Commercial Market Insights

November 2020

National Association of REALTORS®
Research Group

NATIONAL ASSOCIATION OF REALTORS®

Contents

As the economy continues to recover, the commercial real estate market is starting to turn around as well , showing a modest uptick in sales and prices in the third quarter. However, a full recovery is still a long way, and the recovery and the impact of the pandemic has been bifurcated by property sector and geography.

While office and retail (brick and mortars) occupancy has fallen by 62.5 million square feet, industrial property occupancy has more than offset that loss, with occupancy increasing by 113 million square feet as e-commerce continues to accelerate.

The big cities are showing apartment rent declines while smaller cities are showing rent growth. For example, in San Francisco, Seattle, New York, and Boston, rents are down over 15% from one year ago, while rents are up in smaller cities like Boise, Huntsville (Alabama), Virginia Beach, and Fayetteville (North Carolina).

Needless to say, the outlook for the commercial real estate market depends crucially on when a vaccine is discovered, how long it will get fully disseminated, and the evolution of the work from home culture. It appears that there will be a bigger impact only if companies allow their workers to work from home permanently as workers will want to permanently relocate to less expensive cities.

This issue looks at the latest trends across the commercial property markets (multifamily, office, industrial, and retail) and features two pieces on apartment rent trends and how financial volatility impacts commercial sales and prices.

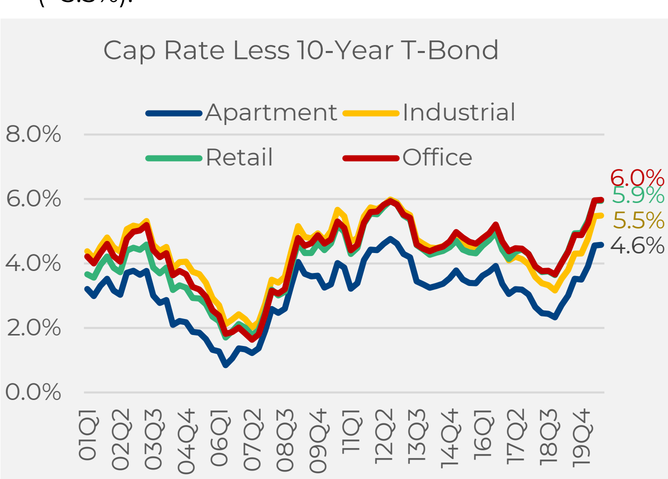
Commercial Market Overview

Commercial sales transactions show mild recovery in 2020 Q3

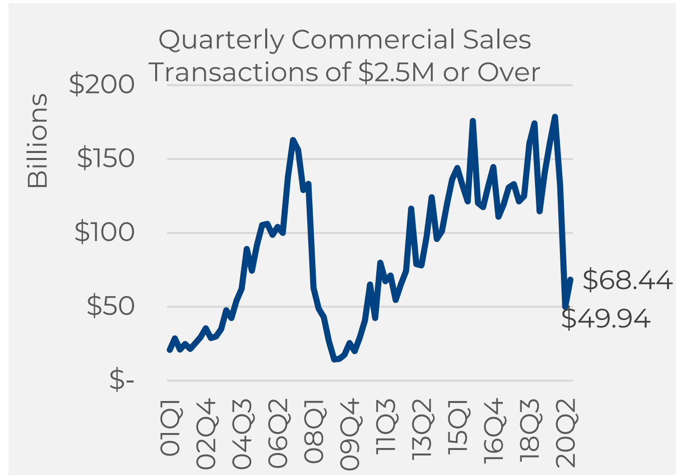
With sustained job growth and as business activity picks up, commercial sales/acquisitions for properties or portfolio acquisitions of $2.5 million or more showed a mild turnaround in the third quarter. Commercial acquisitions for multifamily, office, industrial, retail, senior housing and care, and development site rose to $68.4 billion in 2020 Q3, up from just a little below $50 billion in 2020 Q2, according to Real Capital Analytics. However, 2020 Q3 sales were still lower by 57% from one year ago, with the investment acquisitions contracting in all sectors, even industrial.

REALTORS® who responded to the 2020 *Commercial Real Estate Quarterly Market Survey* reported on average a smaller decline in transactions from one year ago of 3% compared to the 5% year-over-year decline in the second quarter. Retail, office, hotel, had the largest decline whiles sales of land and industrial warehouse were substantially unchanged compared to one year ago.

Risk premiums (the difference between the cap rate and the safer 10-year T-bond, at 0.7% in 2020 Q3) were unchanged in 2020 Q3 compared to 2020 Q2, which means that investors are not perceiving any further significant risks ahead. However, risk premiums remain are still elevated compared to pre-pandemic levels, indicating investors want price discounts. The apartment sector had the lowest risk premium (+4.6%) followed by industrial (+5.5%).

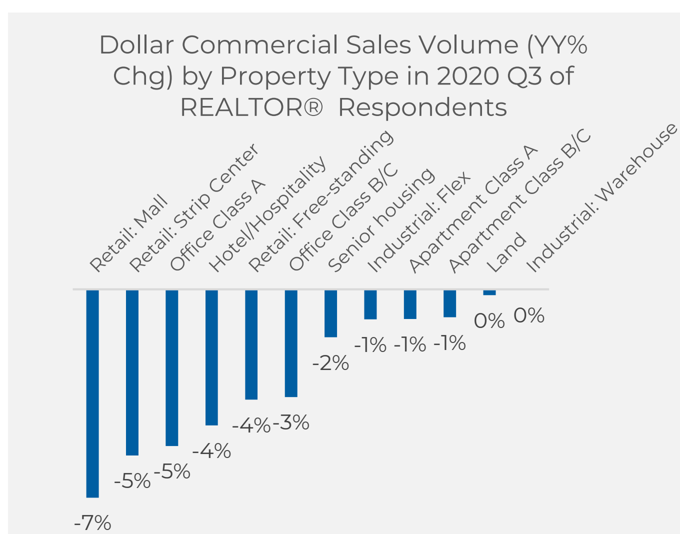


Source: Real Capital Analytics



2020 Q3	Quarterly Volume $b	YOY Chg
All Types	68.4	-57%
6 Major Metro All Types	23.3	-60%
Non-Major Metro All Types	45.1	-56%
Hotel	1.9	-82%
Industrial	15.4	-63%
Office	13.6	-60%
Retail	6.5	-58%
Apartment	24.0	-51%
Seniors Housing & Care	1.6	-68%
Dev Site	5.5	21%

Source: Real Capital Analytics



Source: NAR 2020 Q3 Commercial Real Estate Market Survey

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Commercial Market Overview

Commercial price picking up but still 9% below year-ago levels

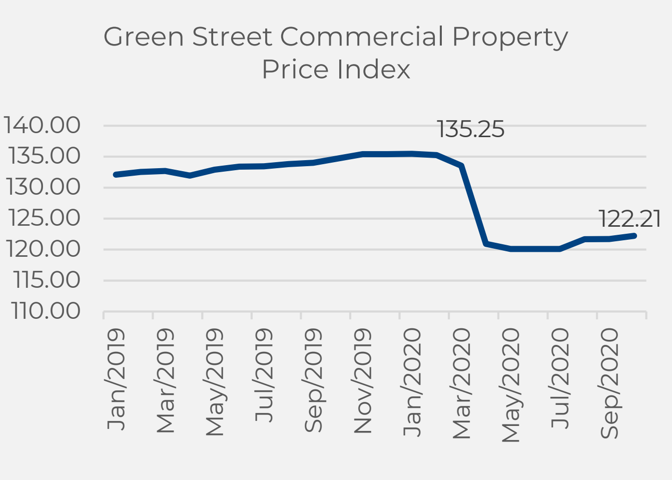
Commercial sales prices are slowly recovering but prices are still below year-ago levels. As of October, the Green Street Commercial Property Price Index was 2% higher since July, but the index is still 9% lower than one year ago.

REALTORS® reported a decline in the sales prices of retail, hospitality, and office sectors in their Q3 transactions. However, sales prices for apartments and industrial warehouses were essentially unchanged.

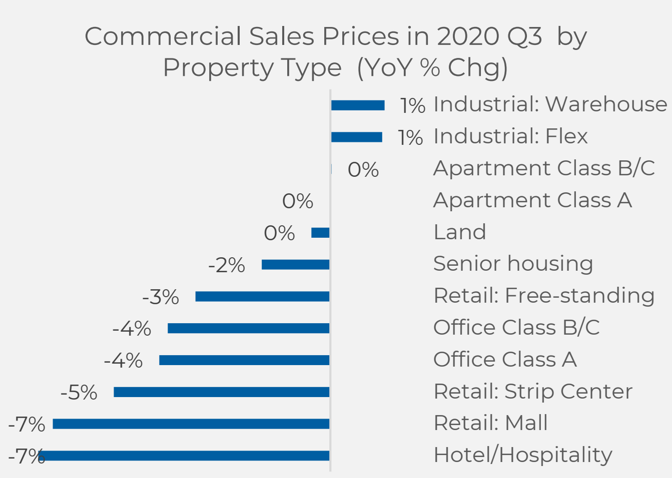
Net loss of occupancy in office and retail is offset by increase in industrial occupancy

The office and industrial sector continued to suffer bigger losses in occupancy in 2020 Q3: office: -41.3 million; 64 million YTD; retail:-13.6 million; -21.2 million YTD). However, these occupancy losses were nearly million). However, these vacancy losses were offset by 113 million in occupancy YTD for industrial space.

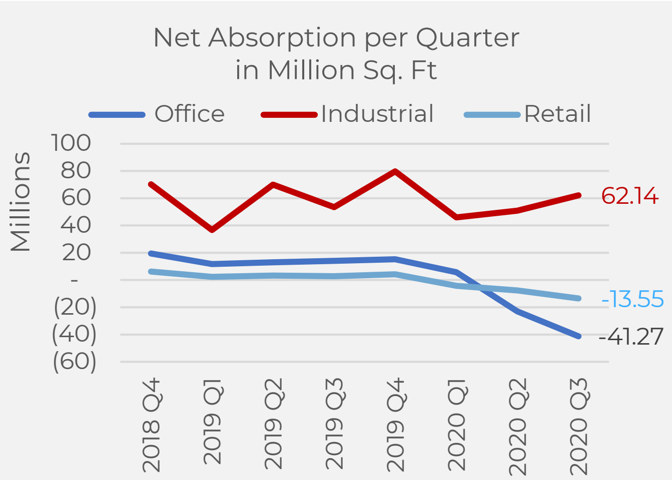
Vacancy rates have increased in all sectors, led by office, at 14,5% (13.6% Q2); multifamily, 6.4% (5.7% Q2); retail, 7.1% (6.8% Q2); and industrial, 5.3% (5.1%). On a positive note, these vacancy rates are all below the levels during the Great Recession, as vacancy rates were low before the pandemic hit, unlike during the Great Recession when vacancy rates were rising due to over-building.



