Commercial Market Insights

September 2020

National Association of REALTORS®
Research Group

NATIONAL ASSOCIATION OF REALTORS®

Contents

Commercial real estate transactions continued to contract in July, hitting all core property sectors. Commercial prices have fallen across all markets compared to pre-coronavirus levels. The difference between cap rates and the risk-free T-bond continued to widen, an indication that investors continue to see high risks in commercial real estate.

Notwithstanding the severe decline in sales and leasing volume, July saw a decline in CMBS delinquency rates.

Jobs also continue to be recovered, with 10.6 million regained, but 11.5 million are still to be recovered, about half of which are in leisure and hospitality, professional and business services, and retail trade.

In the apartment market, demand remains skewed towards mid/high-rise apartments. In the office market, CBD office sales contracted more than suburban market sales, Industrial property acquisitions fell in July, but on a year-to-date basis, only acquisitions of warehouse assets are up year-over-year. In the retail property market, investor interest for large retail centers continue to suffer more than smaller single-tenant establishments.

This issue features two pieces. The first piece shows that workers are starting to return to the office although the fraction of workers working from home remains elevated. The second piece shows that food delivery service and revenues continue to surge. These pieces indicate that the demand for commercial real estate is moving toward new norms.

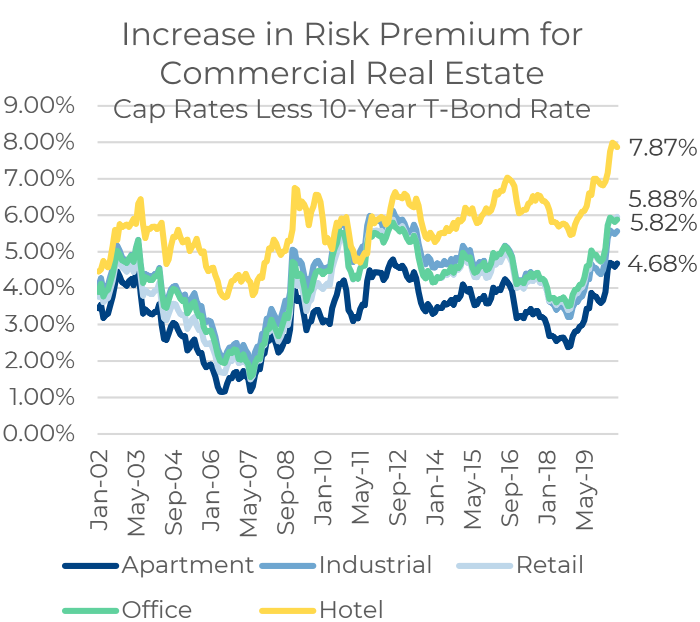
Commercial Market Overview

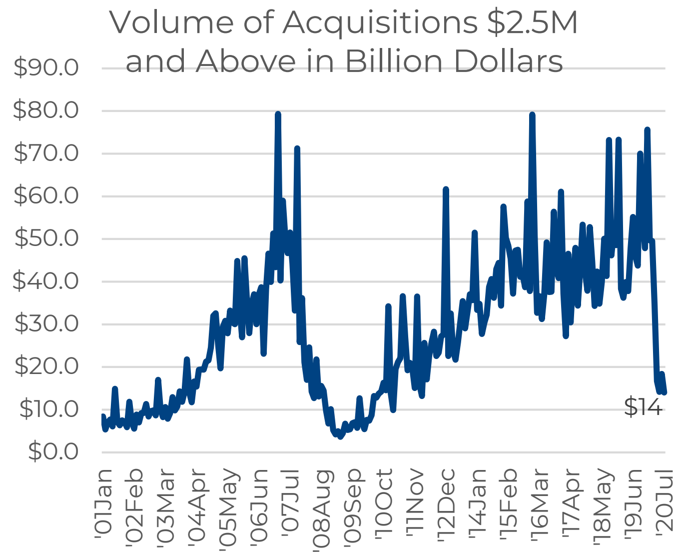
Commercial sales transactions of $2.5M contract 69.5% year-over-year in July 2020, hitting all core property types

Commercial sales/acquisitions for properties or portfolio acquisitions of $2.5 million or over in apartment, office, industrial, hotel, development site, and senior housing and care assets contracted by 69.5% in July 2020, according to Real Capital Analytics. Sales plummeted to $14 billion during the month of July, which is below the pre-pandemic level of about $40 to $50 billion dollars monthly. During the Great Recession, sales hit a low of $3.6 billion.

Sales of all property types— even for industrial—declined by over 50% year-over-year, with the largest declines in retail and apartment: apartment, -74%, office, -67%; industrial, -53%; retail, -75%.

The risk premium, measured as the difference between the cap rate and the safer 10-year T-bond, has increased across all asset classes, indicating investors perceive greater risk of investing in commercial assets. Apartment still has the lowest risk premium, at 4.7%, but the risk premium is up from 2.4% in the last months of 2018. Risk premiums are about the same level during the Great Recession.





Acquisitions of Properties or Portfolios of $2.5 Million and Greater

	July '20		Year to Date	
	Vol ($b)	YOY	Vol ($b)	YOY
Office	3.5	-67%	46.3	-41%
Retail	1.3	-75%	19.5	-44%
Industrial	3.4	-53%	50.1	10%
Hotel	0.4	-84%	6.1	-66%
Apartment	4.0	-74%	58.9	-42%
Snr Hsg & Care	0.4	-87%	5.2	-52%
Dev Site	0.9	-39%	11.0	-13%
Total	14.0	-69%	197.1	-35%

Source: Real Capital Analytics. Data on commercial real estate transactions of properties or portfolios of $2.5 million or greater cited in this report are sourced from Real Capital Analytics.

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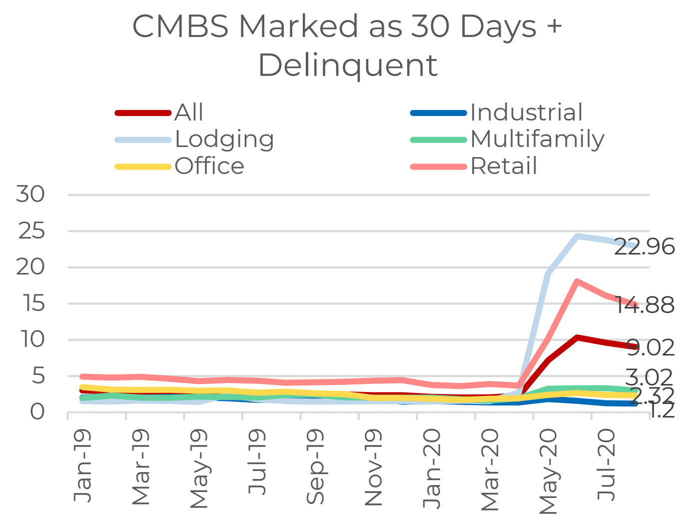
Commercial Market Overview

