Commercial Market Insights

May 2021

National Association of REALTORS® Research Group

NATIONAL ASSOCIATION OF REALTORS®

Contents

The commercial real estate market is recovering, although commercial real estate transactions and the underlying market fundamentals are still weak compared to pre-pandemic conditions.

Year-to-date through April 2021, commercial transactions were 10% below the level one year ago. Commercial real estate prices continue to firm up, but valuations were still broadly down by 5% in April compared to January 2020.

Cap rates, adjusted for the risk-free 10-year T-bond yield (1.6% in April 2021), continued to trend downwards, which means commercial prices are firming up and that investors are more confident of the cash flow outlook of the acquired properties.

Secondary/tertiary cities and the suburban areas are still outperforming the primary cities. On a year-over-year basis, apartment rents and office rents are still below pre-pandemic levels in San Francisco, Seattle, New York, and Washington DC . However, apartment rents are rising in 95% of metro areas given the tight supply of housing, owned and rented.

Investors have been acquiring some hotels for conversion into multifamily housing as documented in NAR's [Case Studies on Repurposing Vacant Hotels/Motels into Multifamily Housing.]

E-commerce and the accelerated use of technology during this working-from-home period has been the growth driver for industrial properties and non-core assets like data centers.

NAR Research anticipates that commercial transactions will continue to improve in 2021 and even more strongly in 2022, with the population practically vaccinated by the end of summer 2021, as more businesses increase their operating capacity, travel resumes, workers start heading back to the office, and consumers spend some of their savings on leisure and recreation and personal services.

Enjoy reading the latest issue!

Download the Case Studies on Repurposing Vacant Hotels/Motels into Multifamily Housing

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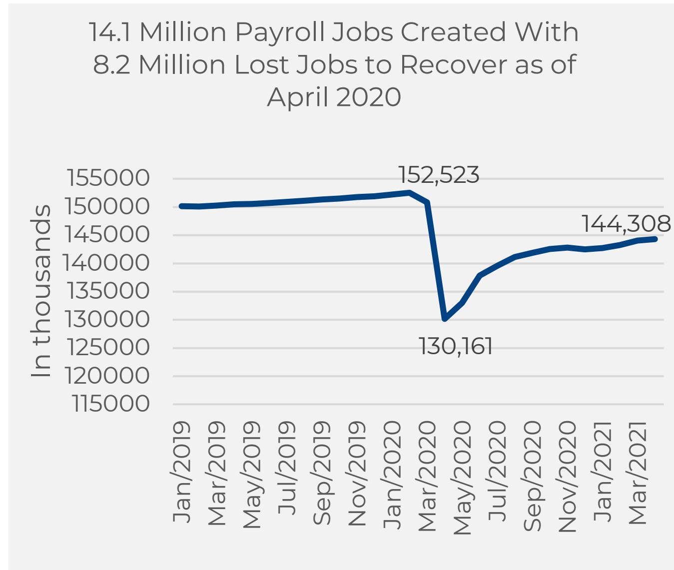
Economic Conditions

14.1 million payroll generated from May 2020-April 2021 with 8.2 million jobs to recover

The economy continues to recover and jobs are coming back, although at a modest pace compared to the third quarter surge. As of April 2021, the economy has gained 14.1 million jobs, or 63% of the 22.4 million jobs lost during March and April 2020. There are 8.2 million nonfarm payroll jobs still to be recovered.

About 34% of the 8.2 million jobs to still recover are in leisure and hospitality, followed by the government sector (local), health care and social assistance, professional and businesses services, and manufacturing. Only the finance and insurance industry had job gains.

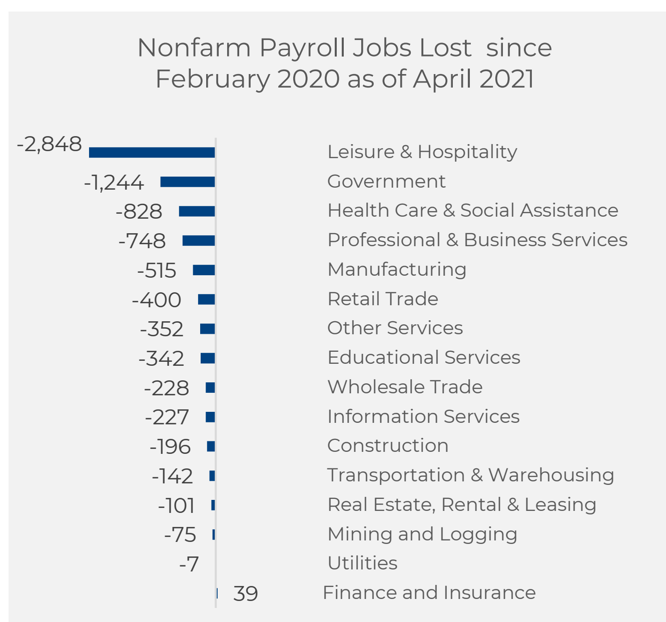
While jobs are coming back, only a few metro areas have more jobs as of April 2021 compared to February 2020.



Source: BLS Establishment Survey

Change in Nonfarm Payroll Employment in April 2021 vs. Feb 2020

Provo-Orem, UT	10.1
Ogden-Clearfield, UT	9.4
Ocean City, NJ	8.0
St. George, UT	4.9
Boise City, ID	4.3
Idaho Falls, ID	4.2
Coeur d'Alene, ID	3.8
Lakeland-Winter Haven, FL	3.5
Salisbury, MD-DE	2.1
Pocatello, ID	1.9
Elkhart-Goshen, IN	1.5
Logan, UT-ID	1.0
Crestview-Fort Walton Beach-Destin, FL	0.8
Winchester, VA-WV	0.6
Salt Lake City, UT	0.5
Panama City, FL	0.5
Lewiston, ID-WA	0.5
Daphne-Fairhope-Foley, AL	0.5
Waco, TX	0.4
Twin Falls, ID	0.4
KenneWick-Richland, WA	0.3
tle Beach-Conway-North Myrtle Beach, SC-NC	0.2
Sierra Vista-Douglas, AZ	0.2
Lake Havasu City-Kingman, AZ	0.2
Rapid City, SD	0.2
Joplin, MO	0.1
California-Lexington Park, MD	0.1