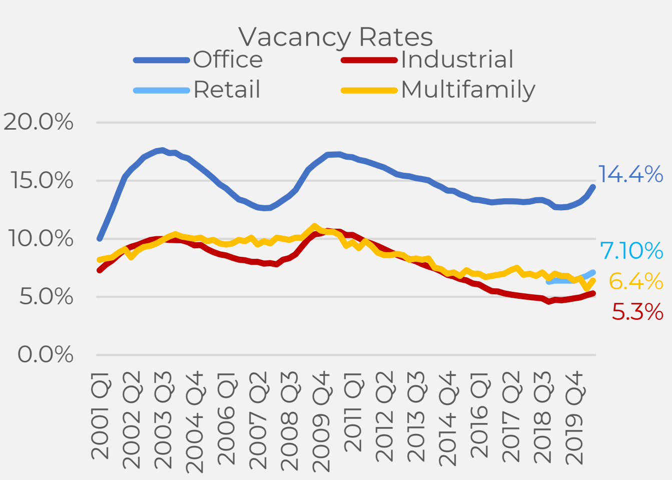
Source: Green Street



Source: NAR 2020 Q3 Commercial Real Estate Market Survey



Source: Cushman and Wakefield



Source: Cushman and Wakefield

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Commercial Market Overview

Asking rents are holding up to the decline in occupancy

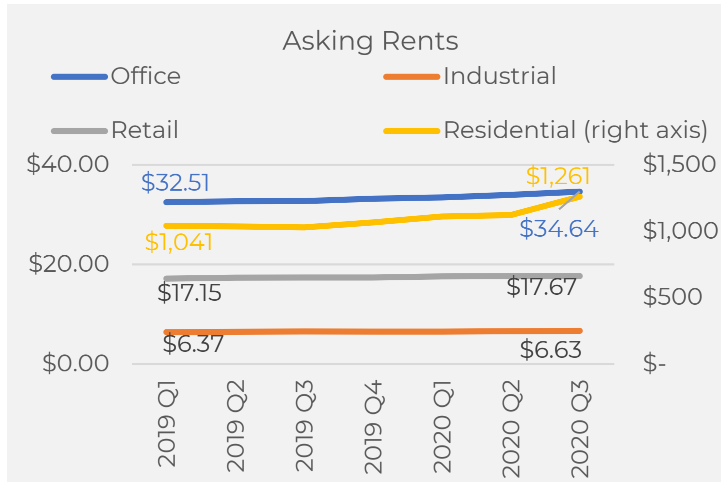
Even with the massive loss in occupancy, average asking rents have remained stable or even increased, according to Cushman and Wakefield data. The average office rent rose 2% in 2020 Q3 from 2020 Q2, while rents for industrial and retail space were essentially flat. Meanwhile, the median apartment rent rose 12% in 2020 Q3, to $1,261, according to data from the US Census Bureau.

CMBS delinquency rates continue to decline in September

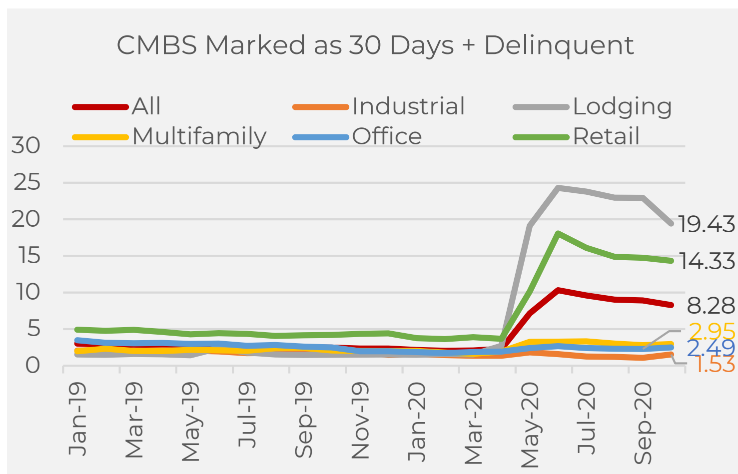
Overall delinquency rates on commercial mortgage-backed Securities declined to 8.28% in September (8.9% in October), according to Trepp. Delinquency rates declined for lodging, retail, and industrial CMBS, but slightly increased for multifamily to 2.95% in 2020 Q3 (2.8% in 2020 Q2) and office to 2.49% (2.28% in 2020 Q2). However, these delinquency rates are modest relative to that of retail CMBS, at 14.33%, and lodging CMBS, at 19.43%.

Lots of industrial and office space is in the pipeline, which can increase vacancy rates

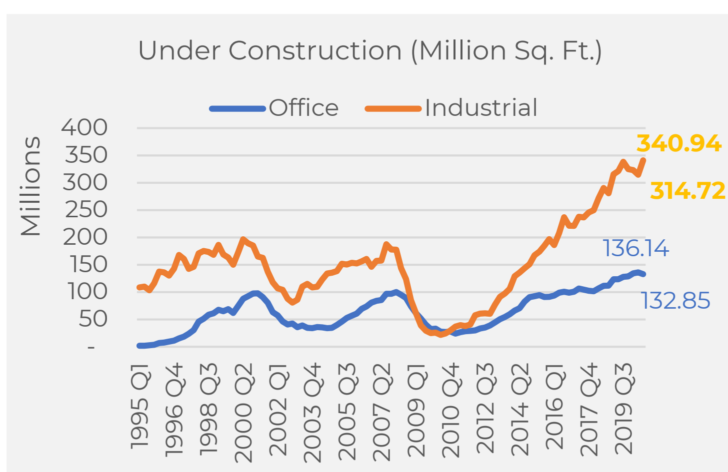
More industrial and office space is in the pipeline. Construction for office properties stood at 132.8 million square feet, representing 2.5% of the current office inventory of 5.4 billion sq.ft. Given the office space being constructed, vacancy rates are likely remain elevated at least in the coming year. Construction for industrial properties ramped up again to 340.9 million square feet in 2020 Q3 after construction declined in 2020 Q2.



Source: Cushman and Wakefield, US Census Bureau



Source: Trepp



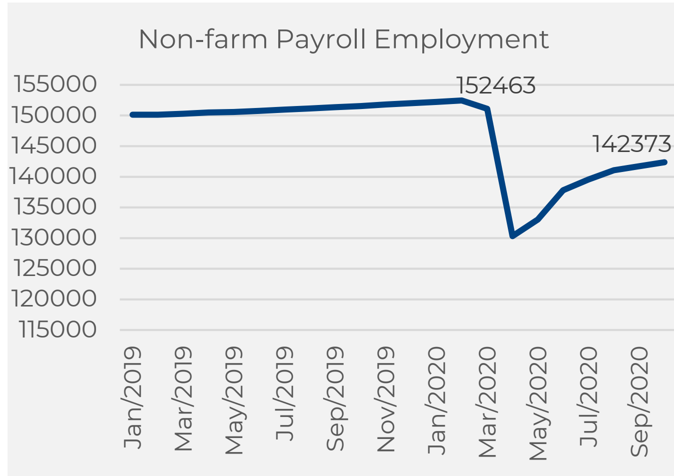
 Source: Cushman and Wakefield

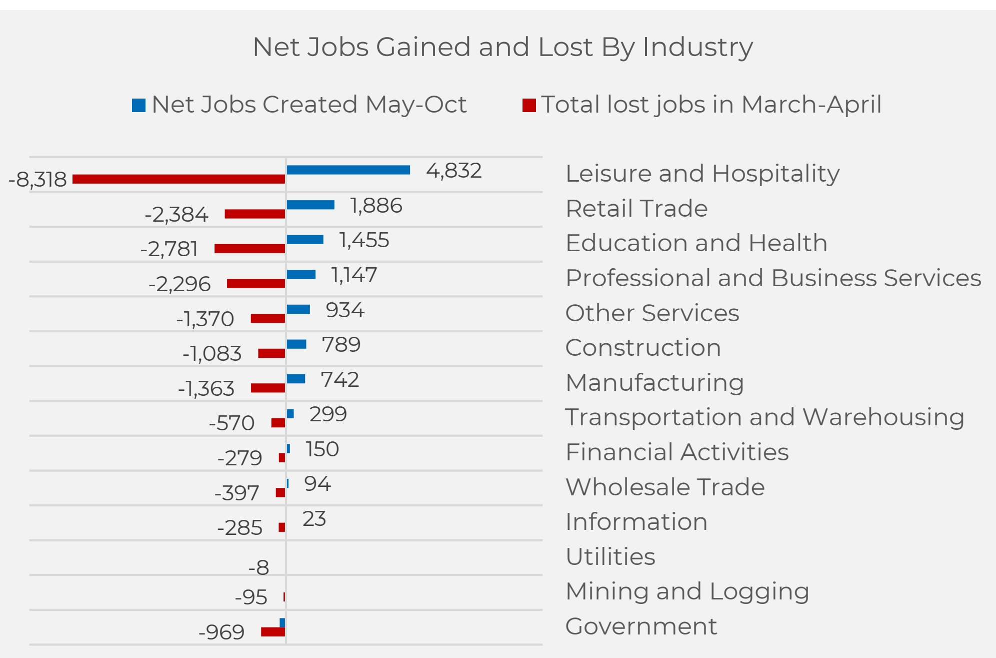
Commercial Market Overview

Sustained job recovery helping in the recovery of commercial real estate transactions

Sustained job recovery is essential to the turnaround of the commercial real estate industry. Since May and through October, 12.07 million nonfarm payroll jobs have been gained, or 54% of the 22.16 million nonfarm jobs lost in March and April. Compared to February, there's still 10 million jobs to regain.

The largest job losses were in leisure and hospitality (8.4 million) and only 58% of those jobs have been recovered. In professional and business services, only 50% of the 2.3 million jobs lost have been recovered. In retail trade, 70% of the 2.4 million lost jobs have been regained.