CMBS delinquency rates decline to 9% in August

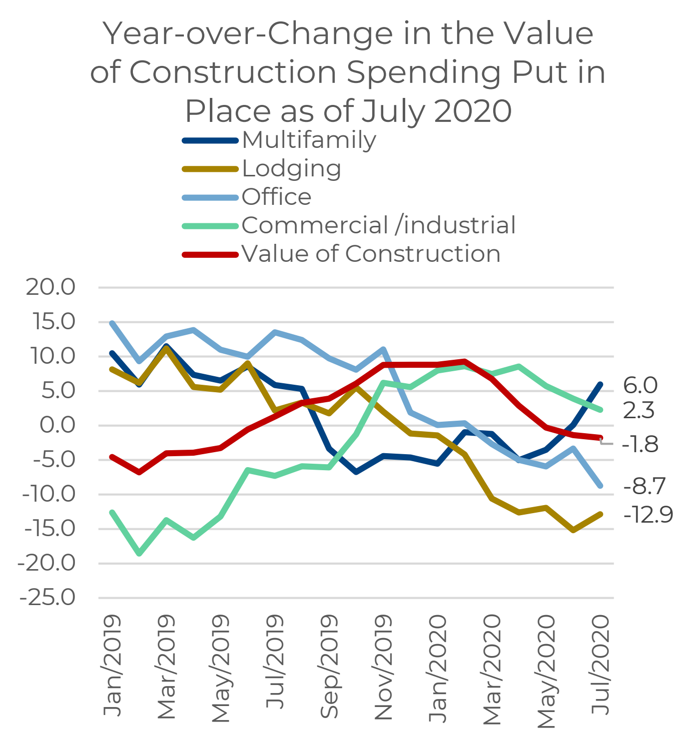
Overall delinquency rates declined in August to 9%, down from a peak of 10.3% in June. Delinquency rates declined across securities backed by multifamily, office, industrial, retail, and lodging properties. CMBS backed by industrial properties had the lowest delinquency rate at 1.2% followed by office 15 2.32%, then multifamily at 3.02%. Securities backed by lodging properties have highest delinquency rate, at 22.96%, followed by retail, at 14.88%. Despite the drop in office gross leasing volume, office delinquency rates have remained modest.



Source: Trepp

Construction spending declined 1.8% in July

The value of construction spending declined for the fifth straight month in July, with the annualized level of construction down by 1.8%. The annualized level of construction spending only increased for multifamily (6%) and commercial buildings (2.3%) properties. 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. With 25% of workers still working from home and as businesses adopt a wait-and-see stance regarding their office expansions, construction for office buildings fell 8.7%. Construction for lodging contracted by 12.7% amid continued social distancing measures (online events vs. live meetings) to control covid-19 infections.



Source: US Census Bureau

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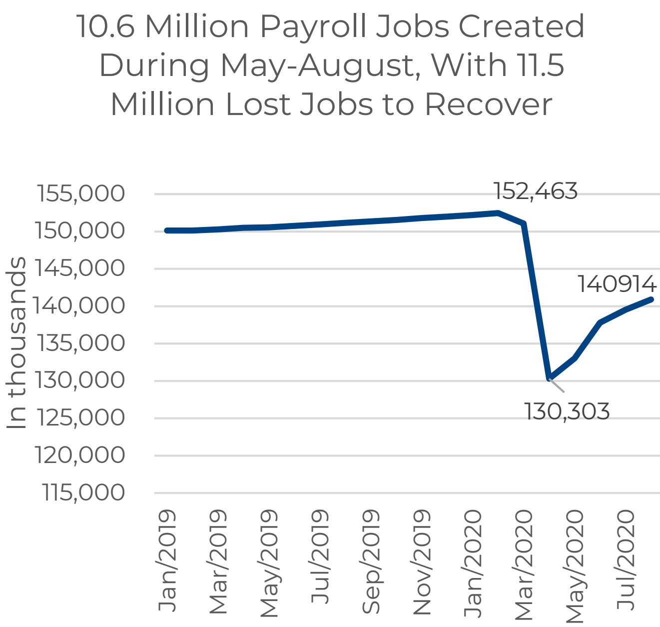
Commercial Market Overview

10.6 M Net Payroll Jobs May-August with 11.5 M Jobs to Recover

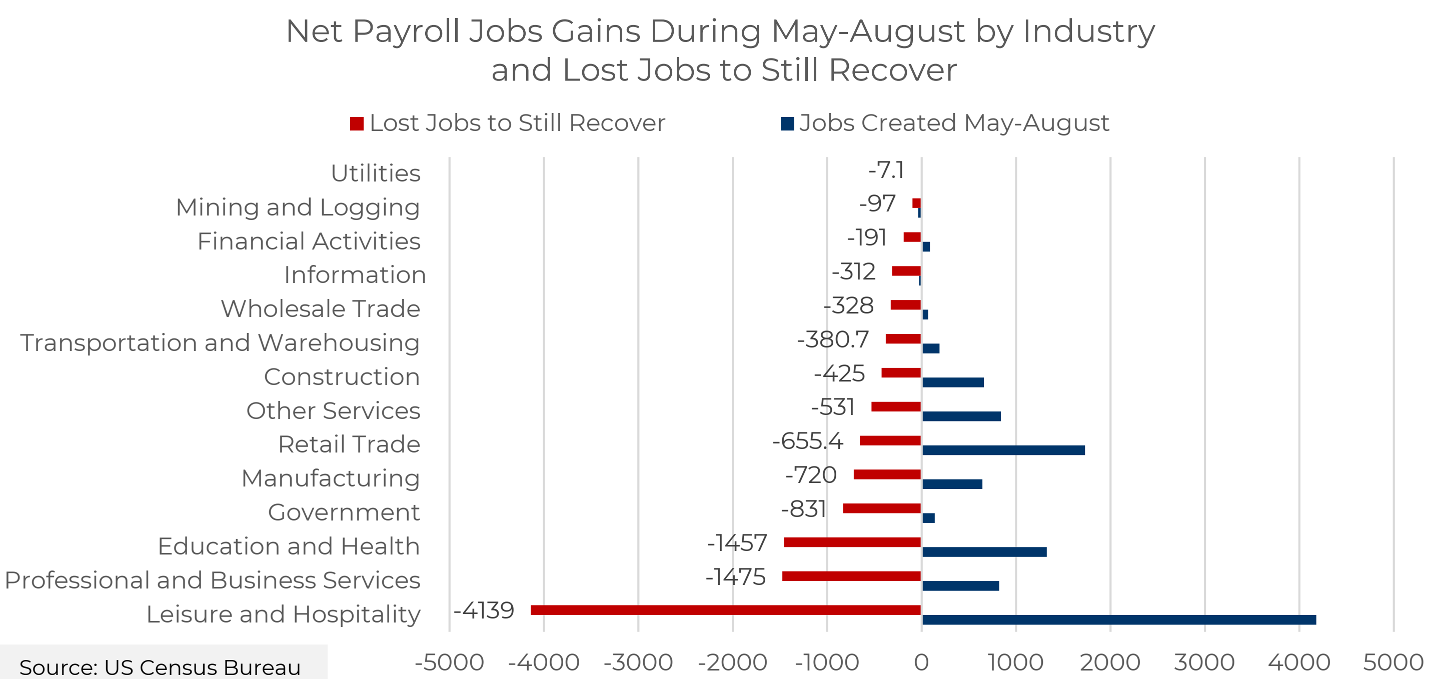
Sustained job recovery is essential to the turnaround of commercial real estate sales and leasing transactions. The economy created 10.6 million net new payroll jobs during May—July, through July, with 55% of those gains created in the leisure and hospitality (food services, accommodation, recreation) and retail trade industries.