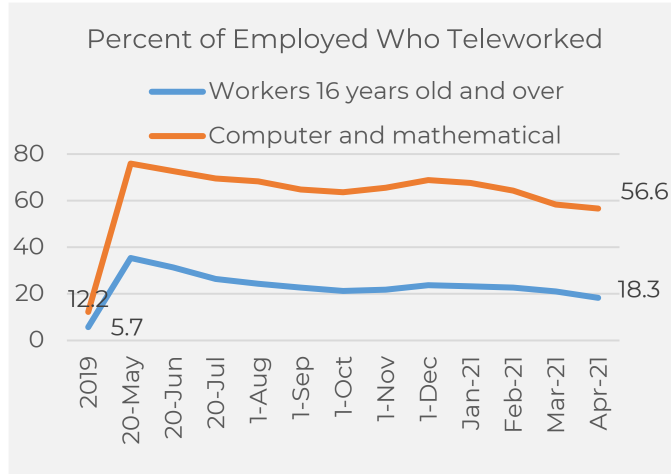


Source: BLS Establishment Survey

Economic Conditions

18% of the workforce still working from home

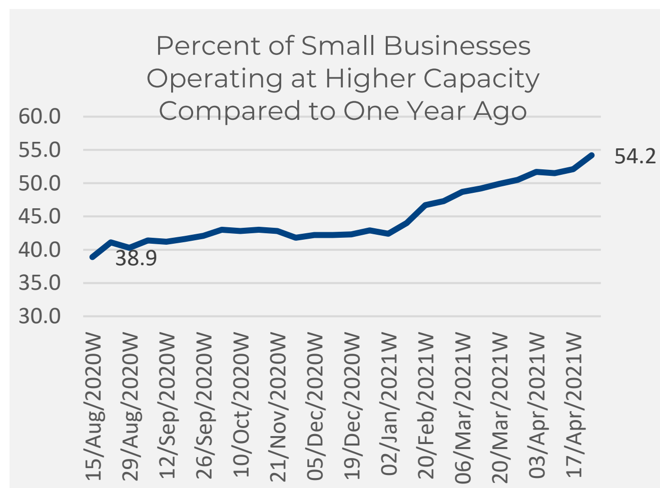
Workers continued to head back to the office. As of April, 18% of workers teleworked, down from a peak of 35%, but still about thrice the 5.7% share in 2019. Among computer and mathematical workers, 57% are teleworking, about five-fold from the 12% share in 2019. The fraction is likely to continue to decline as more people get vaccinated by the end of summer, with hybrid workstyle for some workers.



Source: BLS COVID-19 Supplemental Survey

54% of small businesses operating at higher capacity as of April 2021

As the economy continues to recover, a businesses are starting to operate at higher capacity. As of the week of May 22, 54% of small businesses were operating at higher capacity compared to one year ago as COVID-19 cases started to accelerate. Manufacturer's new orders during March 2021 were already slightly above pre-pandemic level.

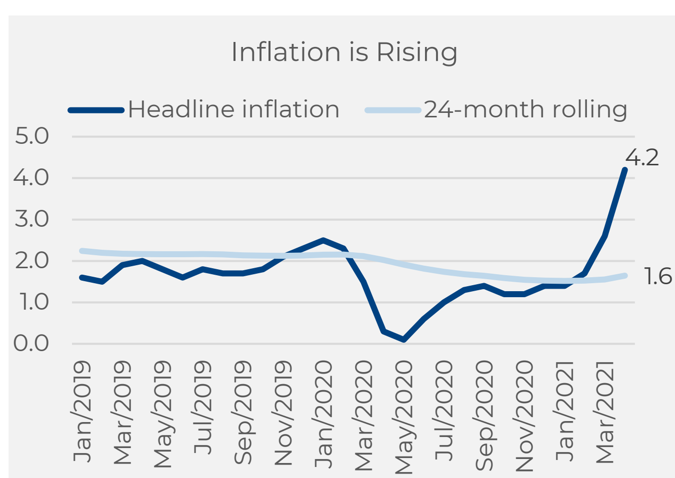


Source: US Census Bureau Small Business Pulse Survey

Inflation surged to 4.2% in April 2021

The inflation rate (all items) surged to a jaw-dropping 4.2% in April 2021 due to rising energy and transportation prices. Energy prices rose 25% while transportation prices rose 5.6% due to rising oil prices. The spot price for West Texas Intermediate rose to $61.7/barrel in April after plummeting to $16.6 one year ago at the nadir of the pandemic. Oil prices have been rising with rising global demand as the global economy recovers from the pandemic. Core inflation rate, which strips out prices of food and energy, also rose to 3%.

The Federal Open Market Committee has adopted an average inflation target in setting monetary policy. It has not defined the window of time to calculate the average. But on a 2-year rolling window, the average inflation rate (headline) is now at 1.6% which is near the 2% inflation target. This higher inflation rate will likely raise mortgage rates as investors anticipate the Fed will start to put the brakes on the easy monetary policy.