Percent of lost jobs recovered

54%	Total non-farm
-	Government
-	Mining and Logging
-	Utilities
8%	Information
24%	Wholesale Trade
54%	Financial Activities
52%	Transportation and Warehousing
54%	Manufacturing
73%	Construction
68%	Other Services
50%	Professional and Business Services
52%	Education and Health
79%	Retail Trade
58%	Leisure and Hospitality

Source of data: Bureau of Labor Statistics, Establishment Survey

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Apartment

Rising demand for low-rise suburban apartments

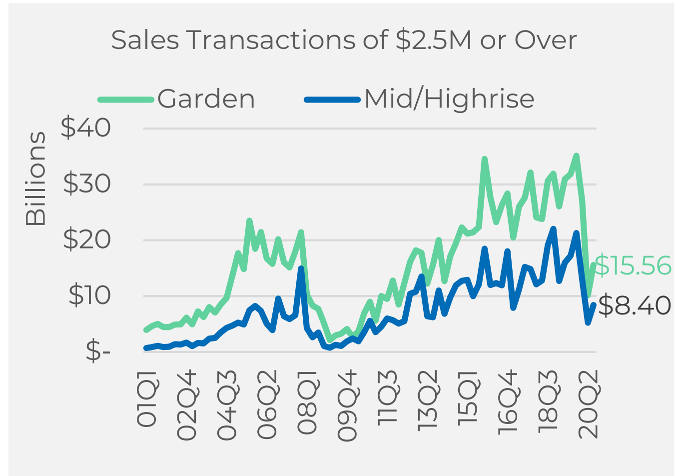
Acquisitions of apartment properties or portfolios of $2.5 million or over made a modest recovery in 2020 Q3 after slumping in 2020 Q2, with acquisition increasing to $24 billion in 2020 Q3 ($15.3 billion in 2020 Q2). However, the dollar volume of transactions is still 51% lower than one year ago.

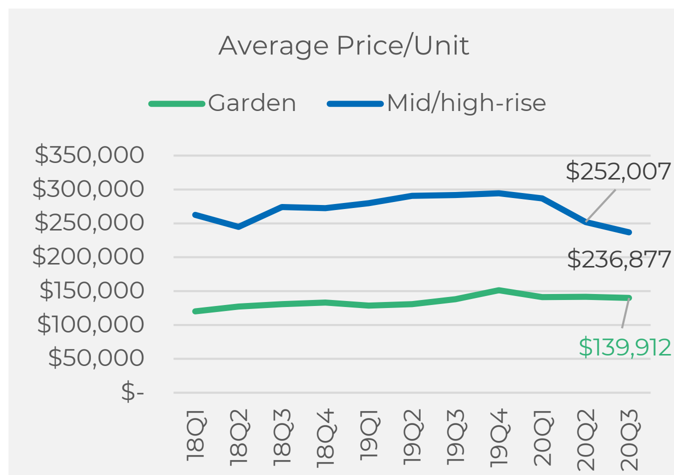
Garden/low-rises (less than four floors) sales accounted for nearly 80% of property acquisitions. The share of garden/low- rise property sales has been rising since the recovery from the Great Recession. Garden/low-rises tend to be found in the suburbs where land is less expensive.

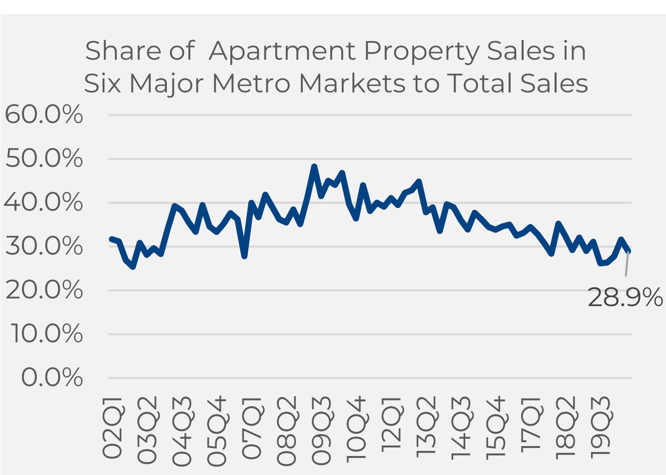
Another indicator of the stronger demand for low-rise apartments is price: the price per unit of mid/high-rise apartment units has fallen by 21% year-over-year as of 2020 Q3 while the average sales price of garden or low-rise apartments is up 1%.

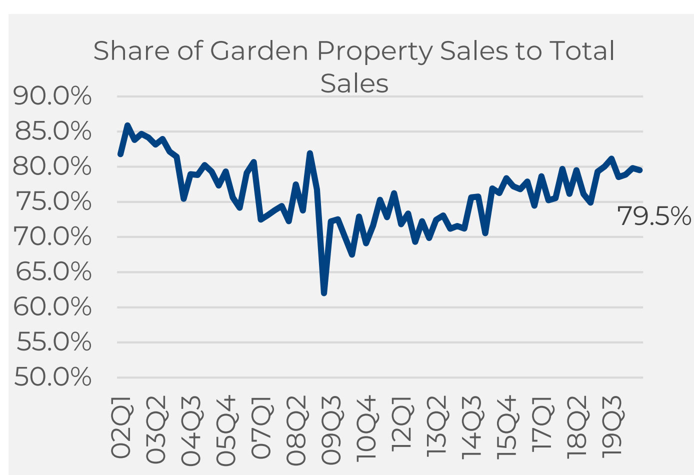
The six major markets (New York, Boston, Chicago, Washington DC, San Francisco, and Los Angeles) accounted for 29% of apartment property sales. The share of these major markets has declined from nearly 50% since 2008-2009.

In 2020 Q3, the most active markets in terms of apartment property acquisitions were Los Angeles (357), Dallas (199), Atlanta (130), Phoenix (123), and Manhattan (98).









Source: NAR analysis of Real Capital Analytics data

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Office

Uptick in suburban office sales while CBD sales decline

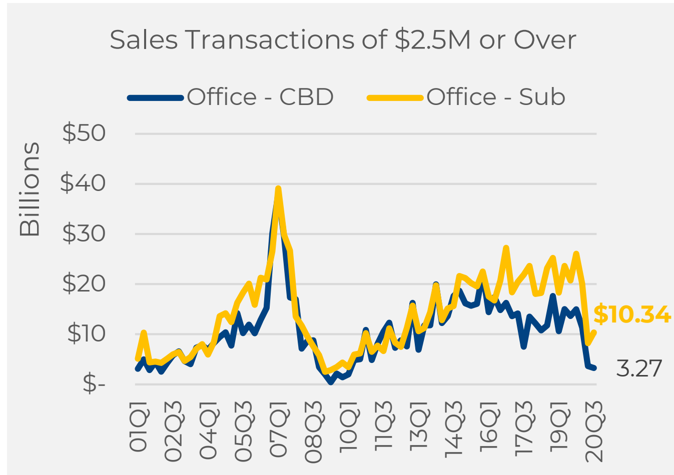
Suburban office sales showed a mild recovery in 2020 Q3 while office-CBD sales continued to decline in 2020 Q3. Acquisitions of office properties or portfolios of $2.5 million or over in the office-suburban market rose to $10.3 billion ($8.2B in Q2) while sales transactions of CBD properties trended downwards to $3.3 billion ($3.7B in Q2). However, sales are still down 60% from one year ago.

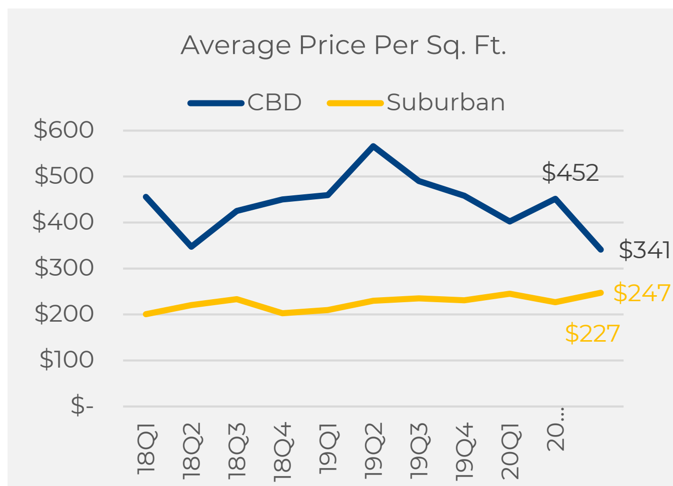
The average price per square foot of CBD transactions fell to $341/sq.ft., a drop of 30% year-over-year drop. Meanwhile, the average price per square for suburban properties was up 7%, at $247/sq.ft.

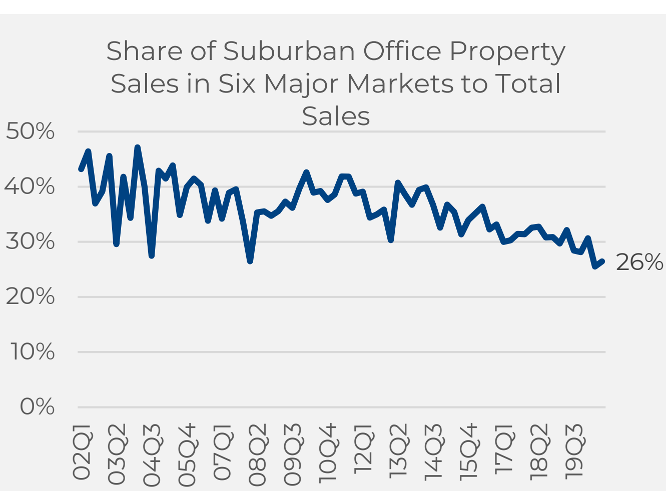
The suburban office market accounted for 90% of the number of property acquisitions. The share of suburban office market sales has been trending up since the recovery from the Great Recession, and the pandemic appears to be accelerating this trend.

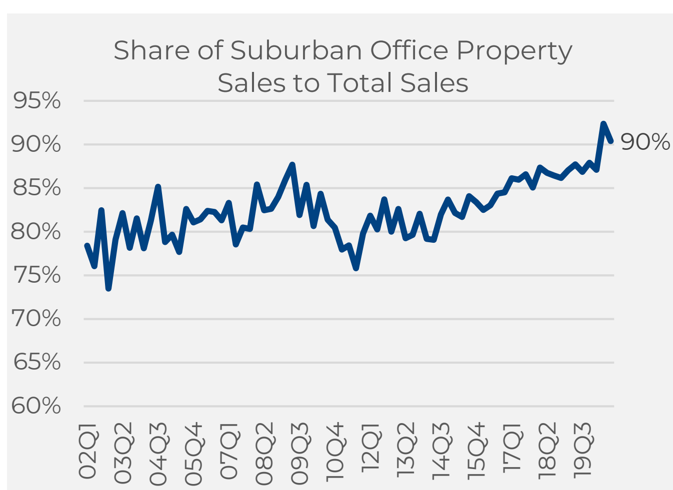
The six major markets (New York, Boston, Chicago, Washington DC, San Francisco, and Los Angeles) accounted for 26% of office property sales. The share of these major markets has declined from about 40% in 2008-2010 (and early 2000s).

