News

National

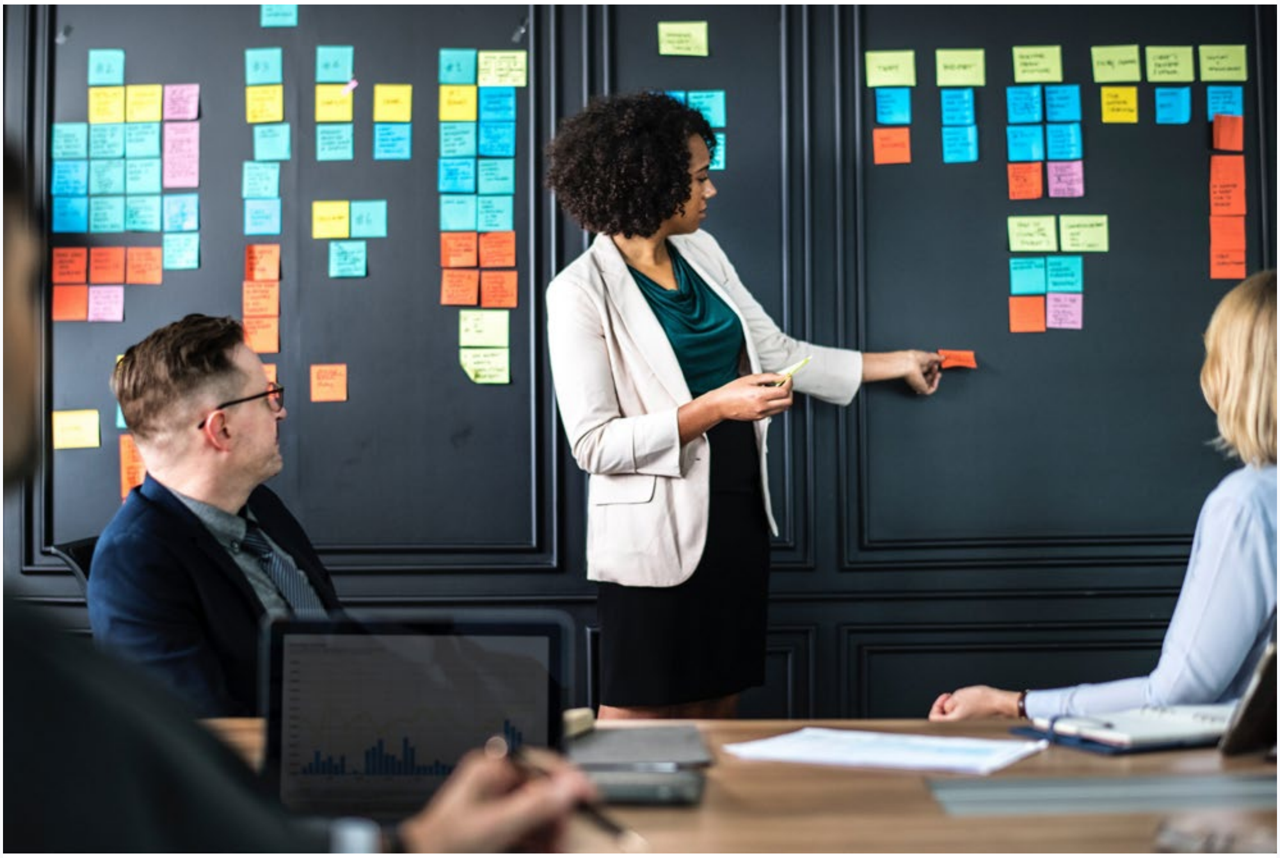
CRE Executives Make Their 2021 Predictions For The Industry

January 3, 2021 | Matthew Rothstein, Bisnow East Coast

As the commercial real estate industry finally puts 2020 in the rearview mirror, the path forward in 2021 is far from certain — and largely dependent on how the country extricates itself from the past year's trials.

A new president has been elected, but the incumbent has refused to acknowledge defeat and promise a peaceful transition of power. Two vaccines for the coronavirus are being distributed, but the prospect of the U.S. population achieving herd immunity is months away at best and uncertain to ever happen at worst.

Still, real estate is a forward-looking industry, and those who make their bets early and decisively will likely wind up the biggest winners of an economic recovery. With that in mind, Bisnow asked experts and executives from across the industry a series of questions to get a sense of the transitional year to come.



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What will the story of hotels be in 2021? Will the year be more defined by distressed asset sales or a comeback?