All private industries created net new payroll jobs, except utilities, information, and mining and logging.

While nearly all industries have been gaining lost jobs, there is still a lot of lost jobs to recover, particularly in education and health, professional and business services, and leisure and hospitality. Vacancy rates for office space and retail brick and mortars will remain elevated until a full recovery of lost jobs.



Source: BLS Establishment



Source: US Census Bureau

Apartment

Continued investor interest in mid/high rise apartments

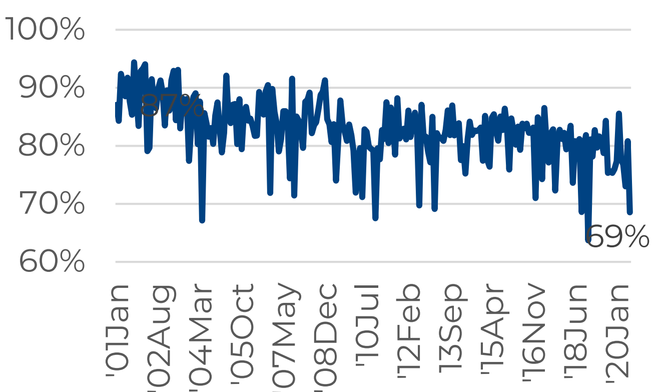
Acquisitions of apartment properties or portfolios of $2.5 million or over declined 74% in July 2020 compared to one year ago. Year-to-date, sales are down 42%. Acquisitions fell in both garden (low-rise, 3 floors or less) apartment and in mid/high-rise apartments.

The price per unit of apartments has decreased by about 7% since January 2020 for both garden and mid-high rise apartments. But mid-high rise apartments continue to fetch a higher price premium compared to low to rise apartments, with a 0.5 percentage point differential in the average cap rates. The development of garden type apartments has been declining as builders maximize the use of scarce land.

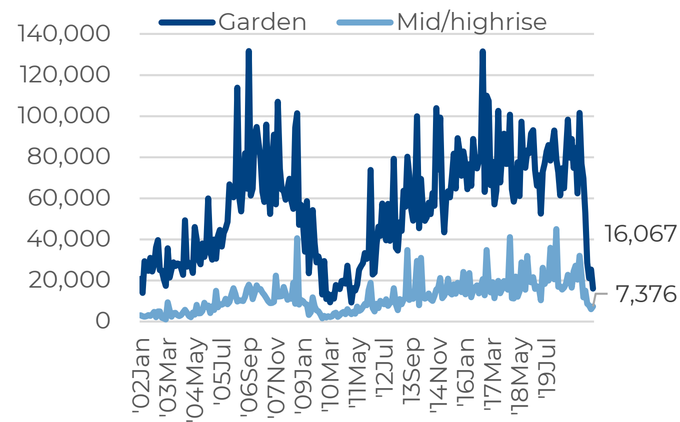
Apartment Volume 2020

	July '20		Year to Date	
	Vol ($b)	YOY	Vol ($b)	YOY
Apartment Total	4.0	-74%	58.9	-42%
Garden	2.1	-79%	38.9	-42%
Mid/Highrise	1.9	-66%	20.0	-42%
Single Asset	3.3	-74%	44.6	-42%
Portfolio	0.7	-77%	14.3	-39%

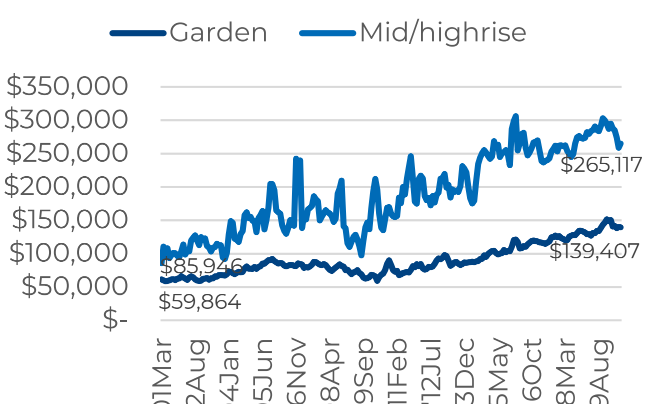
Share of Garden/Low-rise Apartment Sales to Total Apartment Sales



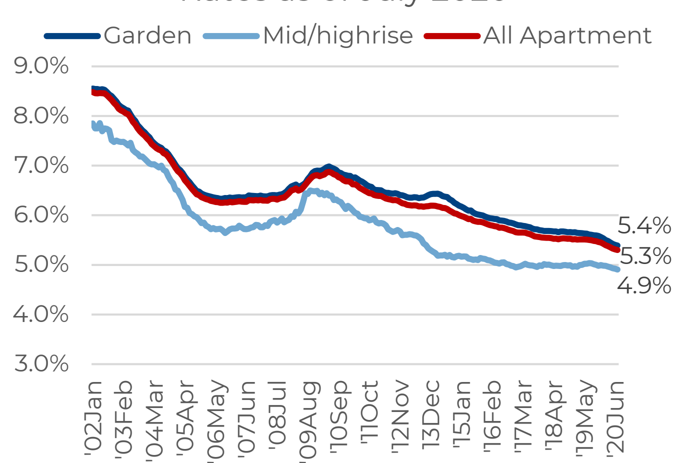
Number of Apartment Units Sold



Average Sales Price Per Apartment Unit



Multifamily Acquisitions Cap Rates as of July 2020



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Office

Deeper contraction in CBD market vs. suburban

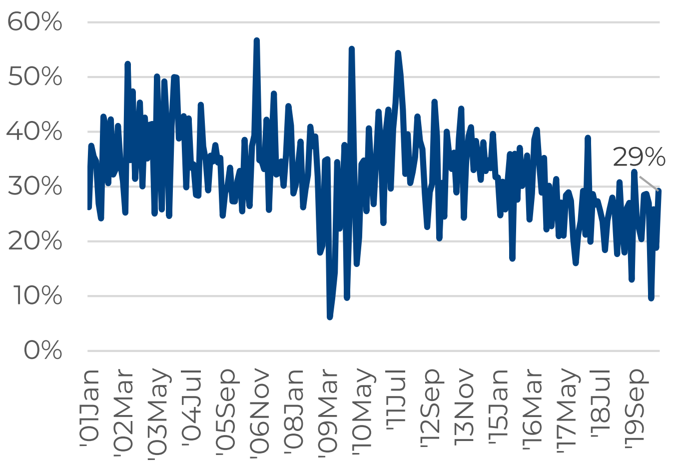
Acquisitions of office properties or portfolios of $2.5 million or over declined 67% in July 2020 compared to one year ago. Year-to-date, sales are down 41% year-over-year. Sales have declined more in the CBD markets (-47% YTD) compared to the suburban markets (-37% YTD) . This may indicate some shift towards suburban markets, but this may also still be a reflection of the lingering impact of the lockdowns in the CBD markets such as New York and Washington, DC.