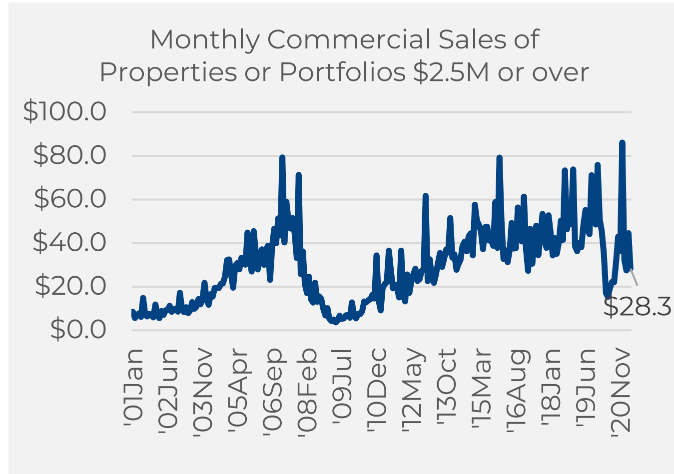
US Census Bureau

Commercial Market Overview

Commercial sales transactions during Jan-Apr 2021 are lower by 10% from year-ago level

Compared to the dollar sales volume in April one year ago as the COVID-19 pandemic was just unravelling, commercial real estate acquisitions of at least $2.5 million rose 66% in April to $28.2 billion. However, on a year-to-date basis, sales are still 10% below last year's level.

Year-to-date sales transactions were below the levels one year ago for office, retail, as well as industrial properties. However, the dollar volume of acquisitions increased for hotel, apartment, and senior housing assets. Investors have been acquiring some hotels for conversion into multifamily housing as documented in NAR's [*Case Studies on Repurposing Vacant Hotels/Motels into Multifamily Housing.*]



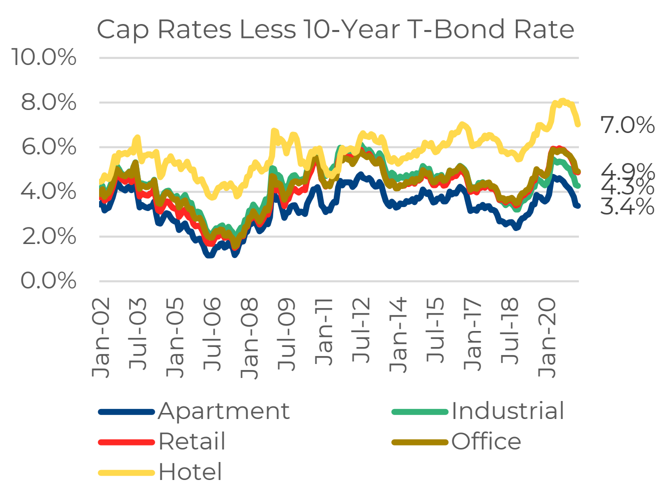
Source: Real Capital Analytics

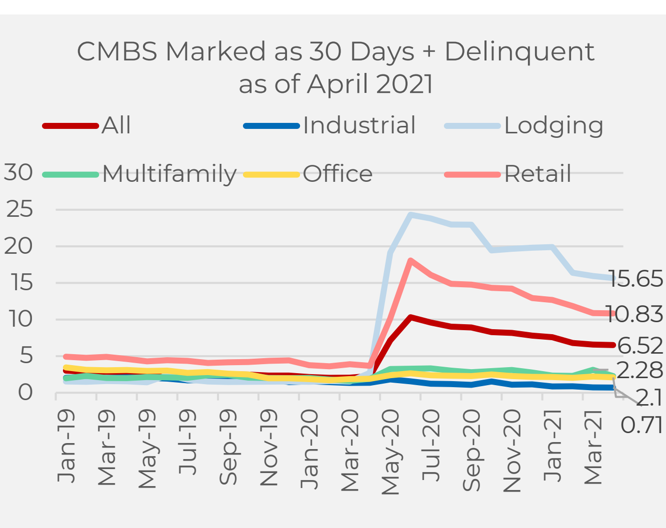
	YTD '21		
	Vol ($b)	YOY	Cap Rate
Office	28.0	-22%	6.6%
Retail	11.4	-24%	6.5%
Industrial	27.7	-12%	5.9%
Hotel	7.2	39%	8.6%
Apartment	48.3	5%	5.0%
Snr Hsg & Care	4.3	3%	5.5%
Dev Site	5.7	-43%	
Total	132.5	-10%	

*All-Property Index; excludes Hotel, Snr Hsg & Care

Cap rates are falling

Cap rates, adjusted for the risk-free 10-year T-bond yield (1.6% in April 2021), continued to trend downwards, which means commercial prices are firming up and that investors are more confident on the cash flow outlook of the acquired properties. Acquisitions for apartment properties had the lowest risk spread (cap rate less 10-year T-note) at 3.4 %, followed by industrial acquisitions, at 4.3%. Hotel acquisitions had the highest risk spread at 7.0%. Retail and office property acquisitions risk spread were both at 4.9%. Risk spreads have declined as the percentage of CMBS delinquent loans has also declined to 6.5%





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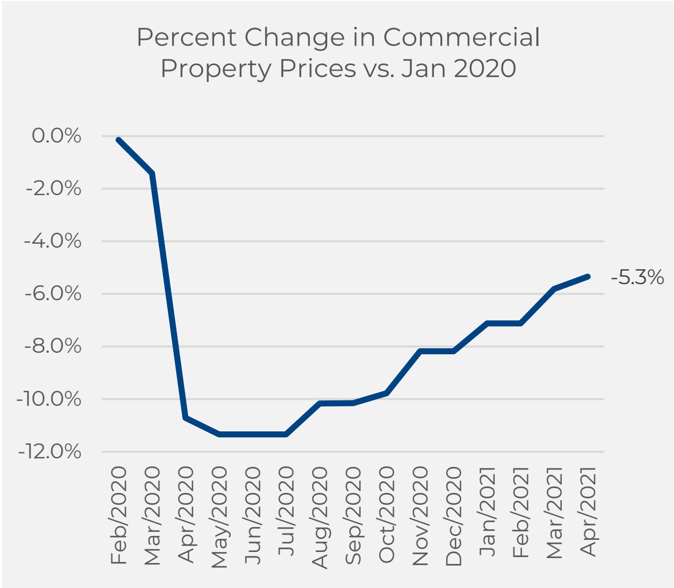
Commercial Market Overview