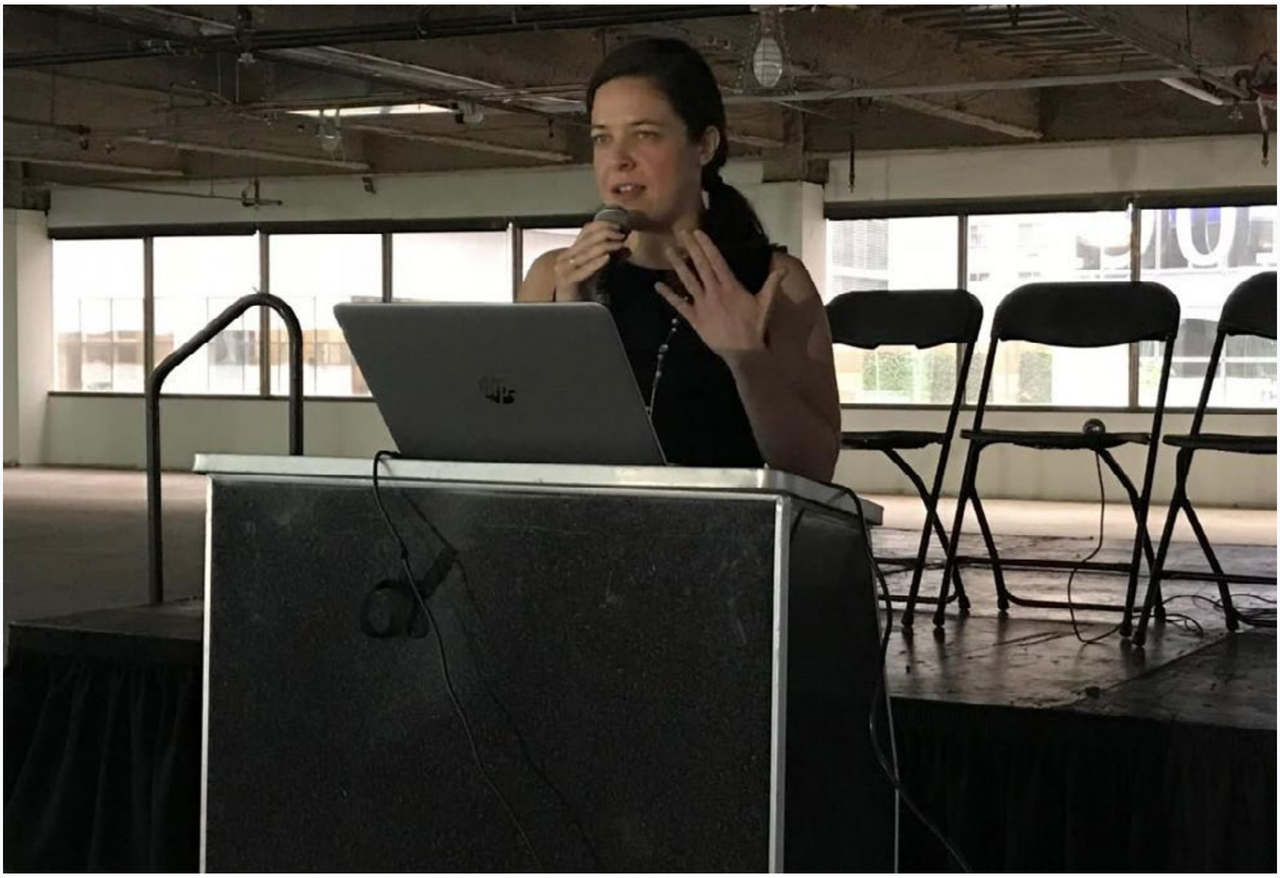
Black Salmon CEO Jorge Escobar (investment): Our firm anticipates increased distressed asset sales in 2021, with an industry recovery beginning to pick up in the second half of the year. Hotel properties that were previously for sale will be available at a more competitive price, anywhere from 15% to 40% less. With the distribution of the vaccine, I believe hospitality will be one of the first to feel signs of a comeback, given newfound appreciation for travel and pent-up demand from this past year.

Although visitor activity may increase, there will still be properties that find the best option is to sell, and that is where the opportunity will be for investors. We are still a few years out from telling the hotel comeback story.

What type of housing will be most popular among those moving to less-dense areas? Suburban multifamily, single-family rentals or purchased homes?

PTM Partners Chief Investment Officer Scott Meyer (investment): We expect well-amenitized multifamily projects to see greater interest, as they offer a sense of community many crave today.

Time Equities Director of Sales and Rentals Javier Lattanzio (investment/ development): For those moving to less-dense areas, I think the most popular housing will be single-family rentals. People realize that COVID restrictions are temporary. With that being said, should their move be more permanent, a rental allows them to experiment with different neighborhoods and towns without having to rush into a permanent situation.