Suburban office space costs about half the cost of CBD office space, and this cost differential will sustain the shift towards suburban offices, a trend that started in 2012 as the cost of CBD office space started rising rapidly.

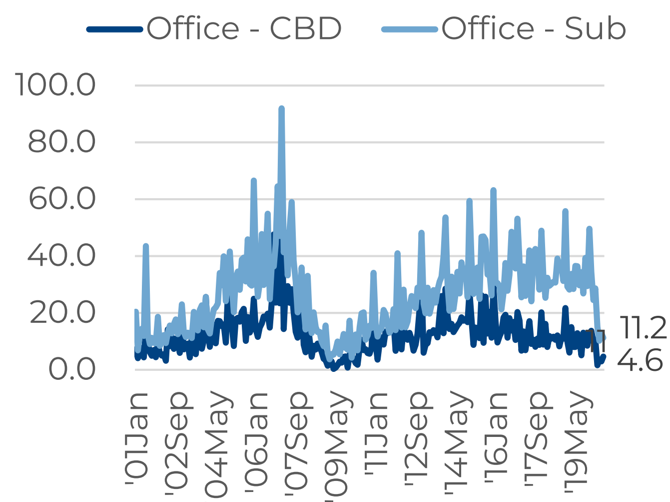
Office Volume 2020

	July '20		Year to Date	
	Vol ($b)	YOY	Vol ($b)	YOY
Office Total	3.5	-67%	46.3	-41%
CBD	1.1	-76%	15.9	-47%
Sub	2.5	-62%	30.4	-37%
Portfolio	1.0	-58%	10.5	-34%
Single Asset	2.6	-70%	35.8	-43%

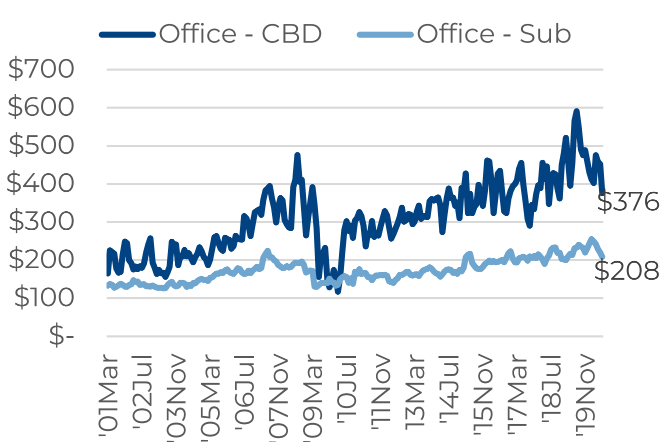
Share of CBD Office Units to Total Office Unit Sales



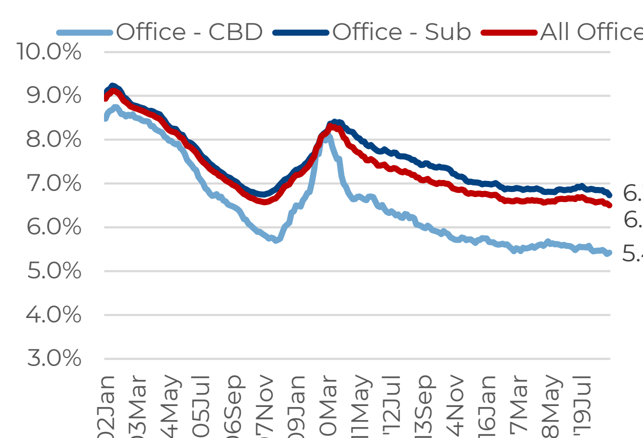
Number of Office Units Sold



Average Sales Price Per Square Foot for Office Properties



Office Acquisitions Cap Rates as of July 2020



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Industrial

Industrial declines in July but warehouse up year-to-date

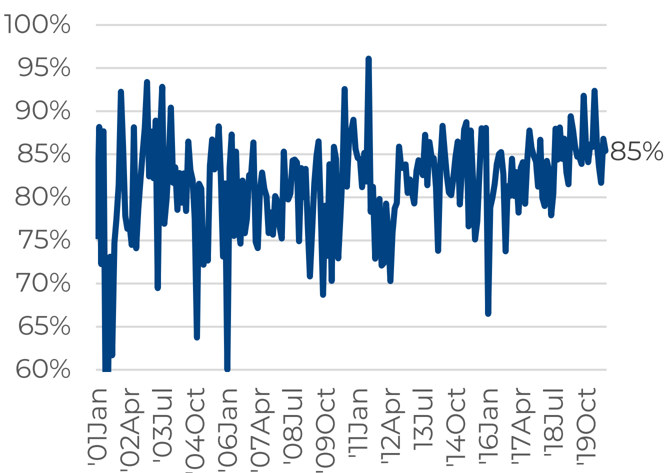
Commercial sales/acquisitions of industrial properties or portfolio acquisitions of $2.5 million or over declined 53% in July 2020 compared to one year ago. Year-to-date, sales are still up 10% due to acquisitions of warehouse properties. However, both flex and warehouse sales fell 50% year-over-year in July.

Warehouses are fetching a better price compared to flex industrial spaces, with a 0.4 percentage point difference. The recovery in consumption demand and the growth of online sales is expected to lead to a recovery in the demand for warehouse space, which accounted for 85% of total sales in July.