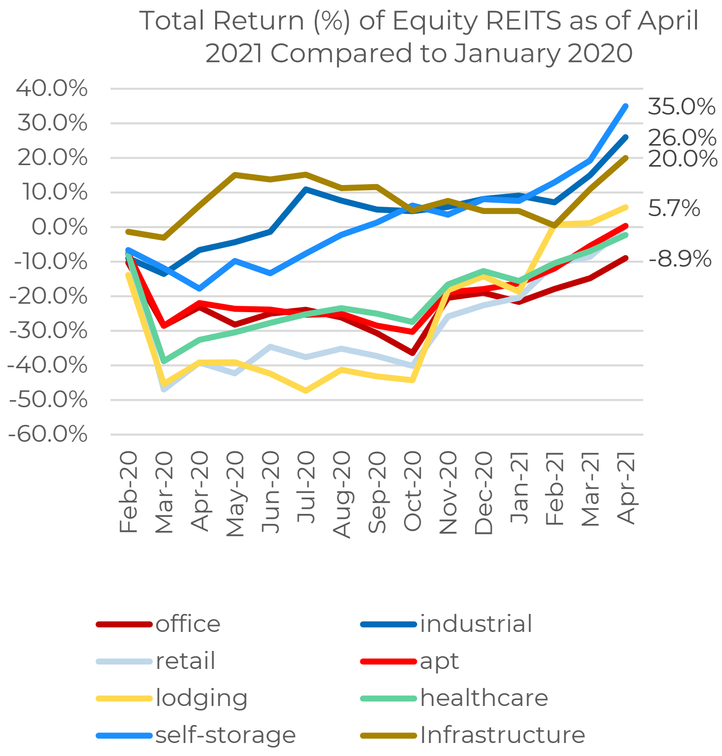
Commercial real estate prices are recovering, but are down 5% since January 2020

Commercial real estate prices continue to firm up, but the value of commercial real estate is still broadly down by 5% compared to the level in January 2020, based on the Green Street Commercial Price Index, an appraisal-based index of high-quality properties held by REITs. The decline has tapered off from about 10% in the second quarter of 2020. Among core properties only (multifamily, office, industrial, retail), prices are down by 3.5% from January 2020.



Real estate associated with e-commerce and infrastructure have highest returns

The return on REIT funds is a good indicator of the valuation of the properties that are held by REIT funds. The total return on REITs invested in various types of assets is positive, except for office REITs which continue to show a loss of nearly 9%. The highest total returns (price and dividend) as of April 2021 relative to January 2020 were in self-storage (35%), industrial (26%), and infrastructure (20%). The return on REITS invested in lodging has reversed from a loss to a positive return of about 6%, an indication that the hotel sector is recovering as travel is starting to pick up.



Source: Nareit

Source: Trepp

Multifamily

Transactions up 5% in Jan-April 2021 with higher demand for low-rises

Apartment sales transactions during Jan-Apr 2021 up 5% from year-ago level

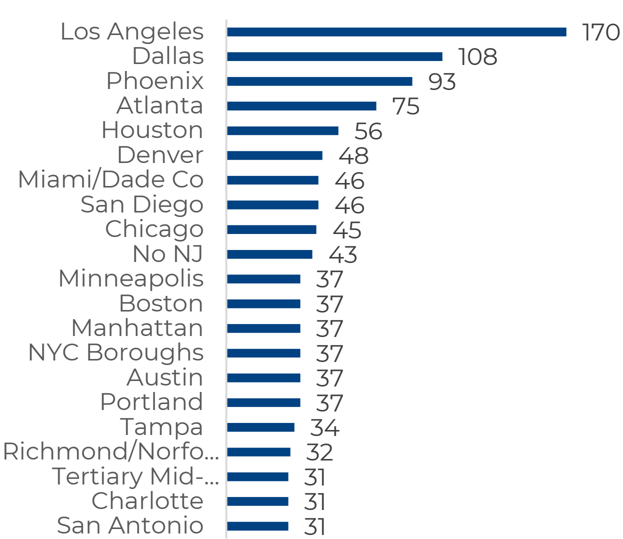
Acquisitions for multifamily properties of $2.5 million rose 5% in the first four months of the year from one year ago.

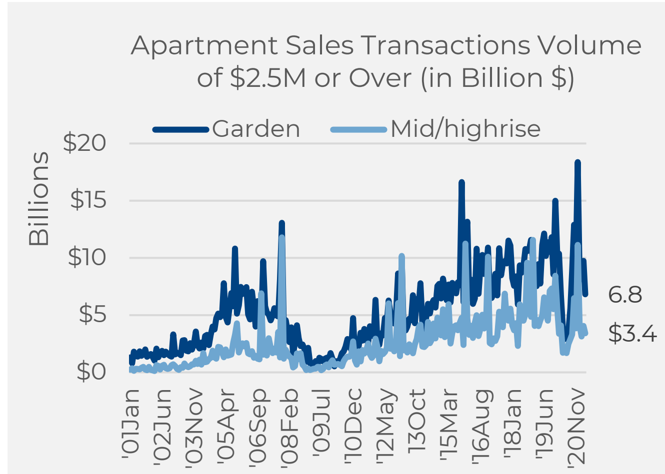
Acquisitions of garden or low-rises (less than four flours) was up 8% while acquisition for mid-to-high rises was down by 1%. Garden or low-rises are usually in the suburbs which indicates stronger demand for multifamily housing in the suburbs than in the central business districts.

