COLDWELL BANKER COMMERCIAL NATIONAL REAL ESTATE OUTLOOK 2021

What Will Drive the Recovery of Commercial Real Estate Markets in 2021?

2020 has been an unprecedented year, with COVID-19 impacting nearly every industry across the country, including commercial real estate. Shutdowns due to the coronavirus pandemic caused a large portion of employees to work from home for much of the year. As the economy stalled, many businesses and property owners found themselves negotiating with both tenants and lenders on rent relief and loan modifications. While the pandemic accelerated trends that were already taking place in retail, it upended the strong momentum in the office and hospitality sectors as well as urban markets. These trends will likely continue in 2021 and reshape what buyers, owners, tenants, and residents may ultimately want to occupy.

The national Coldwell Banker Commercial team met with local leadership and real estate professionals around the country to discuss micro and macro market trends for the coming year. We covered an array of asset classes, user types, and investor profiles ranging from private investors to users of all property types.

2020 LESSONS LEARNED

1. The pandemic expedited the declining demand for traditional brick-and-mortar retail (e.g., enclosed malls, department stores) and forced consumers to adopt online shopping more quickly than they ever planned.

2. As with any economic disruption, there are winners and losers. While the coronavirus outbreak halted the hospitality industry with widespread hotel and restaurant cancellations, it spurred demand for industrial space primarily to support distribution and storage. Freestanding retailers (especially drive-thrus) and net leased office space also held up exceptionally well compared to actively managed retail.

3. The sudden shift to work-from-home has created new expectations about flexibility that cannot be undone. People are making new choices about where they want to live, how and where they want to work; and the massive deployment of remote work technology platforms has only accelerated this push.

2021 OUTLOOK

While we wait for a widely available vaccine, we expect the recovery in 2021 to be led by industrial, grocery retail, multifamily, land, single-tenant net leased, and drive-thru retail properties. The leasing of small office spaces will be preferred over larger ones and tenants will look for flexibility in lease terms. Secondary and tertiary markets will grow echoing people's current preference where to live. Vacant malls will be repurposed for nontraditional tenants as obsolete retail space is recommissioned. The new administration in Washington D.C. will hopefully be successful at reducing economic uncertainty related to combatting COVID-19, bringing back market stability (e.g., foreign capital), and steadying the job market. A recovering economy paired with continued low interest rates should help sustain the private investor market and may push commercial real estate asset prices higher in 2021.

INDUSTRIAL

Ecommerce will continue to drive change like the advent of water transport, air transport and railroads did in the past. While distribution has always been key to retail, the coronavirus pandemic forced brands to pivot their ecommerce strategies significantly to meet constantly changing consumer demand. From accelerated online grocery shopping to an additional $40 billion in online holiday sales (a level not expected for another four years pre-pandemic, according to Digital Commerce 360), it is clear people are avoiding crowds. Limiting in-store shopping for all but necessities has become the new normal. This behavior has led to a huge need for warehouse space – for everything from cold storage to data centers and last-mile distribution in secondary and tertiary markets. For both investors and users, the challenge in many markets is locating suitable product available to buy or lease.

"Small industrial is getting a boost. Distribution center owners are now splitting warehouse square footage up into small spaces … last mile distribution is going really strong."
~ Tim Fabian (Northeast Region)

RETAIL

Given their dependence on foot traffic, retail and restaurants have been the hardest hit sectors in this pandemic and are expected to bear some of the worst long-term impact of the shutdowns. While well-capitalized malls and freestanding omnichannel retailers should pull through this crisis, COVID-19 has changed our lifestyles, and if traffic doesn't return to the enclosed mall format, we will see property owners and investors repurpose the vacant space for nontraditional tenants that will better serve the community. Retail reinvention in 2021 will most likely take the form of distribution centers, micro warehouses (for last-mile delivery and BOPIS), dark stores and kitchens, multifamily, medical offices, schools, churches, pop-ups, and drive-thru entertainment (e.g., movies and concerts). Finally, we expect logistics to lead retail investments as brands try to strengthen their customer loyalty programs and better predict demand.