In 2020 Q3, the most active markets in terms of office property acquisitions were Los Angeles (122), Dallas (93), Atlanta (78), Boston (73), and the DC-VA Burbs (69).









Source: NAR analysis of Real Capital Analytics data

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Industrial

Industrial property acquisitions picked up in 2020 Q3

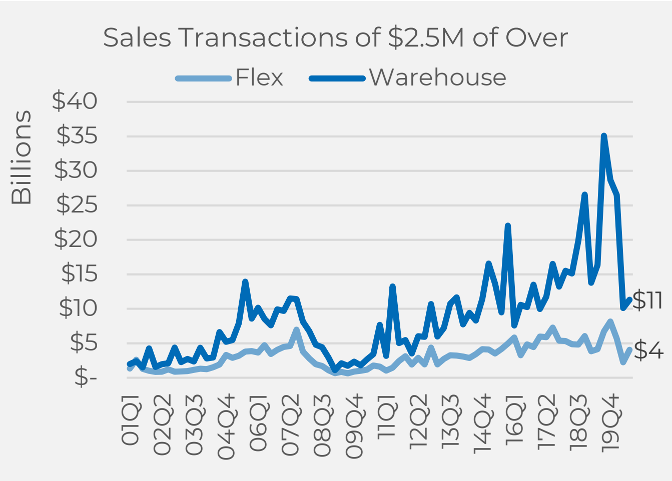
Investor acquisitions of industrial properties or portfolio acquisitions of $2.5 million or rose over rose to $15.6 billion in 2020 Q3 as sales/acquisitions of both flex and warehouse properties increased ($12.3 B in 2020 Q2). However, sales are still down by 63% from one year ago.

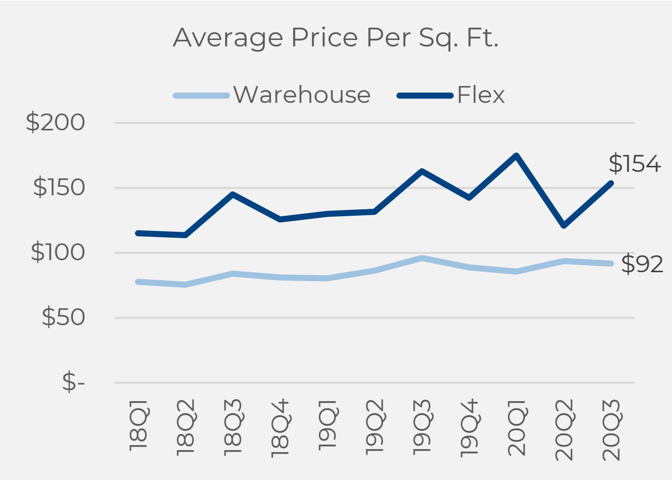
The average price per square foot of warehouse acquisitions was essentially unchanged, at $92/sq.ft., while the average price per square foot for flex properties rose to $154/sq.ft. after falling to $121/sq.ft in 2020 Q2.

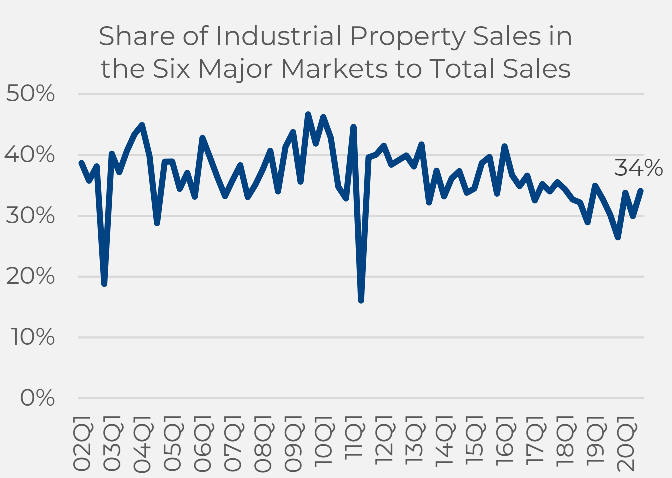
Warehouse acquisitions account for majority of the transactions, or 80% of property acquisitions. The share has trended upwards from just about 75% in 2019. The demand for warehouses is propelled by the acceleration on e-commerce. Electronic shopping and mail-order sales accounts for 15% of total retail sales, with an annual value of $809 billion, up from $709 billion at the beginning of the year.

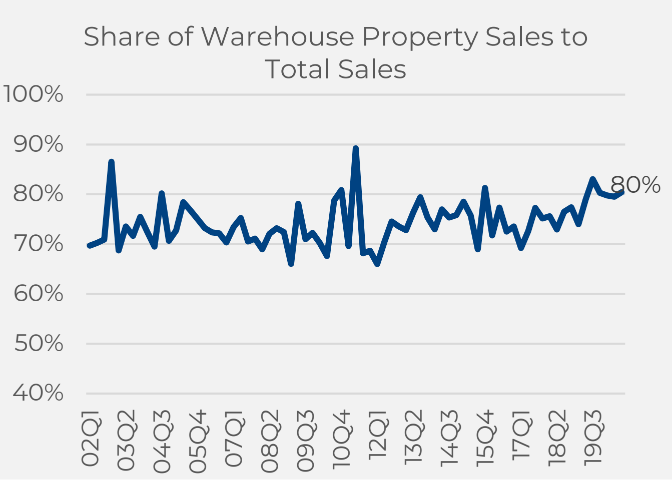
The six major markets (New York, Boston, Chicago, Washington DC, San Francisco, and Los Angeles) accounted for 34% of industrial property sales. The share of these major markets has declined since 2016, from about 40%.

In 2020 Q3, the most active markets in terms of industrial property acquisitions were Chicago (313), Los Angeles (298), Dallas (172), Atlanta (147) and Houston (135).









Retail

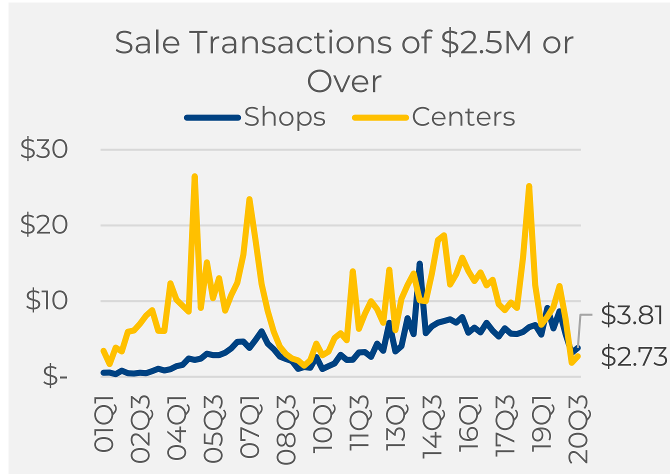
Slight uptick in retail transactions

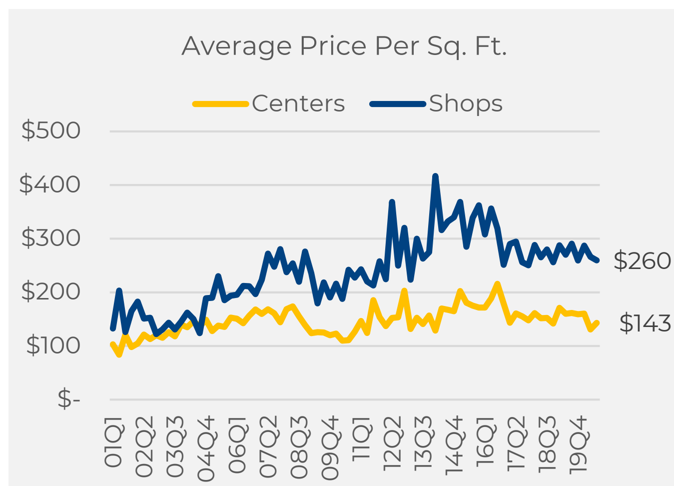
Commercial sales/acquisitions of retail properties or portfolio acquisitions of $2.5 million posted a most turnaround in 2020 Q3, to $6.5 billion ($5B in 2020 Q2) due to more acquisitions of shopping centers (multiple tenants and 30,000 square feet or more) and shops (retail spaces usually occupied by a single tenant and/or under 30,000 square feet). However, total retail property acquisitions are still 58% below year-ago levels.

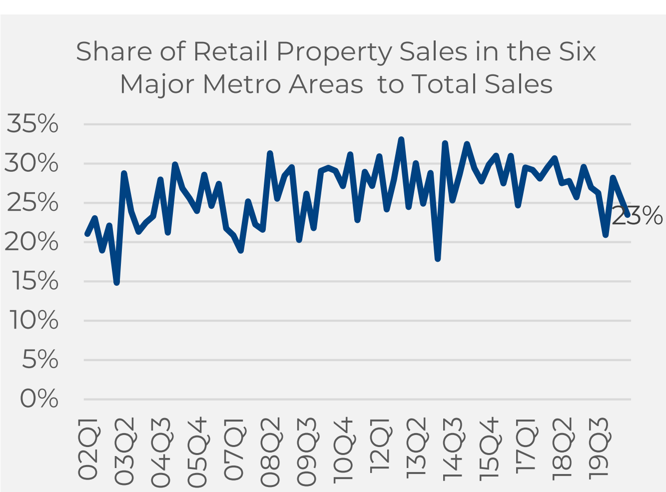
The price per square foot for shops has fallen since 2016 from over $300/sq.ft. to $260/sq.ft in the 2020 Q3 sales deals, while centers sold at an average of $143/sq.ft.