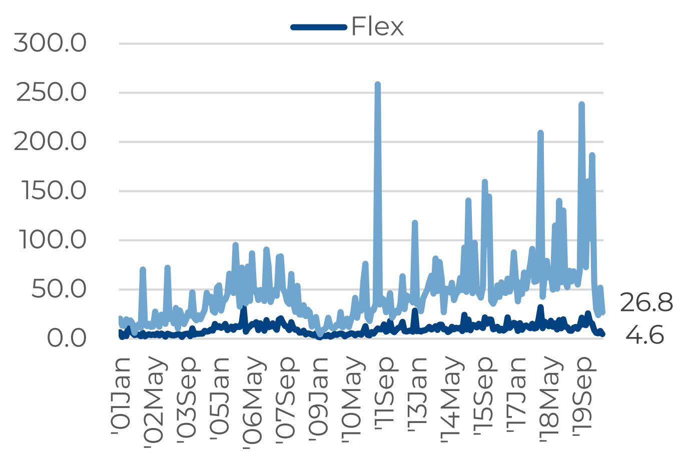
Industrial Volume 2020

	July '20		Year to Date	
	Vol ($b)	YOY	Vol ($b)	YOY
Industrial Total	3.4	-53%	50.1	10%
Flex	0.8	-59%	8.9	-11%
Warehouse	2.6	-50%	41.2	17%
Single Asset	2.6	-53%	24.1	-25%
Portfolio	0.9	-52%	25.9	96%

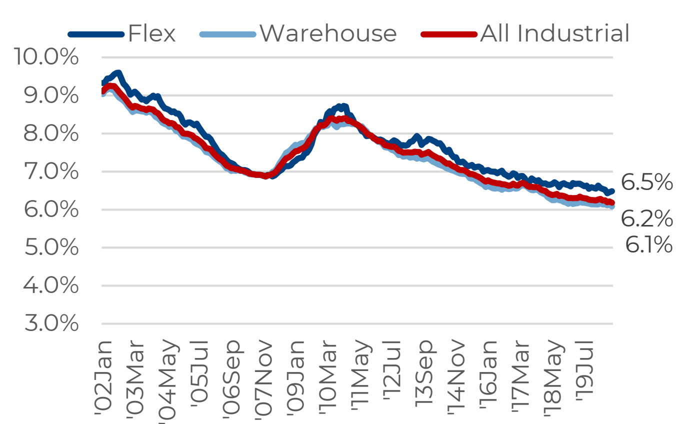
Share of Warehouse Unit Sales to Total Industrial Unit Sales



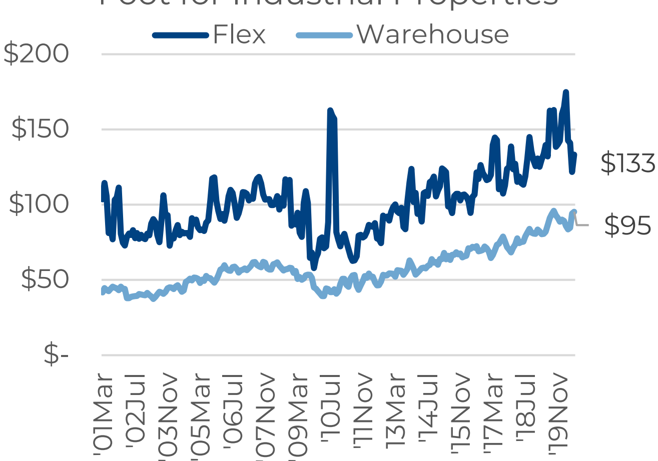
Number of Industrial Units Sold in Million Units



Industrial Acquisitions Cap Rates as of July 2020



Average Sales Price Per Square Foot for Industrial Properties



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Retail

Multi-tenant centers hit harder than single-tenant shops

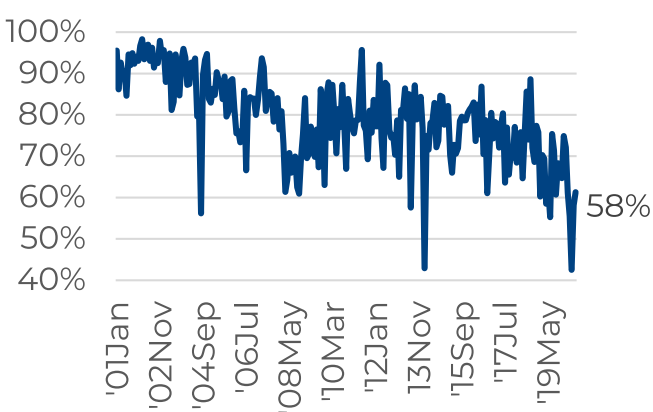
Commercial sales/acquisitions of retail properties or portfolio acquisitions of $2.5 million or over declined 75% in July 2020 compared to one year ago. Year-to-date, sales are down 44%. Investor acquisitions for shopping centers (multiple tenants and 30,000 square feet or more) has contracted more than acquisitions for shops (retail spaces usually occupied by a single tenant and/or under 30,000 square feet).

However, the shops that are being acquired by investors are being acquired on average for 10% less in July compared to March. The cap rate for shopping centers is at 7.1% compared to 6.1% for shops. Shopping center acquisitions accounted for 58% of total sales, down from about 90% in 1990.

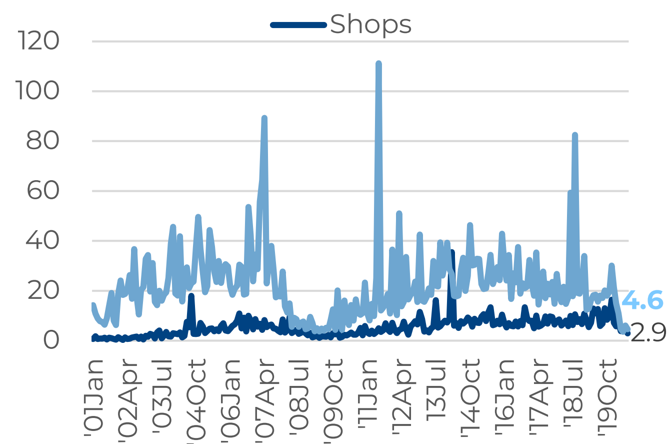
Retail Volume 2020

	July '20		Year to Date	
	Vol ($b)	YOY	Vol ($b)	YOY
Retail Total	1.3	-75%	19.5	-44%
Centers	0.5	-84%	10.0	-45%
Shops	0.8	-56%	9.5	-42%
Single Asset	1.3	-72%	17.4	-40%
Portfolio	0.1	-90%	2.1	-63%

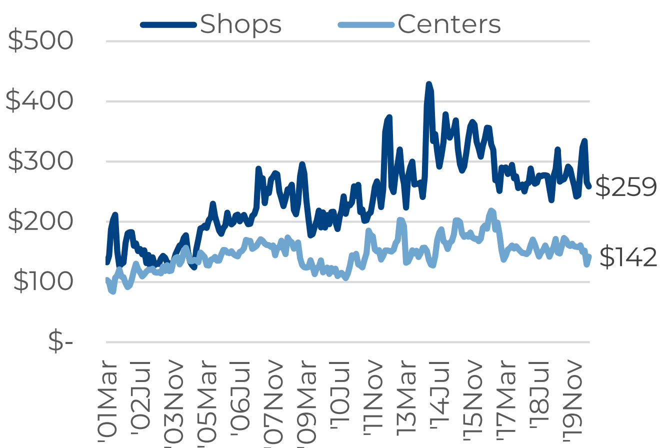
Share of Sales of Units in Shopping Centers to Total Retail Property Sales