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JLL Research Director Lauren Gilchrist, speaking at a NAIOP event at 1900 Market St. in 2018.

By the end of 2021, will flexible office space be in a better or worse position as a property type than it is now?

JLL Senior Vice President and Senior Research Director Lauren Gilchrist (brokerage): JLL remains very bullish on the future of flexible office space in the mid-to-long term, especially now that millions of workers around the country have experienced what it is like to work in a non-centralized office. We predict that by 2030, 30% of all office space will be flexible. However, we think the layouts of flexible space operations will change to include more one- to six-person offices and less open desking area, along with slightly longer flexible lease durations of approximately one to three years. Until a vaccine is widely distributed and the economy has time to adjust, we expect more consolidation of flexible office providers and different management agreement and leasing structures to emerge.

How widespread will the vacation of downtown headquarters for suburban office space be? Will that be in concert with increased work-from-home flexibility or as a compromise from companies that are resistant to it?

Unispace Global Principal of Strategy Albert De Plazaola (interior design): The extent to which organizations will spread into suburban office space is unclear, as nearly all organizations are still evaluating the right approach to support some level of remote work for their employees. However, there is some indication that organizations with large portfolios or offices in major urban hubs where public transportation and commuting can be a challenge will consider a more diverse approach to their portfolio. That can include suburban coworking spaces, mixed-use retail/workspaces, [flexible office platforms like] Liquidspace and providing employees with a stipend to spend on home-office ergonomics.

Simply leasing more traditional suburban office space does not necessarily optimize efficiencies or the employee experience as it limits the flexibility of remote working. A more comprehensive approach to the hub-and-spoke model is to provide a variety of "spoke" work environments, which may not need significant capital investment.

What will be the one or two most common redesign elements for brick-and-mortar retailers in 2021? Will such changes be permanent?

Tango founder, President and CEO Pranav Tyagi (analytics/lease management consulting): Many brick-and-mortar retailers had started to make the shift to "buy online, pickup in store" (BOPIS) services to compete with online giants like Amazon, but the pandemic accelerated this move to e-commerce (by five years) as "in-store only"

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retailers desperately tried to remain viable during months of consumers under stay-at-home restrictions.

BOPIS enables a more integrated approach to inventory management, merging online orders fulfilled through distribution centers with in-store purchases of whatever inventory is on the shelves. To plan for this shift, many retailers are redesigning stores to accommodate for easy consumer access to BOPIS lockers with separate entryways and designated parking spaces.

Another way for brick-and-mortars to remain competitive and provide frictionless shopping for consumers is through contactless self-checkout and/or Amazon Go-type experiences, where consumers can make purchases in-store on their phone without having to be checked out by a cashier or using a self-checkout station.

What COVID-safe design element is most likely to remain in place beyond when pandemic conditions have abated?

Meridian Design Associates Architects Managing Principal Antonio Argibay (architecture/interior design): COVID has made it clear that pathogens are primarily spread through the air and how we supply air to enclosed spaces has to be re-examined. In the last two or three decades, there has been recognition of what came to be known as "sick building syndrome" and newer building codes started requiring increased mixtures of outside air for healthier ventilation.

Today, rather than relying on passive improvements to air quality such as greater quantity of air, we are adding two solutions: better air filters and treatment of air prior to distribution. Many existing air conditioning systems have been adaptable for MERV-13 filters, which are hospital-quality filters. In offices, air treatment with new UV light systems has become commonplace. It is extremely effective against bacteria, fungal growth and viruses, making coming to the office a safer environment against most airborne illnesses.

How big is the number of companies that plan to implement enhanced HVAC/air filtration systems but haven't yet? For such companies, would a quick rollout of the vaccine cause some to abandon the idea?

Motili President and GM Karl Pomeroy (HVAC management): It's difficult to provide an exact number, but our business has seen significantly more inquiries with regard to various options for HVAC filtration options from commercial and multifamily customers. Everyone from retailers to large, tenant-occupied property owners and operators are scrambling to meet consumer demand for improved air quality.