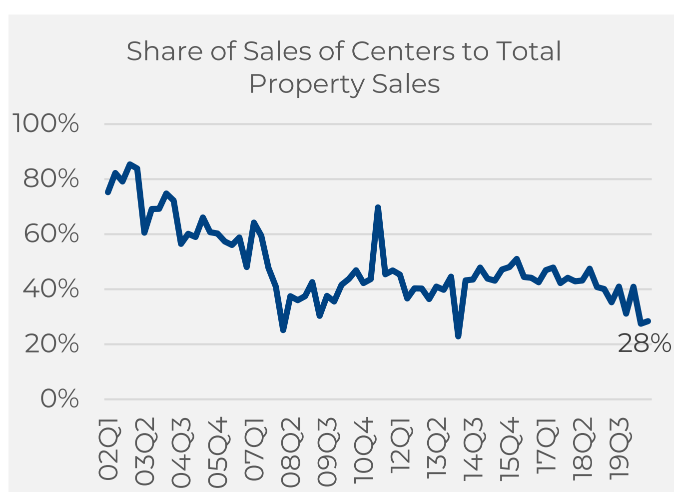
Sales of shopping centers accounted for 80% of deals in the early 2000's, but that share has fallen to just 28% in 2020 Q3. The acceleration of e-commerce has also accelerated the closures of many bricks and mortars. According to CoreSight Research, about 8,000 stores have closed just this year alone, although a little over 2,500 have opened.

In 2020 Q3, the most active markets in terms of industrial property acquisitions were Los Angeles (165), Chicago (116), Dallas (111), New York City Boroughs (96), and Atlanta (87).









Source: NAR analysis of Real Capital Analytics data

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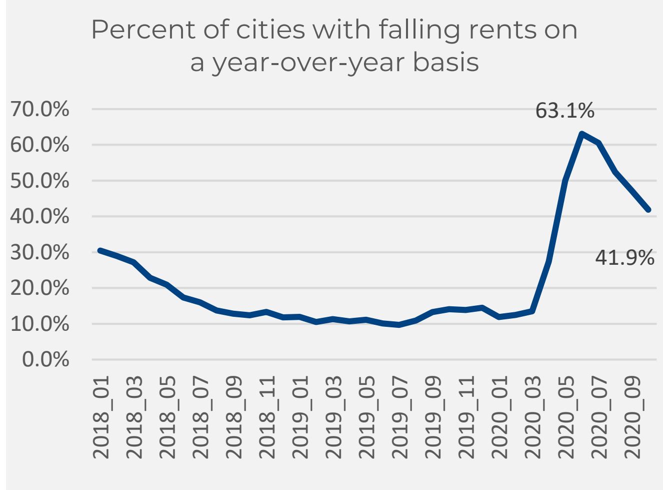
Apartment Rent Trend:
Rents Decline in Key Cities But are Rising in Smaller Cities

Rents Decline in Key Cities But are Rising in Smaller Cities

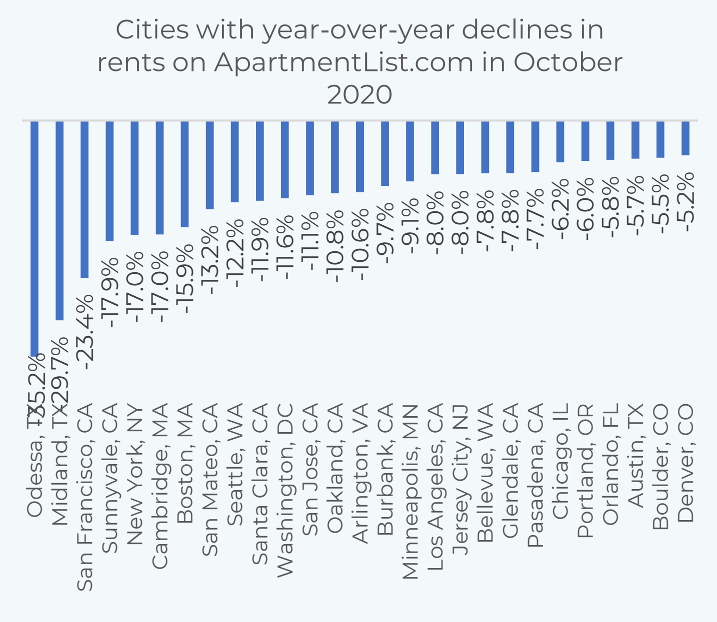
With unemployment rates still elevated and about 40 to 60% of workers in office-related jobs still working from home, apartment rents have declined in many cities, especially in major cities in the East and West coast. Based on ApartmentList.com's rent data, 42% of 504 cities (211 cities) had year-over-year declines as of October. This is a smaller fraction compared to 63% in June, but it is higher than the 14% share in March 2020. However, with sustained job recovery and with offices starting to reopen, the fraction of cities where rents were are falling has climbed down to 42%,

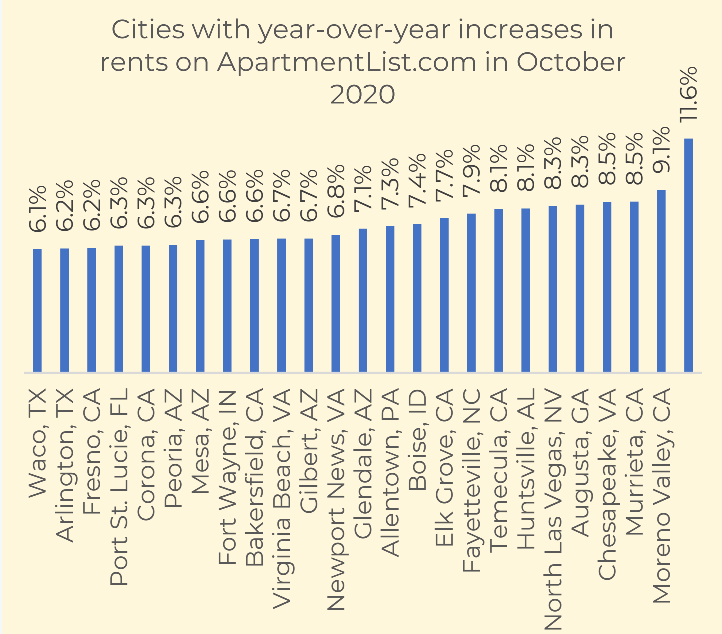
Rents listed on ApartmentList.com continue to decline in San Francisco (-23% y/y), New York (-17%), Boston (-16%), Seattle (-12%), San Jose (-11%), Arlington, VA (-11%), Los Angeles (-8%), Chicago (-6%), Austin (-6%)l, Boulder (-6%), and Denver (-5%).

However, rents are rising in the smaller cities or those closer to the key cities closer to the key cities. For example, while rents declined in Dallas, rents were up in Waco and Arlington, Texas. While rents declined in Los Angeles, they rose in Bakersfield. Rents have increased in Arizona cities such as Mesa and Glendale and Boise, Idaho.



Source: analysis of ApartmentList.com rent index





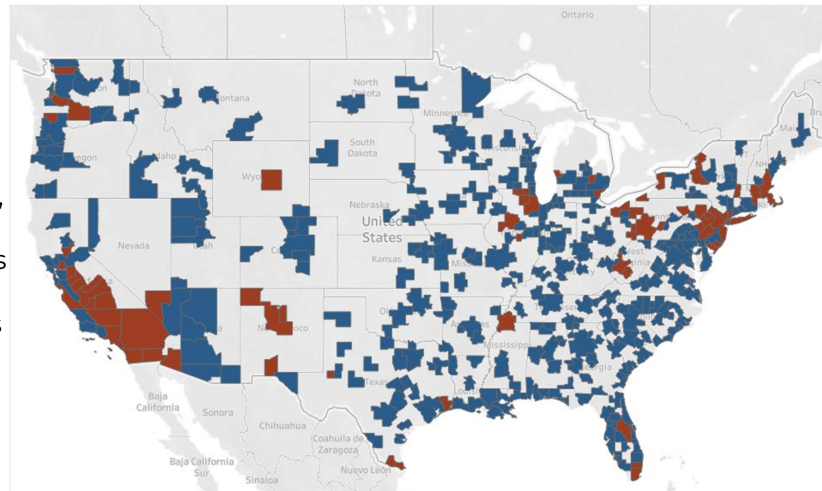
Source: ApartmentList.com rent index for cities

Rents Decline in Key Cities But are Rising in Smaller Cities

What might be causing rents to decline in the big cities?

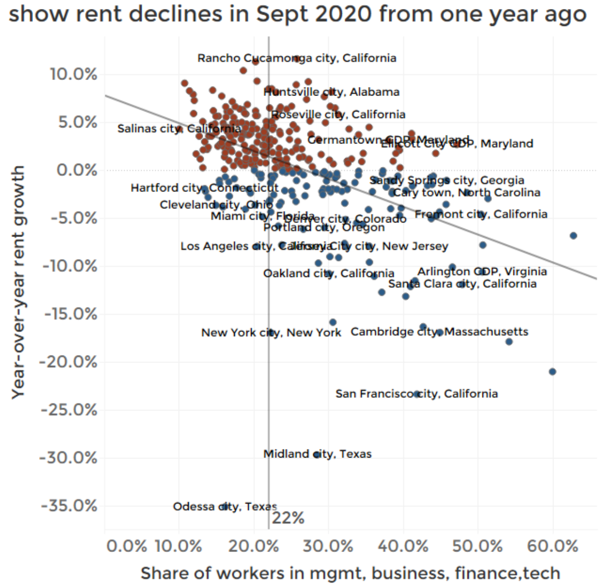
One big reason is that unemployment rates are higher in the key cities in the East and West Coast, as the map (right) shows, where red areas have unemployment rates of more than 10% that include Los Angeles (16.5%), Boston (11.8%), New York (12.3%), Chicago (12.3%), Miami (12%), Orlando (12%). Big cities draw domestic and international tourists are magnets for office headquarters and universities, and are sites of major sports or corporate events which employ hospitality and leisure sectors (food services, hotels) and retail trade workers where a higher fraction remain unemployed,

Unemployment Rate by Metro Areas as of 2020 Q3 (red areas above 10%)



Another reason why bigger cities are showing rent declines compared to the smaller cities is that workers who may have seen their hours cut or are working from home may have moved back with their families to save on rent payment. These can include many tech workers living in expensive cities such as San Francisco and New York. The chart on the right shows a negative association between the fraction of tech worker an rent growth. A survey by job company Hired found that 40% of Bay Area workers will live to a less expensive city if they were asked to permanently work from home. A survey by Blind also found that two-thirds of Bay Area workers will leave if hey can work from home permanently.

Cities with high fraction of workers in management, business, financial, computer, engineering, and science were more likely to show rent declines in Sept 2020 from one year ago



Author's analysis of ApartmentList.com data and US Census Bureau ACS 2019 1-year Table S2401

Tech companies who have announced workers can work from home include: Google (work from home till summer of 2021), Twitter (permanently work from home), Facebook (permanently work from home), Microsoft (permanently work from home), Amazon (work from home until June 2021), Apple (work from home until early 2021), and real estate companies like Zillow (work from home indefinitely).