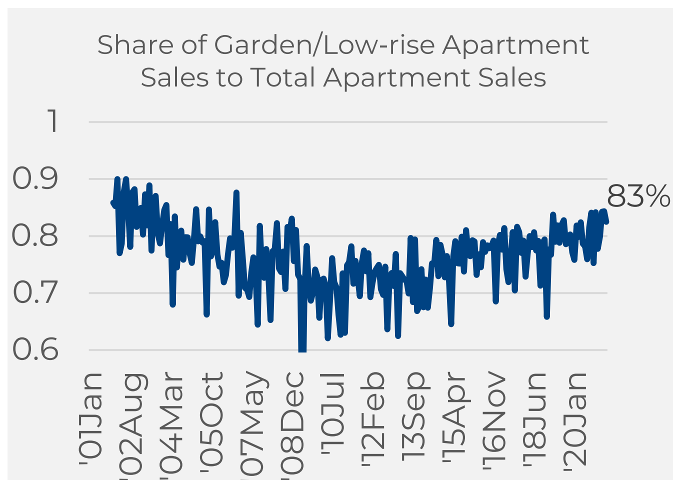
In fact, the share of garden or low-rises has been rising, to 83% of the total number of property acquisitions as of April.

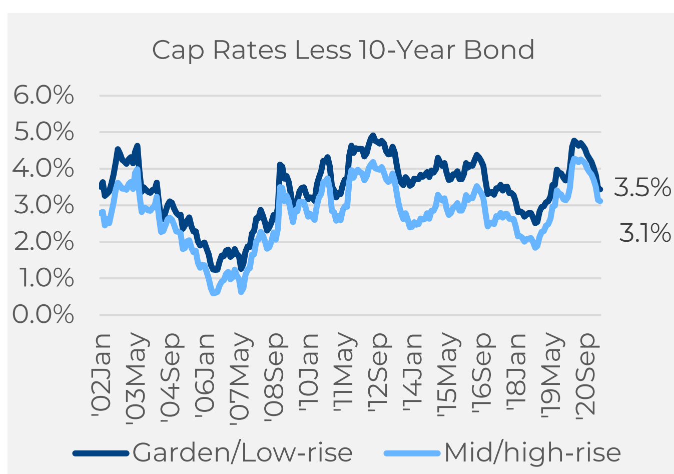
The cap rate, adjusted for the 10-year T-note (1.6%), has declined for both garden/low rises and mid/high-rises. Mid-rises have a slightly lower risk spread of 3.1% compared to garden/low-rises of 3.5% but the gap between these cap rates has narrowed, which again points to the growing demand for housing in the suburbs.

Most Active Multifamily Markets in April 2021 by Number of Property Acquisitions









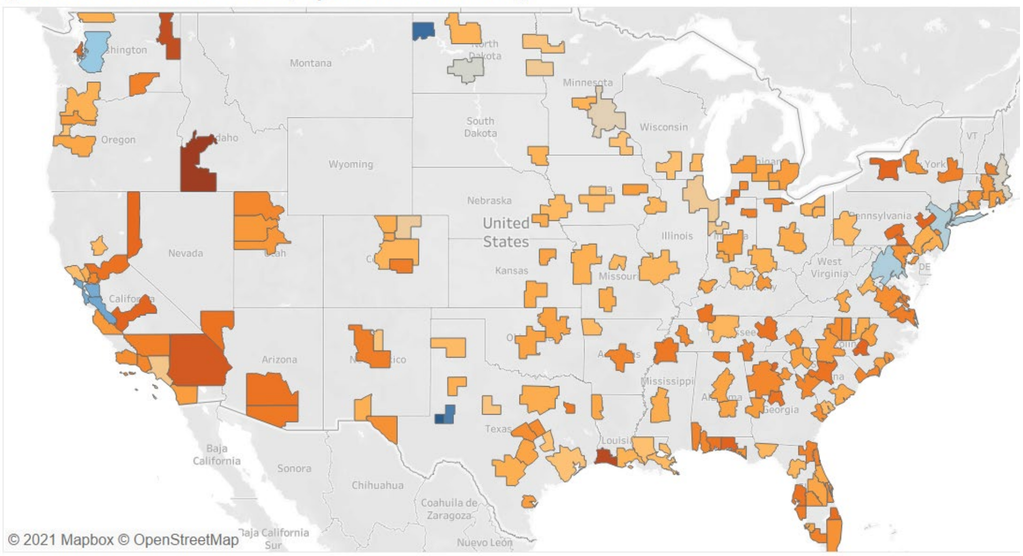
Source of data: Real Capital Analytics

Multifamily

Rents up in 95% of metro areas from one year ago

According to ApartmentList.com®, rents for 2-bedroom apartments were higher in May 2021 from one year ago in 95% (173 out of 182) metro areas it tracks. Nationally, 2-bedroom rents were up 2.2%. Among the nine metros with still lower rents are San Francisco (-9.1%), San Jose (-8.3%), Seattle (-2.8%), Washington DC (-1.6%), and New York (-1.4%) . However, rents are recovering are up month-over-month in May 2021.

173 out of 182 (95%) metro areas have higher apartment rent in May 2021 compared to one year ago
(Source: 2-bedroom rent, ApartmentList.com)



	% Y/Y	% M/M
Boise City, ID	30.0%	7.4%
Lake Charles, LA	25.0%	1.3%
Spokane-Spokane Valley, WA	23.4%	6.9%
Riverside-San Bernardino-Ontario, CA	20.1%	2.6%
Crestview-Fort Walton Beach-Destin, FL	17.5%	6.6%
Fresno, CA	17.1%	3.0%
Fayetteville, NC	16.9%	2.1%
Allentown-Bethlehem-Easton, PA-NJ	16.7%	3.5%
Rochester, NY	16.6%	2.8%
Gainesville, GA	16.4%	4.5%
Reno, NV	16.1%	3.8%
York-Hanover, PA	15.6%	2.9%
Harrisburg-Carlisle, PA	15.2%	5.4%
Port St. Lucie, FL	15.2%	4.2%
Bremerton-Silverdale-Port Orchard, WA	14.8%	3.8%
Macon-Bibb County, GA	14.4%	3.8%
South Bend-Mishawaka, IN-MI	14.4%	1.7%
Sacramento-Roseville-Folsom, CA	14.3%	2.6%
Phoenix-Mesa-Chandler, AZ	14.3%	2.8%
Las Vegas-Henderson-Paradise, NV	14.3%	2.6%
Tampa-St. Petersburg-Clearwater, FL	14.1%	3.5%
Columbia, SC	14.1%	3.5%
Knoxville, TN	14.1%	3.8%
Pensacola-Ferry Pass-Brent, FL	14.0%	3.0%