"Some retail is doing very well. We are seeing very high demand for fast food chains like Chic-Fil-A and Chipotle."
~ Mid-Atlantic

MULTIFAMILY

Despite weakening fundamentals due to the pandemic, multifamily remains a viable housing product that continues to be supported by low interest rates and high leverage. Strong operators are still completing refinancings and buying value-add properties in dislocated markets. While the pandemic drove vacancies and steep rent declines in institutionally owned buildings across major cities, private-market apartments have lost very little value compared to other sectors, particularly those absorbing city transplants to the suburbs. As the job market recovers and provides more financial flexibility in 2021, demand for multifamily should rise from new household formations. For private investors, continued low cost of capital will help fuel acquisitions. According to Coldwell Banker Commercial professionals in secondary markets across the country, demand for rental units never slowed down during the summer nor did local developer projects.

"This pandemic is causing landlords to redesign the lobbies of all their mixed use buildings. Multifamily owners are changing their strategies, converting 1-bedroom units into offices, lofts, and flex space."
~SF/West Coast

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OFFICE

Nationwide stay-at-home orders and uncertainty caused by COVID-19 has impacted the U.S. office market to unprecedented levels, with vacancies expected to reach an all-time high and rents to decline by 11.7% (per REIS) or much more in 2021. The lockdown has changed the way many people work and demonstrated that a considerable amount of tasks can be accomplished outside of the traditional office space – leading many companies to adopt flexible schedules. With the need to commute drastically reduced, many people have relocated to the suburbs, and this will impact the future of office space, especially in urban markets. Working from anywhere will become the new norm – and will not always be just at home once risks related to the pandemic are mitigated. Work style changes may bring back shared service models like coworking; and an increase in hybrid workers will likely spur demand for small office spaces over larger ones as companies rethink the need to maintain expensive real estate portfolios.

"New office spaces will likely include large conference rooms and accessible outdoor areas where offsite employees can meet occasionally for training and bonding. Parking needs will be significantly reduced."
~ Bill Ukropina, CBC NRT

"Seeing a high exodus of businesses leaving NYC to go to the suburbs and demand for 1-3 unit offices for satellites going quickly."
~ Nic Sakalis (Northeast Region)

SUBURBAN MARKETS

The ability to work from anywhere will fuel growth in secondary and tertiary markets as high-wage city renters continue to become suburban homeowners in 2021. This accelerated population shift to the suburbs (thanks to COVID-19) will create new development demands to replicate the city-like amenities that Millennial and Gen-Z workers are used to and desire. Because these people still have the same expectations of an urban lifestyle, smaller markets need to recreate themselves with restaurants, shopping, delivery services, entertainment, and everyday conveniences. As a result, expect investment and recovery in the suburbs to outpace urban markets for several years.

MEDICAL OFFICES

General reluctance to seek medical care in hospitals (where risk of exposure to extremely sick people is high) should drive strong demand for outpatient care over the next year. The pandemic not only accelerated the need for outpatient locations, it is requiring more square footage to support new pathways for patient flow, telehealth services, and flexible screening areas. Owners and investors looking for medical office product will need to adapt their searches to align with these new design solutions. They will also likely need to find easy accessibility to senior housing facilities and other high-density residential projects

"Medical tenants need the physical space and are paying for it or expanding."
~ Todd Glaskin (Northeast Region)

PROPERTY MANAGEMENT

While we expect property owners to continue deploying smart technologies to keep buildings competitive and operating expenses steady, the COVID-19 pandemic has led to significant changes in day-to-day property management. Landlords are now conducting much of their business online – with virtual walk-throughs, e-signatures for leases, lockboxes for access, and apps to collect rent and accept maintenance requests. Many owners have embraced video calls to proactively communicate with tenants and carry out repairs. Expect digital technology to continue to transform this business post-pandemic.

Context is important – this was not a real estate led recession. Many investors are well-capitalized and remain active in the market, even during the shutdown, especially local private investors and those with 1031 tax-deferred exchanges. As a result, cap rates should see steady to downward movement when the crisis eases, with exceptions in retail, hospitality and mid/high-rise office which could remain unstable over the next few years. Expect land sales for housing and industrial development product to continue to be in short supply in 2021. Freestanding net lease formats, drive-thru retail and essential businesses should also hold up well compared to actively managed retail over the next few years.