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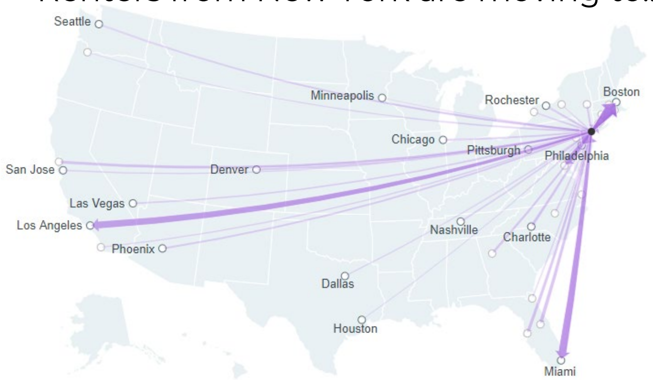
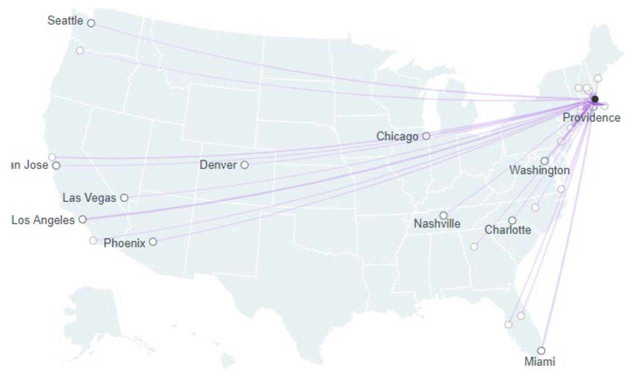
Rents Decline in Key Cities But are Rising in Smaller Cities

ApartmentList's analysis * of rent movers show that renters do move from more expensive to less expensive areas.

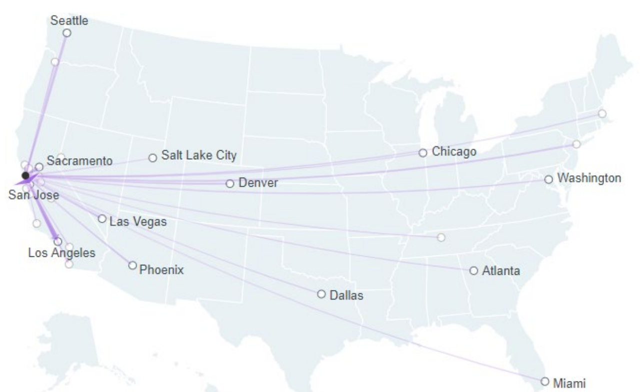
Renters from New York are moving to..



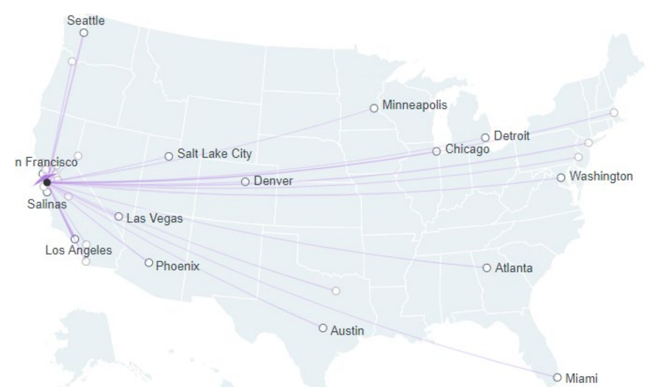
Renters from Boston are moving to..



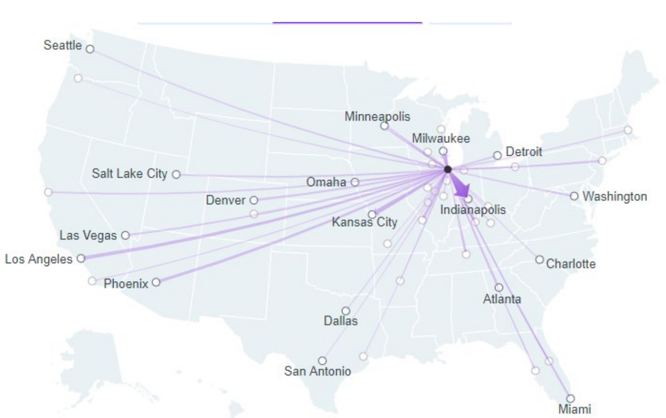
Renters from San Francisco are moving to..



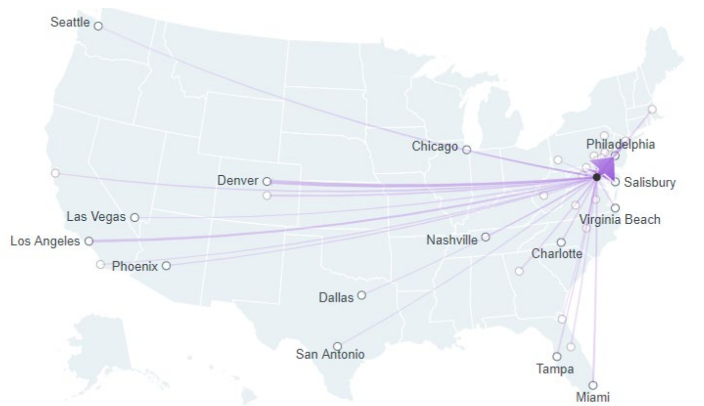
Renters from San Jose are moving to..



Renters from Chicago are moving to..



Renters from Washington, DC are moving to..



Source: Maps from ApartmentList.com

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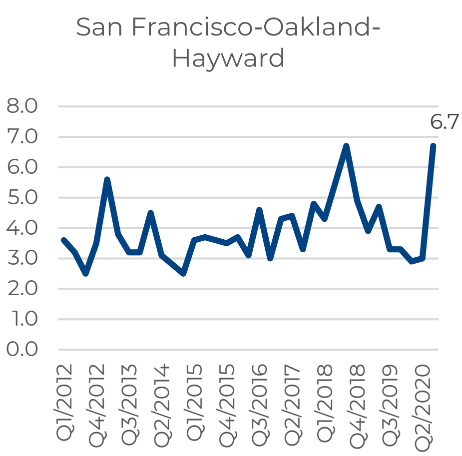
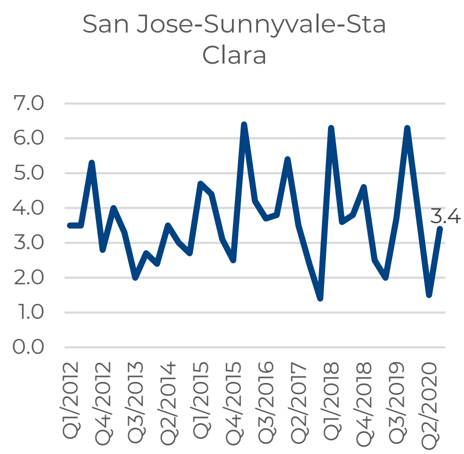
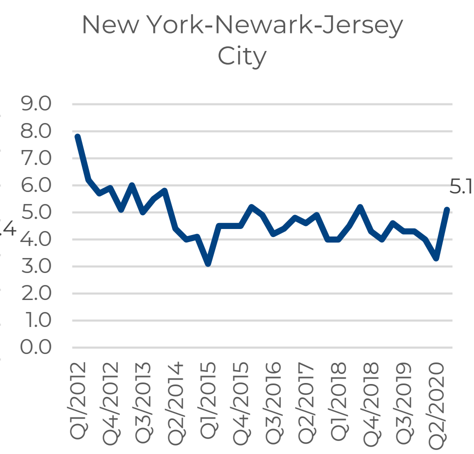
Rents Decline in Key Cities But are Rising in Smaller Cities

The long-term rent outlook for rents in the big cities depends on the continued pace of recovery in the leisure and hospitality industries and the continued effect of working from home. Currently, vacancy rates are still tight in the West and East coast metro markets, as of 2020 Q3, but vacancy rates can remain elevated or rise if coronavirus infection rates continue to rise or if social distancing will continue to keep businesses operating at below historical capacity even if a vaccine is discovered. Vacancy rates can rise if workers are also allowed to work from home permanently or work for just say one day a week, which can make the longer commute more bearable.   For example, vacancy rates have already increased in San Francisco and likely in San Jose and New York. Nationally, the rental vacancy rate rose to from 5.7% in Q2 to 6.4% in Q3.

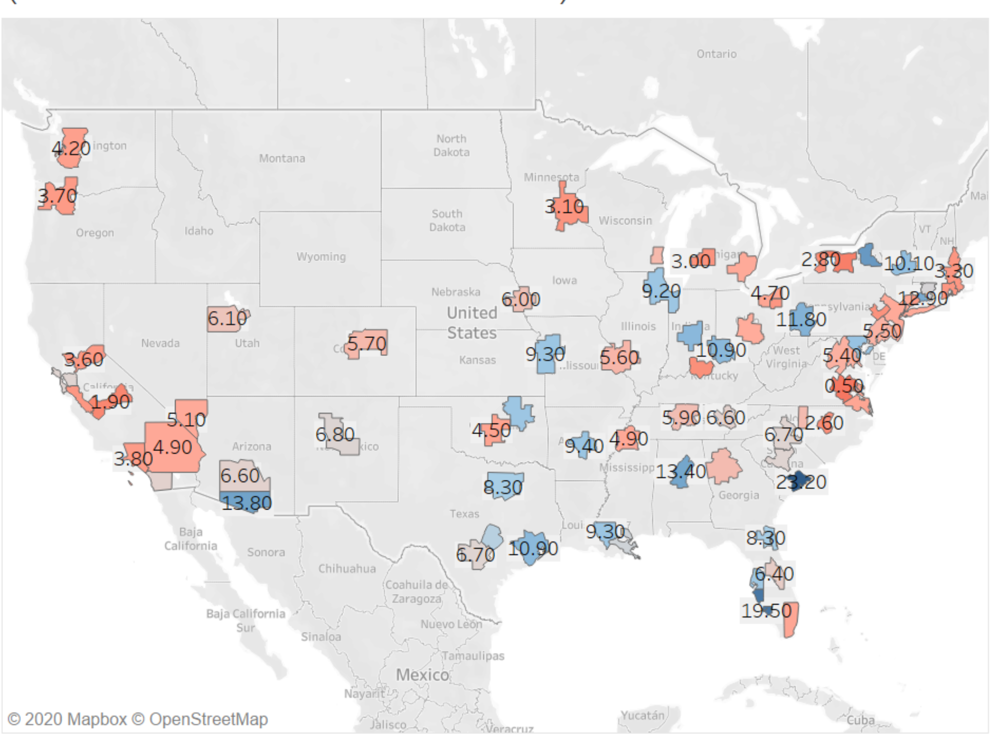






Rental Vacancy Rate in 2020 Q3

(red areas: below the US rate of 6.7%)