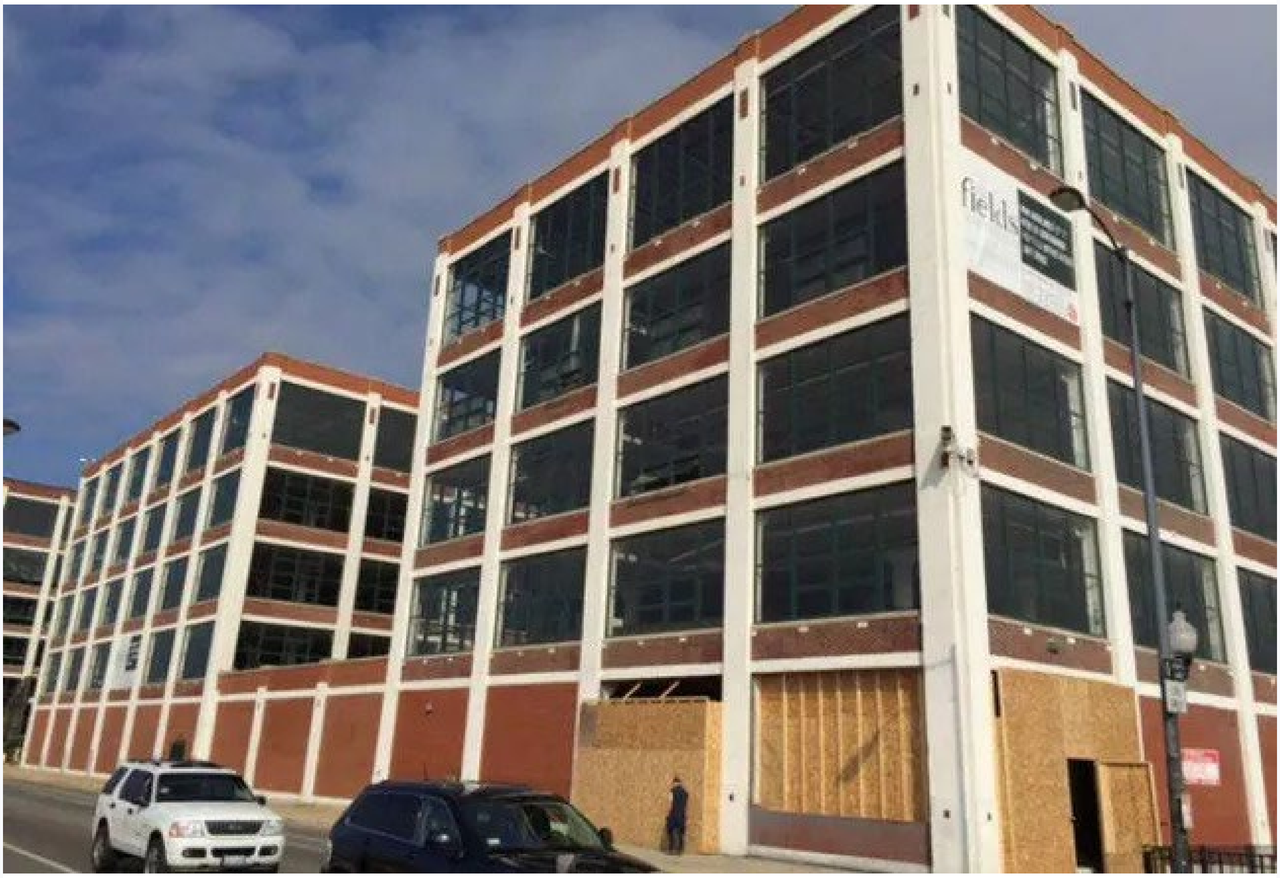
While COVID may have influenced this increased focus on indoor air quality (IAQ), it definitely goes beyond that. Even with the rollout of the vaccines, we anticipate demand for our IAQ products to grow over the course of 2021 and beyond.

Is there a path back to, if not profitability, then more long-term survival for shopping malls that doesn't involve redevelopment/integration of other property types?

Newmark Capital Markets Group Vice Chairman Thomas Dobrowski, leader of the firm's retail transactional and advisory group (brokerage): There is absolutely a path back to both profitability and sustainability for many shopping malls spread across the country. Most shopping malls already contain a healthy concentration of apparel, experiential [retail], dining and services, as the trend to diversify the tenant base has been ongoing for the past decade. Where there is a need, however, is for more omnichannel platforms to service consumers.

There is tremendous opportunity to create and adapt current locations into this new hybrid model, which integrates traditional elements of brick-and-mortar retail with industrial and logistics technology. COVID-19 has demonstrated that consumers want options when it comes to shopping, which include the convenience of ordering online, picking up at the store and returning or exchanging at the store.

Most shopping malls fit the bill to introduce this new form of omnichannel retail, as they are extremely well located, with great access and a great concentration of retailers that comprise many of the most in-demand e-commerce retailers. The bottom line is the landlords that are able to adapt and offer this type of experience and service will not only be able to survive, but thrive.



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Will we see fewer construction starts next year in urban cores for office and/ or multifamily?