	% Y/Y	% M/M
Odessa, TX	-24.5%	-0.5%
Williston, ND	-20.4%	2.3%
Midland, TX	-16.9%	2.0%
San Jose-Sunnyvale-Santa Clara, CA	-9.1%	2.2%
San Francisco-Oakland-Berkeley, CA	-8.3%	2.2%
Bismarck, ND	-0.2%	-0.3%
Seattle-Tacoma-Bellevue, WA	-2.8%	3.3%
Washington-Arlington-Alexandria, DC-..	-1.6%	2.5%
New York-Newark-Jersey City, NY-NJ-PA	-1.4%	2.5%
Fargo, ND-MN	1.6%	0.1%
Greeley, CO	1.4%	0.4%
Lafayette-West Lafayette, IN	1.8%	0.2%
Santa Fe, NM	2.4%	0.1%
Minneapolis-St. Paul-Bloomington, MN-..	0.6%	2.0%
College Station-Bryan, TX	2.7%	0.1%
Grand Forks, ND-MN	2.3%	0.5%
Abilene, TX	2.3%	0.6%
Ames, IA	2.4%	0.7%
Madison, WI	2.9%	0.5%
Los Angeles-Long Beach-Anaheim, CA	1.9%	1.5%
Corvallis, OR	2.7%	0.8%
Boston-Cambridge-Newton, MA-NH	0.1%	3.7%
Rochester, MN	2.6%	1.3%
Baton Rouge, LA	2.8%	1.4%

Office

Transactions down 22% during Jan-April 2021 with the suburbs accounting for most of the acquisitions

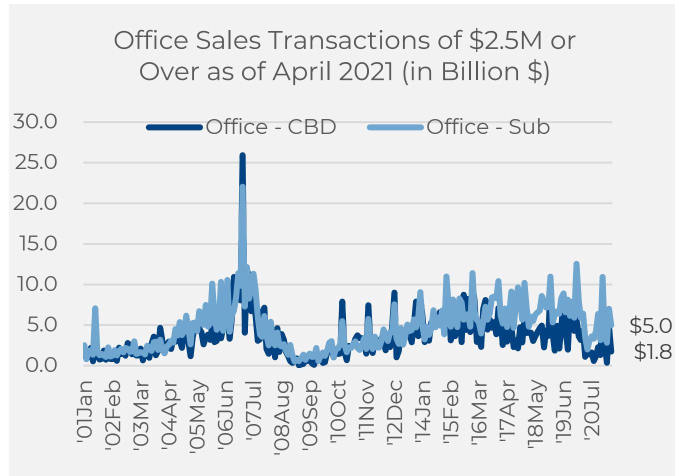
With businesses still strategizing on their work-from-home policies, acquisitions of office real estate properties or portfolios of $2.5 million or over during January-April 2021 were 22% below the level one year ago.

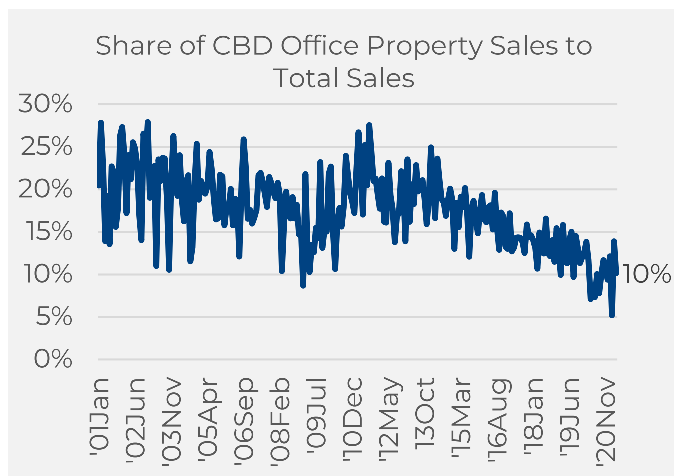
Year-to-date, acquisitions declined in both the central business district areas (-21%) and in suburban areas (-23%).

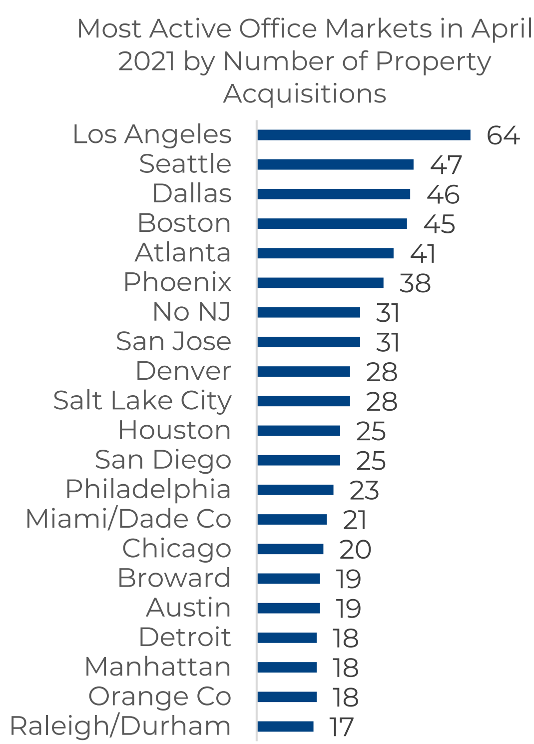
Since 2010, CBD areas have accounted for just 10% of the number of property acquisitions compared to about 15% prior to the pandemic.