Richmond	0.50
Rochester	1.20
Raleigh	2.60
Louisville/Jefferson County	2.70
Buffalo-Cheektowaga-Niagar..	2.80
Allentown-Bethlehem-Easton	2.90
Grand Rapids-Wyoming	3.00
Minneapolis-St. Paul-Bloomin..	3.10
Akron	3.30
Boston-Cambridge-Newton	3.30
Providence-Warwick	3.30
San Jose-Sunnyvale-Santa Cla..	3.40
Sacramento-Roseville-Arden-..	3.60
Bridgeport-Stamford-Norwalk	3.70
Portland-Vancouver-Hillsboro	3.70
Los Angeles-Long Beach-Anah..	3.80
Seattle-Tacoma-Bellevue	4.20
Oklahoma City	4.50
Cleveland-Elyria	4.70
Miami-Fort Lauderdale-West ..	4.70
Virginia Beach-Norfolk-Newp..	4.70
Memphis	4.90
Riverside-San Bernardino-Ont..	4.90
Detroit-Warren-Dearborn	5.10
Las Vegas-Henderson-Paradise	5.10
New York-Newark-Jersey City	5.10
Columbus	5.20
Washington-Arlington-Alexan..	5.40
Philadelphia-Camden-Wilming..	5.50
St. Louis	5.60
Denver-Aurora-Lakewood	5.70

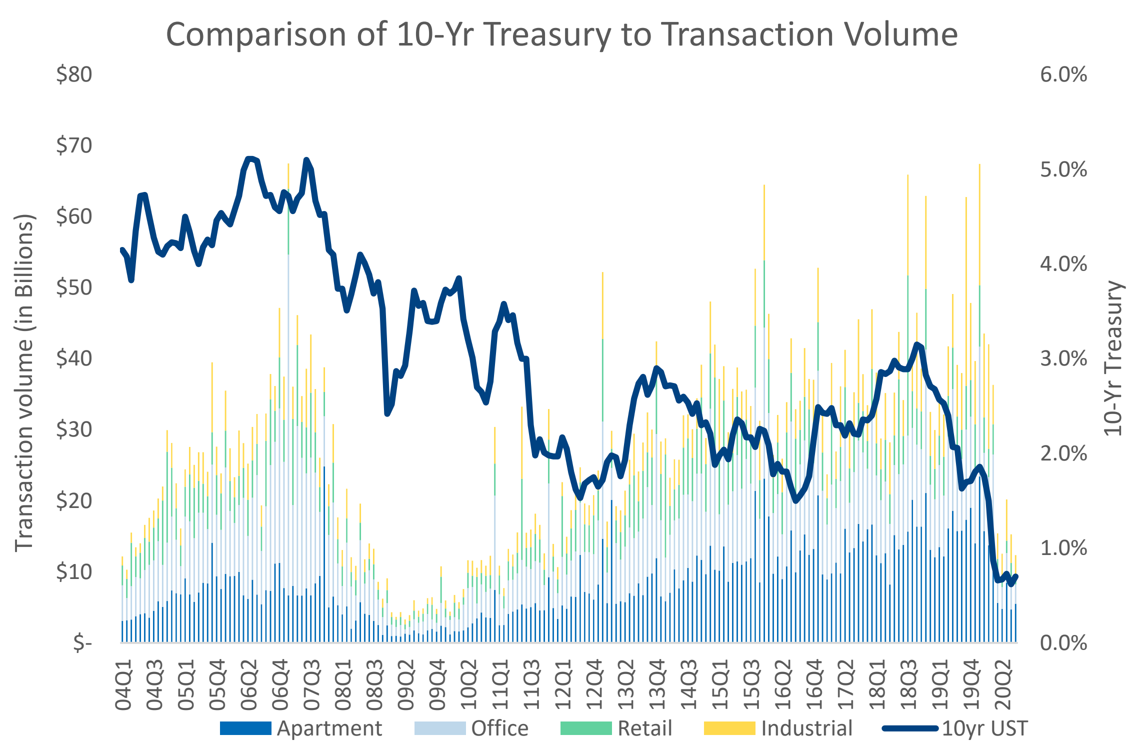
Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility

Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility

Financial markets have seen increases in volatility, primarily propelled by the coronavirus pandemic and elections.

Prior to the coronavirus pandemic, the U.S. economy was in a good place. Inflation was below the Federal Reserves' 2.0% target and unemployment was at its lowest in 50 years. Financial markets hit a high in February before it bottomed out in March. From that point forward there were substantial bankruptcies, store closures and unemployment. Banks pulled back on lending as demand for credit increased and deal volume decreased as a result of travel restrictions and stay-at-home orders all the while, interest rates hit historic lows. Contracts and deals that were in progress were terminated or renegotiated in consideration of low interest rates and parties' that were unable to meet current deal terms, renegotiated or terminated contracts as well. The ensuing Fed overnight repurchase agreements charged analogous effects.

Thus, the volatility in interest rates result in the reassessment of deals and increases in refinancing, given interest rates are at a historic low. For the rest of this article we shall look at historical commercial real estate transaction market data to provide insight into how the commercial real estate reacts when volatility in financial markets peaked. In particular, we will examine the characteristics of transaction volume and prices amid times of high interest rate volatility. In consideration of the importance of the 10-year treasury throughout commercial real estate as a benchmark, we shall use the 10-year treasury rate to illustrate volatility.

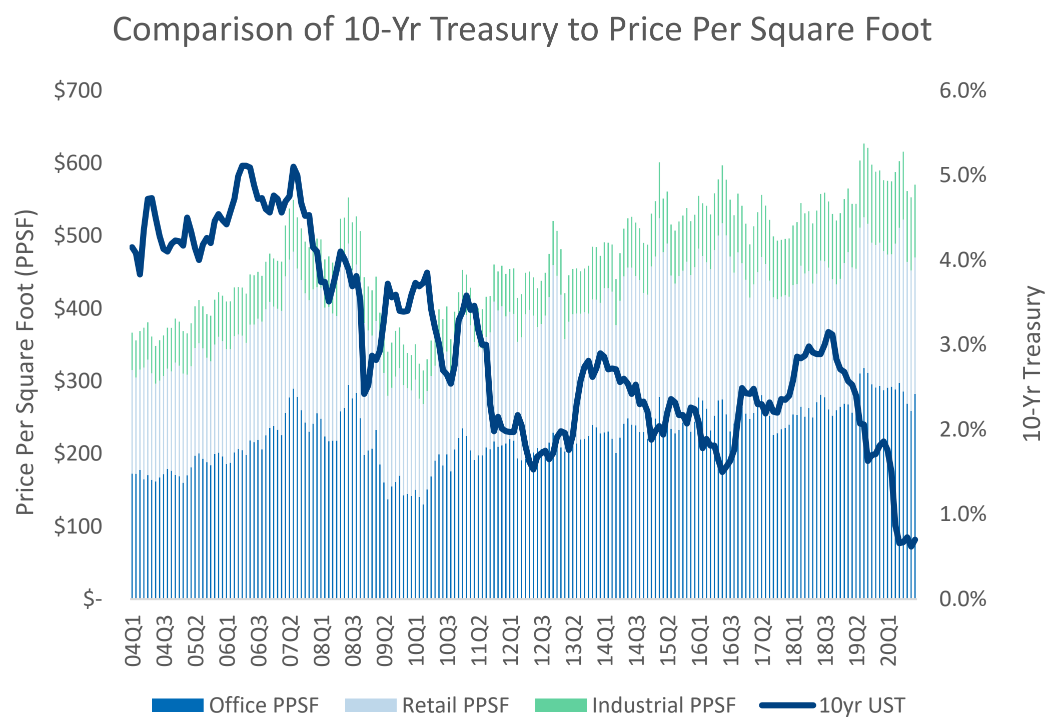


Source:RCA

Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility

The chart comparing the 10-year treasury to transaction volume illustrates retail, office, apartment and industrial sector transaction volume. Transaction volume as a whole increased until it spiked in 2007, prior to a significant decrease as a result of the recession from Q4 2007 to 2009.

Amidst this period, the 10-year treasury illustrated a downward trend and reflect the overall economic environment in the U.S. (and other countries) where interest rates were trending downward. But, over this same time, trends in prices were sturdier in comparison to transaction volume trends.



Source: RCA

Throughout the Great Recession, transaction volume significantly decreased. This implies that the deals that were finalized were between sellers and buyers who agreed on all terms and conditions. While transaction volume mirrors near-future sentiment, the steady increase in office, retail and industrial price per square foot (ppsf), not including the decline experienced during the 2008-2009 Great Recession, reflects the long-term demand for CRE assets.