Northspyre co-founder and CEO William Sankey (data/analytics platform): Not necessarily. The more recent pullback across some cities created tremendous buying opportunities for assembling sites or repositioning struggling existing assets.

These new underwriting opportunities, coupled with owners and developers building in areas with promised diversified economies and vibrant city life, will fuel construction starts in core urban areas. While major cities took a hit this year, developers are always looking into the future and recognize that any project breaking ground in 2021 will not be complete for one to three years or more, when the landscape will likely be much different — and optimistic — than it is today.

Office builds will likely look different from both the construction and design side in 2021. Developers and landlords will need to configure spaces to attract workers that are now accustomed to remote work. Humans are social creatures and developers are creative at unlocking value in those social interactions, so I expect a flurry of construction to meet the moment and lure workers and others back.

Will we see a significant number of projects in those sectors and retail that were started this past year abandoned in the year to come?

Sankey: Even in more normal times, there is always a subset of projects that are abandoned for a number of reasons. The main causes of disruption include issues with government approvals, complex site regulations, permit delays, zoning discrepancies and financing issues.

Looking into 2021, I don't believe we will see a disproportionate amount of stalled or abandoned projects due to COVID-19. If anything, they may be delayed and repositioned. Many projects that kicked off in 2020 had a multi-year timeline and financing in place, which will carry them through to completion.

And, of those owners and developers that decided to pivot, they moved very quickly to adjust their plans as soon as they realized the impact COVID-19 would have on their retail or office project, switching to more favorable asset classes.

Will the demand for adaptive reuse prompt redevelopment of the core urban office buildings that are seemingly falling out of favor?

LightBox Principal Analyst Dianne Crocker (consulting): It will not immediately prompt the redevelopment of the core urban office buildings. Much depends on where the chips fall in terms of employers with office space in central business districts opting to leave in favor of suburban locations.

Companies with expiring leases will be considering how much office space they need, especially if they don't plan on having 100% of staff in the office full time. These decisions will take shape over time and not be immediate. Essentially, the jury is still out on this. It's safe to assume to a certain extent that the oversupply of downtown office space that we saw even pre-pandemic will be more pronounced in hard-hit cities like NYC and LA, so some will need to be redesigned into uses that are more in-demand, but again, this will not be sudden.

For adaptive reuses of office buildings, is multifamily the only potential new use of such buildings?

Crocker: Multifamily is certainly a popular way buildings will be repurposed, especially given the housing shortage, but it's not the only way. Expect to see some innovative uses of old offices as an adaptation mindset takes hold.

In New York, there is already evidence of demand for older office buildings to be converted to vertical warehouses. Some companies are creating their own coworking [divisions] as property managers build out space and lease it.

BONUS PREDICTIONS

Newmark Vice Chairman Aaron Swerdlin, co-head of the firm's Houston self-storage practice group (brokerage): While the popularity and outperformance of self-storage has been on an upward trend for years — and certainly throughout this entire expansionary cycle — 2021 will be a meaningful inflection point for storage as a validated asset class amongst the most sophisticated real estate investors.

Blackstone's acquisition of Simply Self Storage (for which Newmark advised) and Cascade Investment's investment in the Storage Mart platform are representative of the diverse sources of capital flowing into the sector. This collection of growth capital will lead to self-storage transactions pricing more in-line than ever with the core real estate investment product types.

Courtesy of Marcus & Millichap

Eastside Self Storage in North Bend

Leading into the early spring of 2020, self-storage operating fundamentals were indicating a robust leasing season with rebounding market rental rates. With the challenges of COVID-19, the traditional leasing season for self-storage was muted. However, activity rebounded throughout the second half of 2020 and the industry enters 2021 with all-time record-high occupancy. Given the operating strength with which the industry enters 2021, the expectations from early 2020 indications have been pulled forward and 2021 will be a benchmark year for rental rate growth, revenue growth and average annual occupancy.

Urban Land Institute 2021 Emerging Trends In Real Estate report (nonprofit trade organization): The big drop in GDP in 2020 will likely lead to a slow-growth decade. The Congressional Budget Office forecasts U.S. GDP to average 1.7% from 2020 to 2030, down from the 1.9% forecast of a year ago. The Fed's announcement of low base rates through 2023 will also keep real estate borrowing rates low.

"I don't personally think that there's a high probability of the 10-year [Treasury rate] ramping up to 2%," a real estate executive at a major bank notes. "I never thought I'd say ramping up to 2% — that's the kind of year we're in."

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See Also: Brokers Put 2020 In The Rearview Mirror, Search For Bright Spots Ahead

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