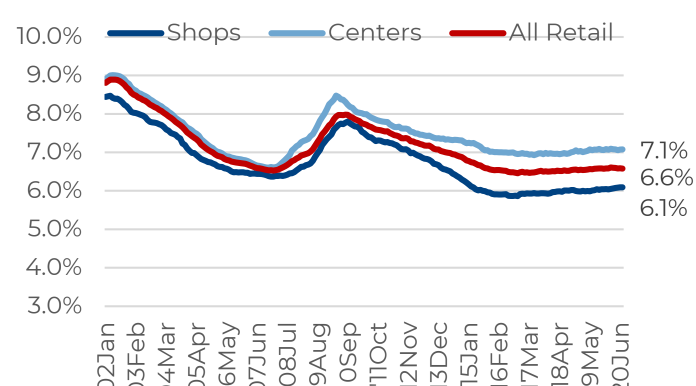
Number of Retail Properties Sold



Average Sales Price Per Square Foot for Retail Properties



Retail Acquisitions Cap Rates as of July 2020



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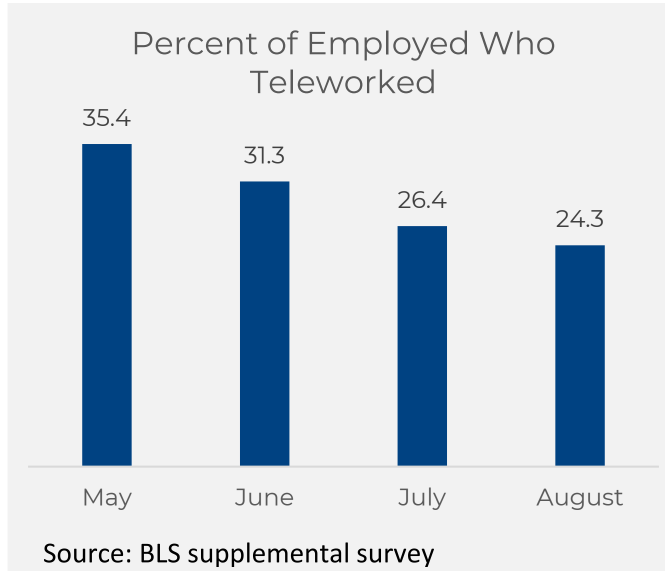
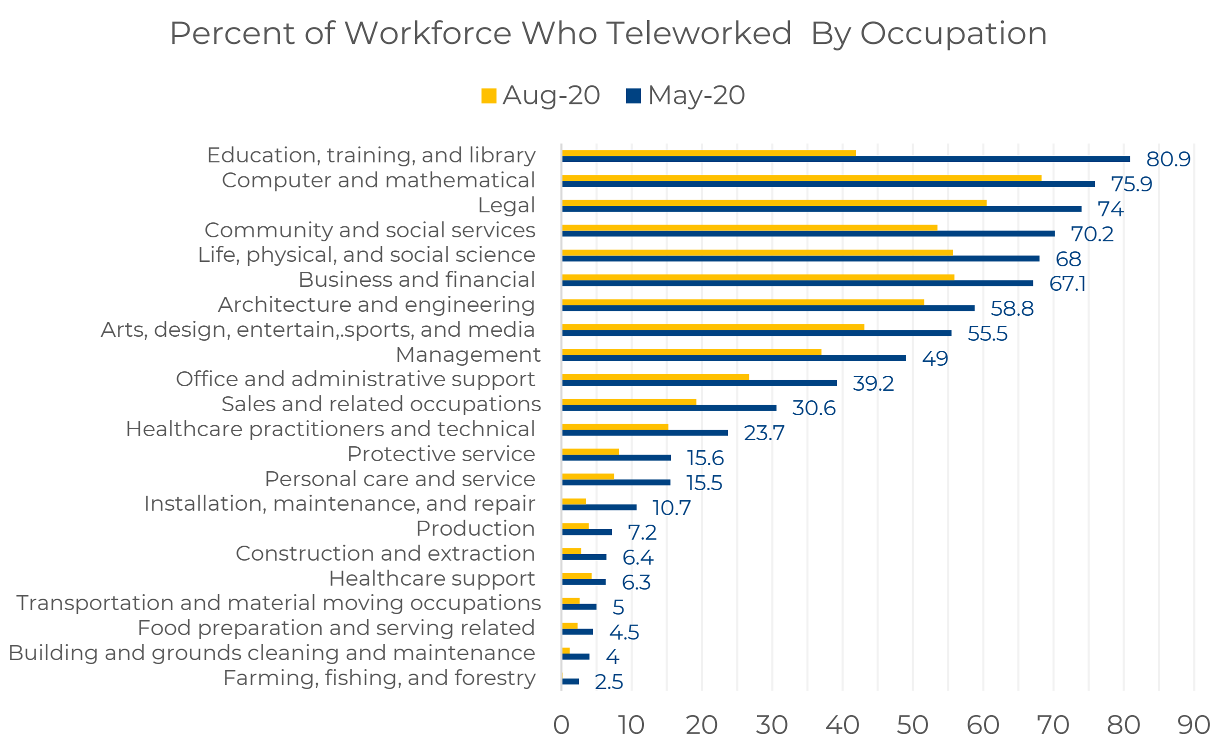
Workers Starting to Head Back to the Office

Workers are slowly returning to the office, according to the Bureau of Labor Statistics supplementary survey. As of August, only 24% of employed workers 16 years old and over who worked either full or part time teleworked. Much of that decline came from the decline in the share of teleworking employees with education, training, and library occupations, from 81% to 42%.

In occupations related to education, computer, legal, sciences, business, engineering, and arts, more than half of the workforce teleworked. While there is a downward trend in the fraction of office-using occupations, these rates are still about 10 times than the 5% fraction of workers who worked at home prior to the pandemic. While states no longer have shelter in place orders, the fraction of workers working from home has remained elevated as businesses are still in the process of preparing their offices for a safe re-entry of workers.





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Workers Starting to Head Back to the Office

How companies will be receptive to having their employees work from home depends on the nature of the business and the technological infrastructure that enable employees to work from home productively. One would expect that in areas where a large fraction of the workforce is in office-using occupations and where broadband service is provided efficiently, companies may be more open to having their workers work from home for at least some days of the week to save employees travel time. In addition to working from home, they may also allow flexible work times to provide a better work-life balance for employees.

In its 2020 Work from Home Counties Report. NAR looked at nine factors related to internet connectivity, urbanization, office-related jobs, home affordability, and a county's population growth to assess the conditions that support working from home in approximately 3,000 counties. Texas leads all states with seven counties among the top 30. Virginia is second with four, followed by Colorado and Georgia with three each, and Florida and North Carolina with two apiece. The following states have one county each within the top 30: Indiana, Iowa, Kansas, Minnesota, New Mexico, Ohio, South Dakota, Tennessee, and Utah.