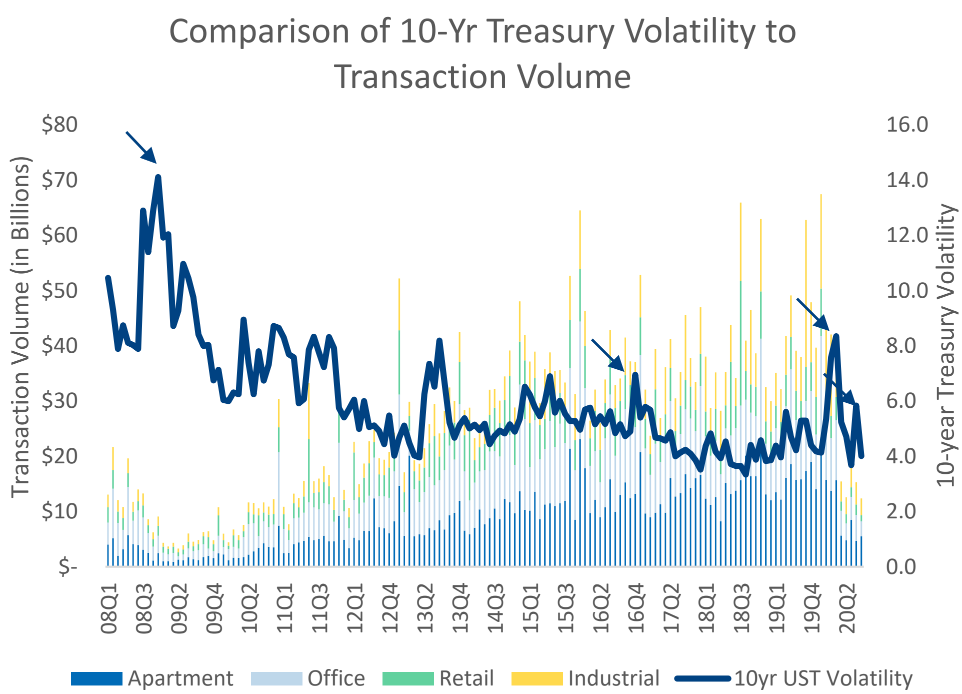
But what transpires during times of high interest rate volatility? Interest rates are continuously changing and as such, we shall use the Chicago Board of Trade (CBOT) 10-year U.S. Treasury Note Volatility Index (TYVIX Index) to capture the volatility of interest rates. The TYVIX Index measures the expected volatility of the 10-year Treasury Note that is calculated using real-time prices and the prior day's deviation of the opening and closing bids.

Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility

By using the TYVIX Index, we can see what the market's expectations were of future bond price changes. The more unpredictability there was surrounding changes to interest rates, the TYVIX index trends higher. Considering the TYVIX was discontinued by June, we use the VXTLT (a substitute for and who closely trends the delisted TYVIX) for the remainder of the period.

We can consider a higher levels of volatility as opposed to the standard levels of volatility as higher levels of volatility convey the ideals described in the beginning of this article where deals are reassessed, and transaction volume decreases.

There are four specific periods of high volatility in the U.S. where high volatility in the 10-year treasury led to perceivable decreases in transaction volume. The chart comparing the 10-year treasury volatility index to transactions volume during the 2008, 2016, and 2020.



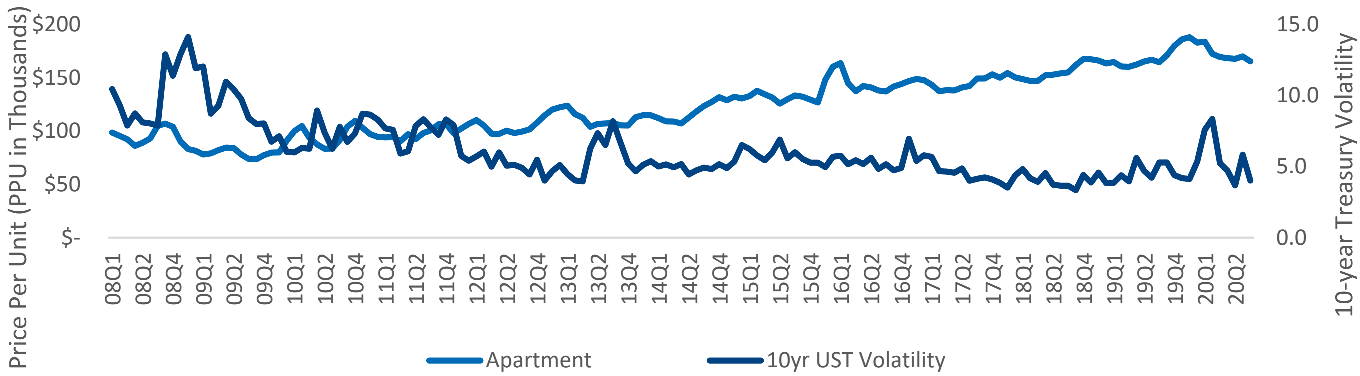
Source: RCA, CBOE

So, what happened? The events during the past 13 years that led to a decrease in transaction volume were the Lehman Brothers crumbling (2008 Great Recession), uncertainty around the 2016 presidential election and 2020 events. 2020 is different than the other events as the year is still in progress and has experienced and is experiencing two individual events. The first of which is the coronavirus pandemic. The second event was the uncertainty around the presidential election.

But how was pricing affected? We can see prices declined in 2008, 2016, and 2020 although the magnitude of the decline varies, with the largest decline during 2008. Other factors such as the response of monetary and fiscal policy to economic conditions also contribute to the volatility of interest rates that impact commercial transactions and prices.

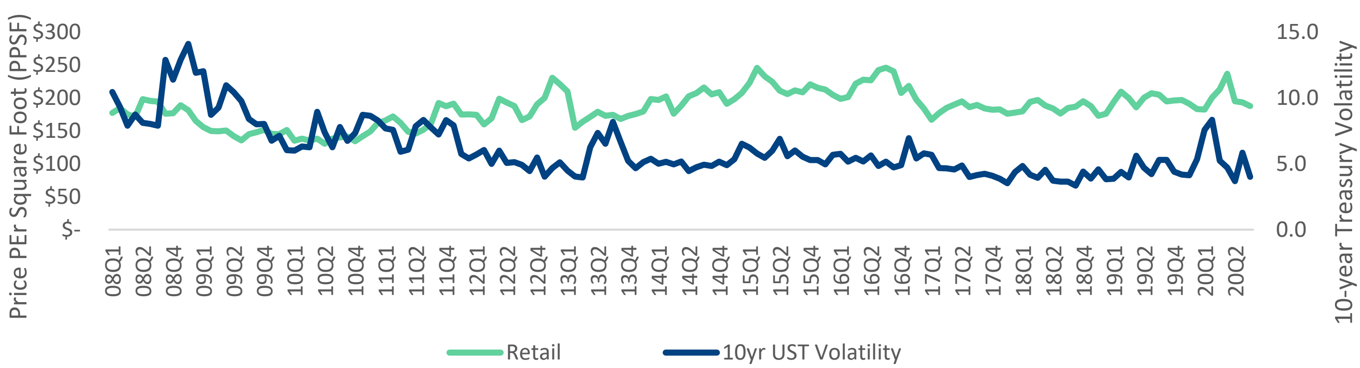
Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility

10-Yr Treasury Volatility to Apartment PPU



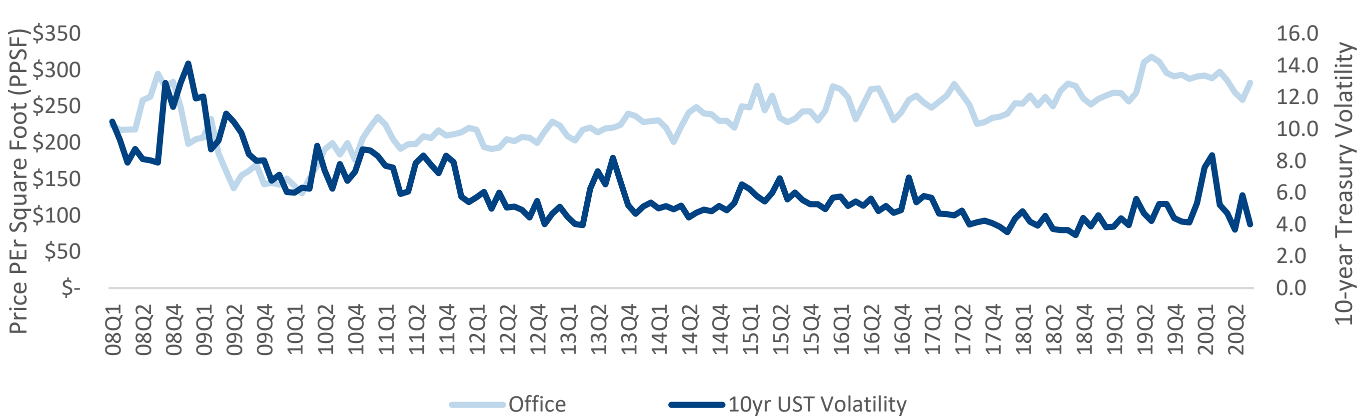
Source: RCA, CBOE

10-Yr Treasury Volatility to Retail PPSF



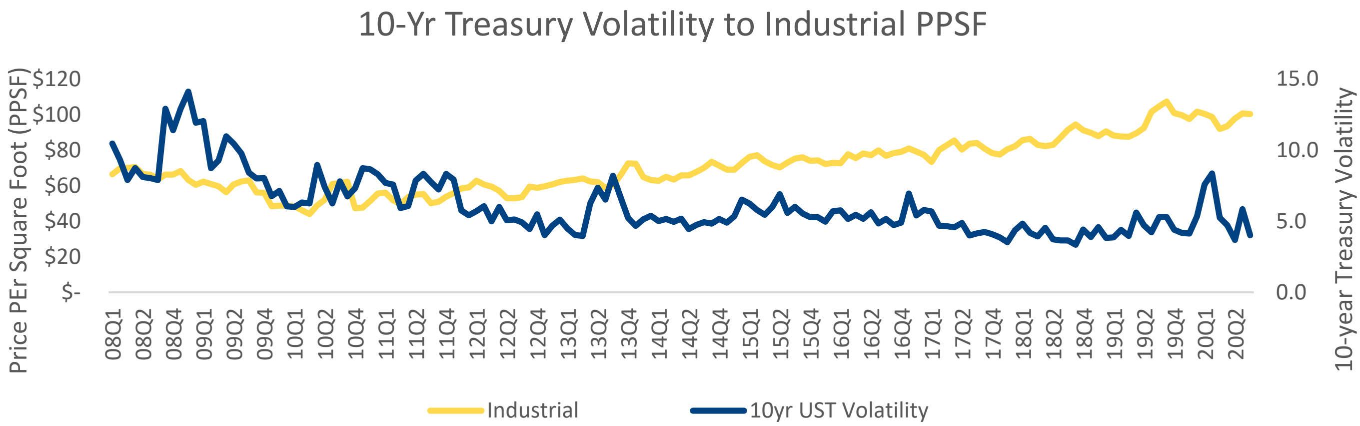
Source: RCA, CBOE

10-Yr Treasury Volatility to Office PPSF



Source: RCA, CBOE

Commercial Real Estate Transaction Markets: Elections, Pandemic and Volatility



Source: RCA, CBOE

While predicated on only four specific events where the characteristics of each event was and is uniquely differentiated, this analysis shows that anticipated non-economic and economic risks (e.g., resurgence of the coronavirus, fiscal imbalances) can result in higher volatility which can impact commercial sales transactions and prices.

COMMERCIAL MONTHLY INSIGHTS REPORT
September 2020

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