-of-interest captured the change in foot traffic. Recent SafeGraph data indicates that retail traffic has plateaued after the rebound from April, May, and a portion of June as a surge in daily coronavirus cases trended upward causing consumers to reconsider visiting physical brick-and-mortar retail locations. There was no retailer that saw no reduction in retail foot traffic.

Even Walmart saw a significant reduction in visits to its brick-and-mortar locations compared to 2019 and throughout the pandemic according to SafeGraph data. Walmart, followed the trend of retail foot traffic in general as it saw a slow down in foot traffic although there was a recovery through the middle of August. Walmart, which has capital reserves and access to more capital, has been in a better position that other less fortunate retailers.

According to Coresight Research, a research and advisory firm that provides data insights on retail & technology, 6,650 retail stores have shuttered as of August 14, 2020. The retail pain does not end there, Coresight forecasts U.S. retail could potentially more than double the retail loss of 2019 with between 20,000 and 25,000 retail store closures this year.

Source: SafeGraph
Note: Indexed to March 1

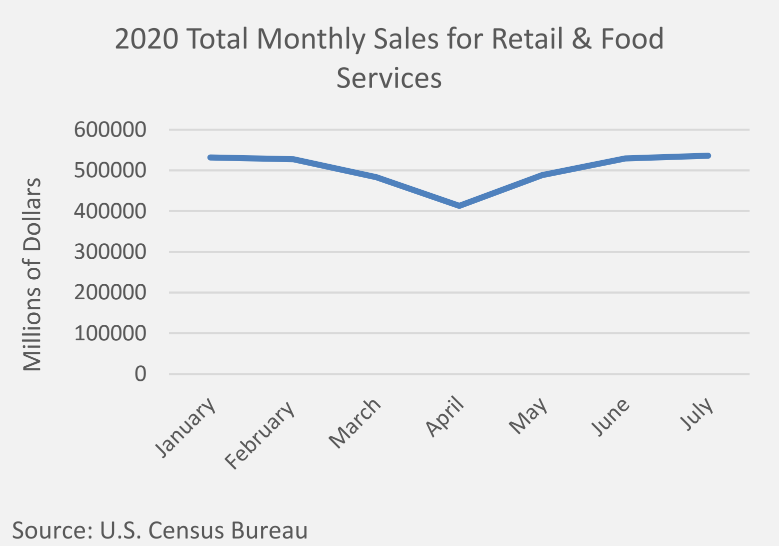


Source: SafeGraph

The ceiling of e-commerce share of total retail sales is difficult to predict as it depends upon several factors, such as technology, consumer preferences and fulfillment. While e-commerce sales are increasing and there is no ceiling in view, the surge in ecommerce sales will not wholly make up for the losses incurred by the U.S. retail market this year.

Retail Filtered

The badly wounded U.S. retail market is making a recovery as July's advance estimates of U.S. retail and food services sales were $535.9 billion, which represents an increase of 1.2% from June figures, and 2.7% from year-ago levels.

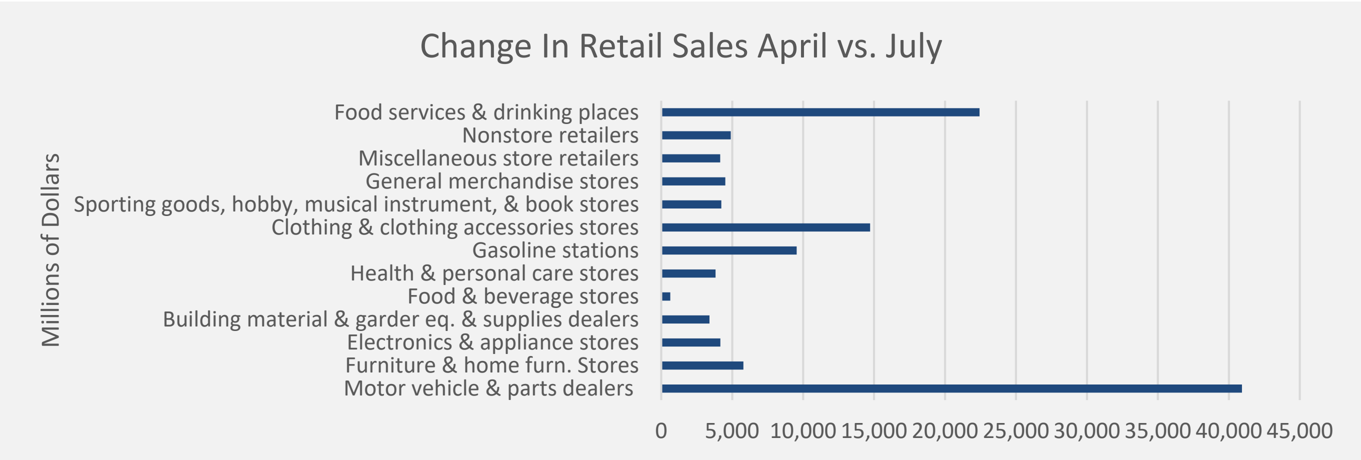


Retail trade sales were up 0.8% from the prior month and 5.8% from year-ago levels. The most significant increase month-over-month was electronics & appliance stores at 22%. Other notable improvements were seen in miscellaneous store retailers up 6.2%, gasoline stations increased 6.1%, clothing and clothing accessories stores at 5.6%, Food services & drinking places (5%) and health & personal care stores (3.6%).

Not all of retail faired so well, sporting goods, hobby, musical instrument, & book stores, building material, garden equipment & supplies dealers, motor vehicle & pars dealers saw reduced sales from the prior month at 4.9%, 2.9% and 1.2% respectively.

On a year-over-year basis, non-store retailers were up the most at 24.7% from July 2019 with sporting goods, hobby, musical instrument and book stores performing well at an 17% increase.

can be seen throughout retail & food services in general but the most drastic increase in recovery is in clothing & clothing accessories stores whom increased sales 488% from April to July. This is a dramatic increase as clothing & clothing accessories stores saw sales decrease to $3 billion in April to July's $17.7 billion. Other sizable increases in sales since April were in furniture & home furniture stores (143%), sporting goods, hobby, musical instrument, & book stores (115%), and Electronics & appliance stores (110%).



Retail Filtered

Despite the improvements in retail, in recent weeks, large scale retail closures and bankruptcy filings have begun to mount including JC Penney, J. Crew, Brooks Brothers, Stein Mart, Neiman Marcus, Tuesday Morning, Pier 1 Imports, Lord & Taylor and many more as the coronavirus filters retail. Bankruptcy filings among U.S. retailers may peak this year, and Chapter 7 filings may rise as well as the pandemic continues with talks of potential additional lockdowns to combat the increases in COIVD-19 cases.

Considering a significant portion of retail closures are located in Malls, around 55-60% according to Coresight Research, the vacant storefronts will have landlords actively seeking to fill those voids or find new uses for their property and there are a few viable options such as redeveloping vacant space into ghost kitchens or portions of the mall into apartments or warehousing.

Simon Property Group Inc., the largest mall operator, who is currently redeveloping vacant mall space into ghost kitchens in some of their malls, is in talks with Amazon to convert vacant space remaining from ailing retail stores into warehousing. This option makes sense considering the growth of e-commerce as it provides mall owners with some rental income and helps Amazon meet increasing demand while reducing shipping times as malls are in close proximity to more dense populations. Whatever the outcome of retail, those retailers who survive, will come out on the other side stronger.

Source: Coresight Research and Company Filings

Source: Coresight Research, U.S. Department of Commerce, eMarketer

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COMMERCIAL MONTHLY INSIGHTS REPORT
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