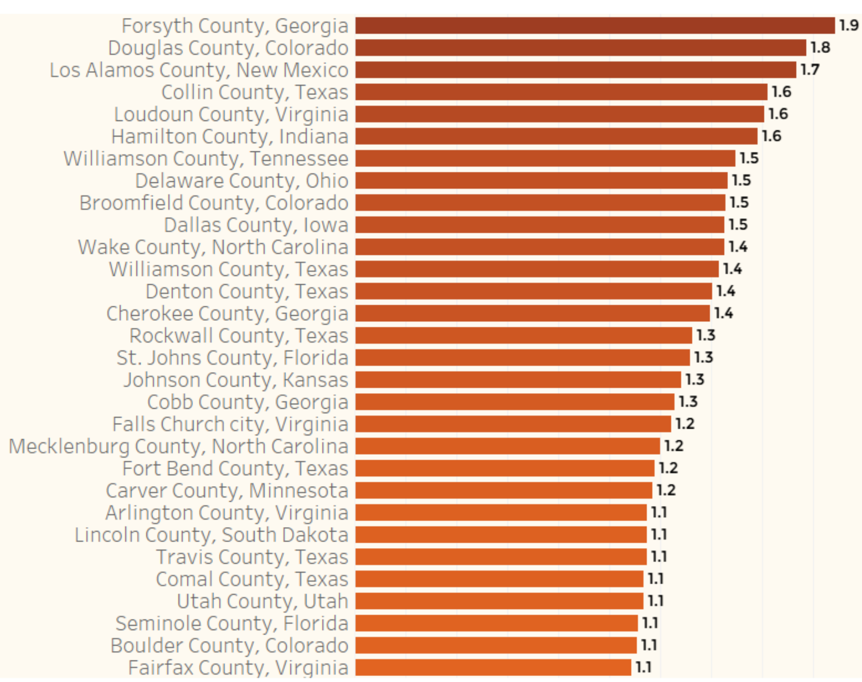
NAR Work from Home Score ranked counties that offered best opportunity for working from home based on 9 factors:

- percent of households with computer or laptop
- percent of households with internet broadband access
- percent of population with 3 or more providers
- percent of workers who worked at home
- percent of area that is urban
- population growth from 2014 to 2019
- percent of population working in the information; finance and insurance; real estate, rental, and leasing; and professional, scientific, management, administrative and waste services,
- median value of property to median household income
- percent of housing units with a mortgage who spent 30% or more of income on housing costs

Counties that are attractive to the working from home workforce will see an increased demand for homes and retail trade business (online and offline).

Top 1% Work from Home Counties

NAR Work from Home Score



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Workers Starting to Head Back to the Office

Impact of Working from Home on Worker Productivity

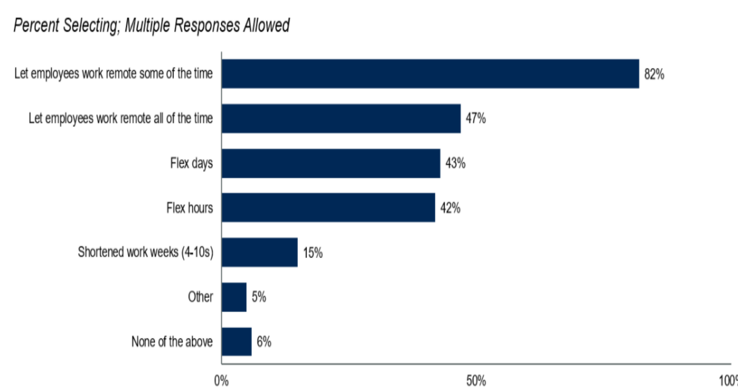
Where and for how long the trend will hit a new normal will likely continue to take some time as businesses assess the impact on worker productivity and on building a strong office culture.

Working from home has positive and negative effects. For example, Agile, a company that studies the impact of work from home on workers found that teleworkers are 35% to 40% more productive (such as Best Buy, Dow Chemicals, and British Telecom workers). Sun Microsystems employees spent 60% of the commuting time saved by doing work (Agile).

On the other hand, Nicholas Bloom, a senior fellow at the Stanford Institute for Economic Policy Research (SIEPR) who studies worker productivity, conducted an experiment that explicitly asked employees to work from home four days a week and come into the office every fifth day. After nine months of allowing those employees to do their jobs at home, half of them requested to return to the office, despite their average commute being 40 minutes each way. The reason was that the workers wanted social company, and they reported "feeling isolated, lonely and depressed at home." Bloom also warns that the challenging aspects of working from home— attending to the education of children and working in unsuitable spaces with little privacy— will "create a productivity disaster for firms." (Stanford News).

Given the pros and cons of working from home, what could be the new norm is a hybrid model where workers spend a mix of time between working from home and at the office. In a Gartner, Inc. survey on June 5 of 127 company leaders, 82% of respondents intended to permit remote working some of the time. Nearly half (47%) said they intend to allow employees to work remotely full time. About four in ten reported they will grant employees flex time (see Figure 1).

Figure 1: Company leader intentions regarding flexible working after COVID-19



n = 127
Q: Are you, or do you plan on, providing any of the following flexibilities to employees as you reopen closed workplaces? Select all that apply..
Source: Gartner Return to the Workplace Benchmarking Against Your Peers Webinar Poll (5 June 2020)

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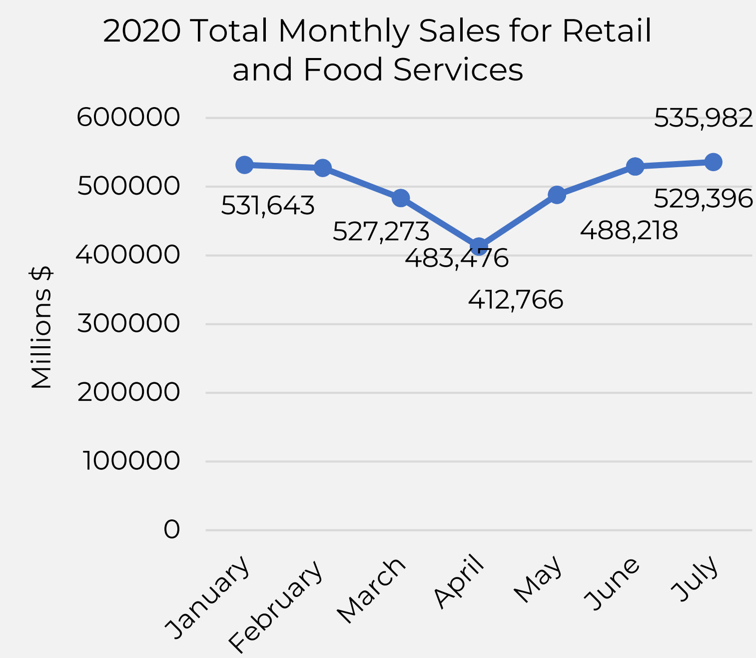
Food Delivery Services Continue to Surge

Retail and food services sales are no longer just recovering, but are surging, in part due to strong food service sales. Retail and food service sales rose 2.7% in July from one year ago and have exceeded the pre-pandemic level, reaching $536 billion in July, according to advanced estimates of the US Census Bureau.