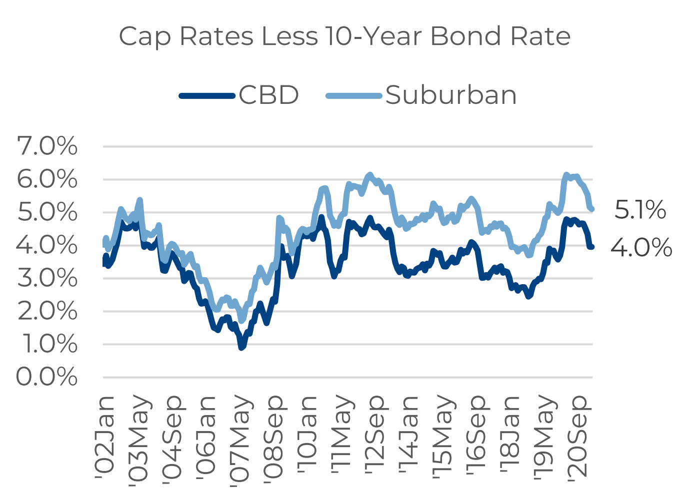
Cap rates, adjusted for the 10-year-T-note (1.6%) trekked downward to 4% for properties in CBD markets and to 5.1% in suburban markets, which means that commercial asset prices are firming up.

Los Angeles, Dallas, Phoenix, Atlanta, and Houston that had the most office property investor deals in April 2021.









Source of data: Real Capital Analytics

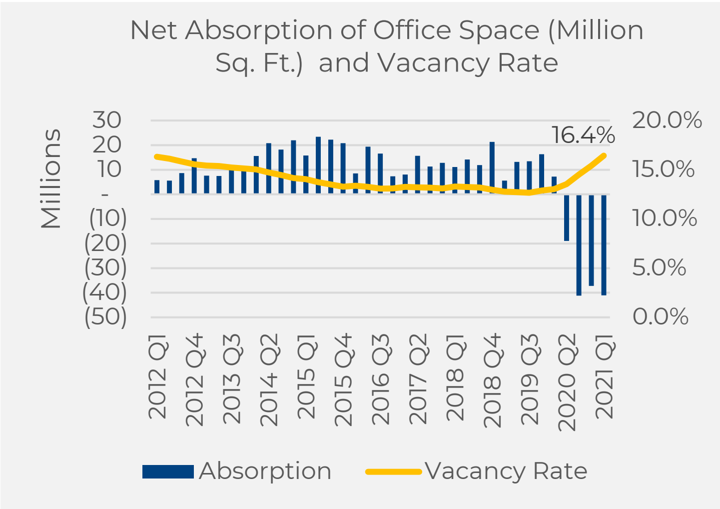
Office

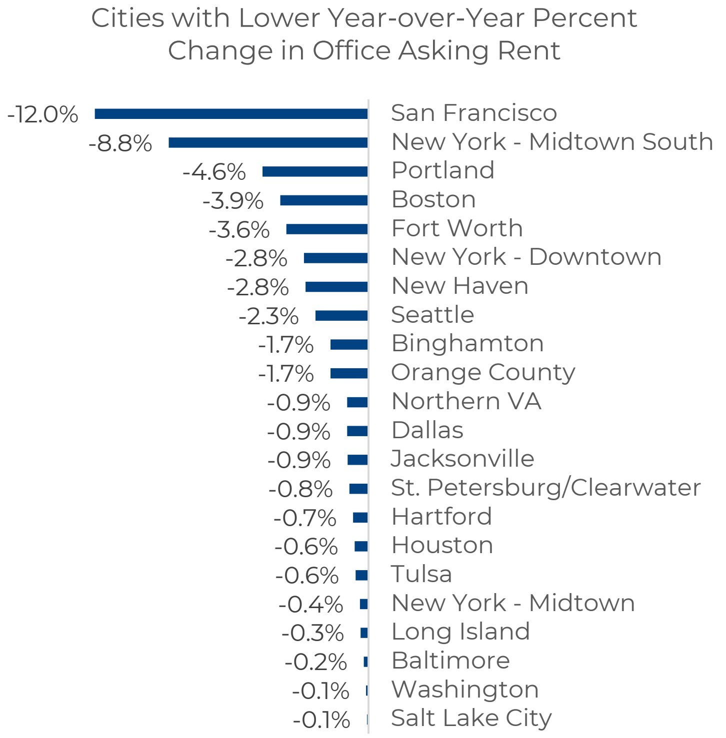
Occupancy continues to decline in 2021 Q1

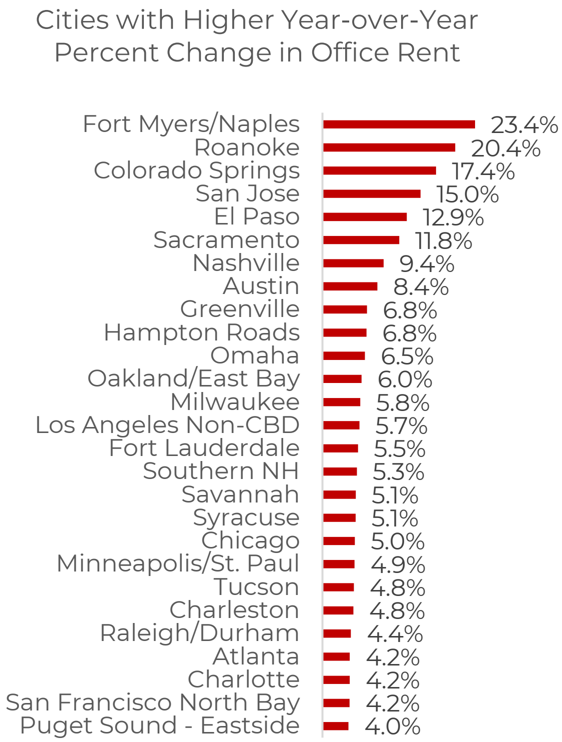
Negative net absorption in 2021 Q2

Office occupancy continued to decline in 2021 Q1, with 41 million square feet of space released by tenants. All in all, 138.4 million sq. ft. of office space has become unoccupied since 2020 Q2, leading to a sharp rise in vacancy rate, to 16.4%, from 12% in 2020 Q2.