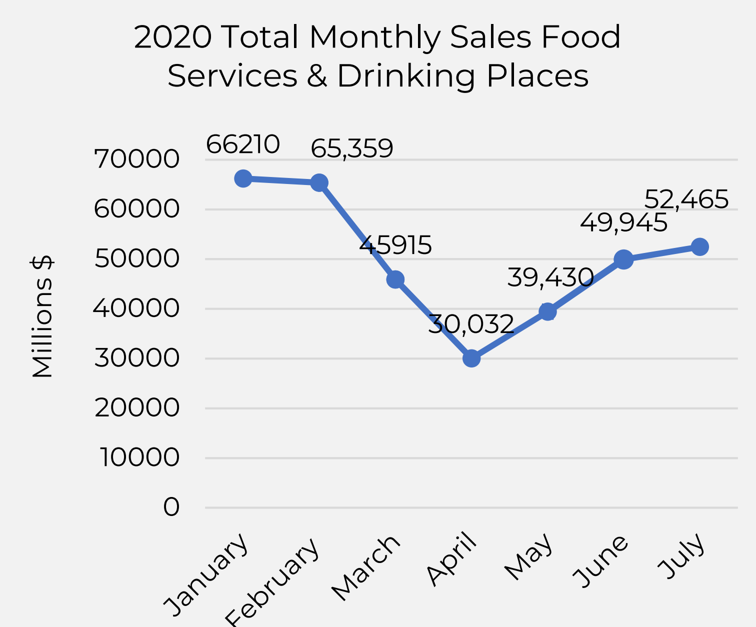
A component of retail and food service sales that has seen a strong growth is sales in food services and drinking places. While sales are still slightly down from pre-pandemic levels, sales are up 5% from June and up significantly at 74%, at $52 billion, from the bottom experienced in April as the economy began to reopen in May and consumers felt some confidence in returning to the traditional dine-in restaurant experience.

While on-demand food delivery was a trend increasingly gaining popularity prior to the pandemic, the on-demand food delivery culture saw food delivery sales reach new heights as consumers placed orders for their favorite dishes from their favorite restaurants online. According to data collected from Second Measure, a data analytics company, monthly sales for food delivery companies such as DoorDash, Uber Eats, Grubhub and Postmates not only continued to grow throughout the coronavirus pandemic but continued to grow when the economy reopened.

Although the July monthly sales were slightly down from the high experienced in May, July's food delivery monthly sales for DoorDash, Grubhub, Postmates and Uber Eats represent a year-over-year increase of 172%. Food delivery sales slightly dipped in June as consumers returned to the traditional dine-in experience.



Source: U.S. Census Bureau



Source: U.S. Census Bureau

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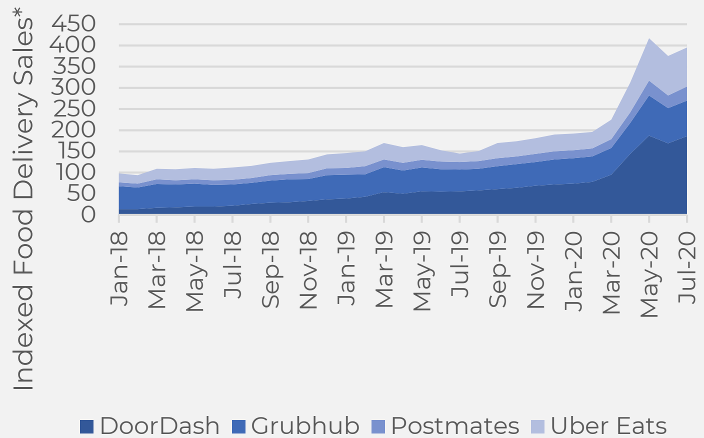
Food Delivery Services Continue to Surge

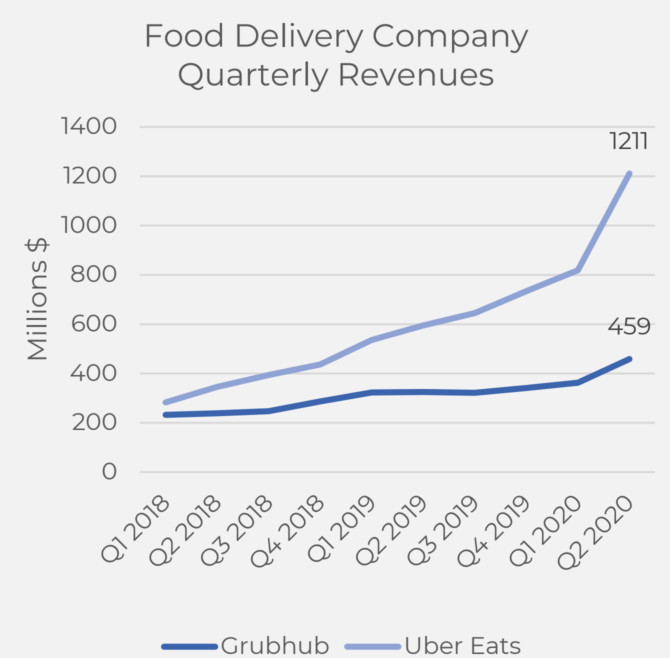
Food delivery company revenues are rising to new record levels.. The second quarter 2020 results indicate increased revenue for food delivery companies such as Uber Eats and Grubhub. Uber Eats revenue for three months ending on June 30 grew 103% year-over-year to $1.2 billion and increased 47% from first quarter 2020 revenues. Uber Eats competitor, Grubhub, had an 41% year-over-year increase for $459.3 million, up from $325.1 million in the second quarter of 2019 and increased 26% from first quarter 2020.

To continue moving the industry forward by delivering new products, technologies and capitalizing on the momentum of food delivery, these flourishing food delivery firms are making the moves to do so. Uber agreed to acquire Postmates for approximately $2.65 billion, acquired Routemate, a leading provider of software/SaaS solutions to public transportations systems and agreed to acquire Autocab, a technology company that provides taxi and other operators with booking and dispatching software. Grubhub is to combine with Just Eat Takeaway.com for $7.3 billion in an all-stock transaction that would create the largest online food delivery firm outside of China and DoorDash is to partner with CVS Pharmacy for same-day delivery of food, groceries, and non-food products.

While it is too early to determine whether consumer food delivery habits will continue, the U.S. continues to be an underpenetrated market with a potential revenue upside across its total addressable market with strong trends for food delivery that are persisting throughout the coronavirus pandemic and the reopening of the economy. By that same vigor continuing in July, it becomes more evident that the coronavirus pandemic may not be a temporary demand peak but more like a permanent catalyst as it boosts the shift towards ordering food online.



* Sales are indexed to food delivery January 2018 (sales=100)
Source: Second Measure



Source: Company filings

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COMMERCIAL MONTHLY INSIGHTS REPORT
September 2020

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Chief Economist & Senior Vice President for Research

GAY CORORATON
Senior Economist & Director of Housing and Commercial Research

BRANDON HARDIN
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