Asking rents have are still depressed, such as in San Francisco (-12%) and New York Midtown South (-9%). But in cities with low office vacancy rates, asking rents have sharply increased, such as In Fort Myers/Naples, Roanoke, Colorado Springs, El Paso, Sacramento, with asking rents at over 10%.







Source of data: Real Capital Analytics

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Industrial

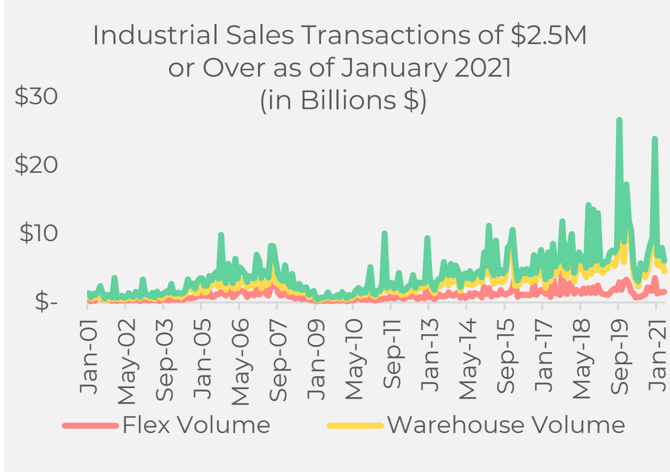
Acquisitions increased 66% in April 2021, as investors preference for warehouse space continues

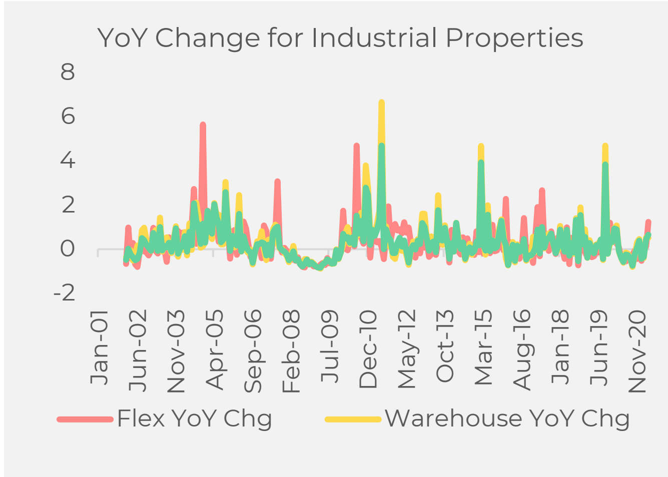
Acquisitions of industrial properties of $2.5 million or over rose 66% in April 2021, as acquisitions increased for both flex (124%) and warehouse (52%).

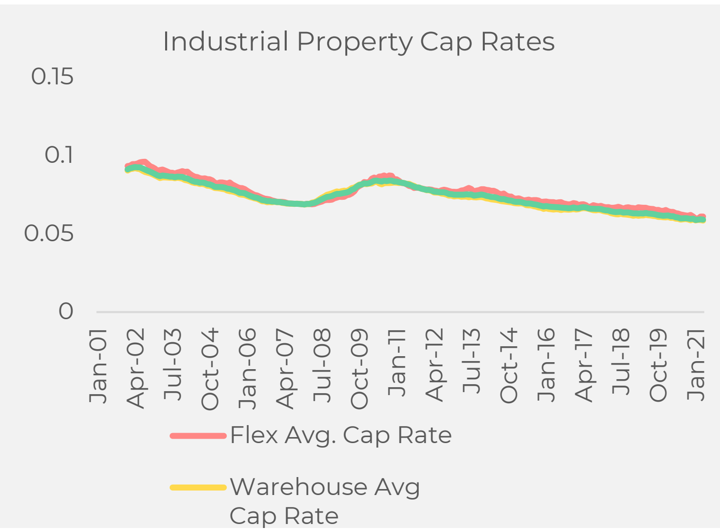
The majority of industrial acquisitions—75% — is for warehouse space. Although flex has a significant y/y volume change with respect to April 2020's dismal performance, investors have not shift their preference from warehouses. Warehouses continue to be more attractive to investors considering the strength and durability displayed throughout the pandemic, in addition to the acceleration of online shopping trends for which require space to fulfill and distribute.

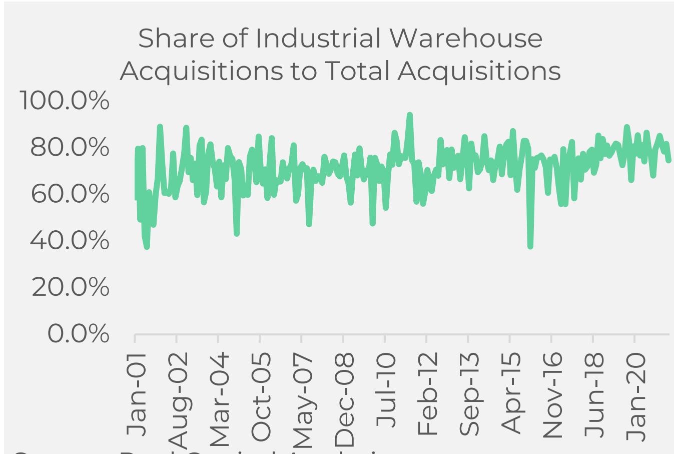
The average cap rate among warehouse acquisitions has been treading downwards, to 5.8%, which indicates higher valuations in comparison to acquisitions in the past year. Even with higher valuations, investor interest for the acquisition of warehouse space persists. While across the long-term, flex space average cap rates has been trending downwards, to 6.0% in January and February 2021 respectively, rates remain essentially unchanged as they marginally increased to 6.1% in March and April 2021.

YTD through April 2021, the most active markets with respect to industrial property acquisitions were Atlanta (28), Los Angeles (26), Boston (22), Chicago (21) and San Diego (18).









Source: Real Capital Analytics

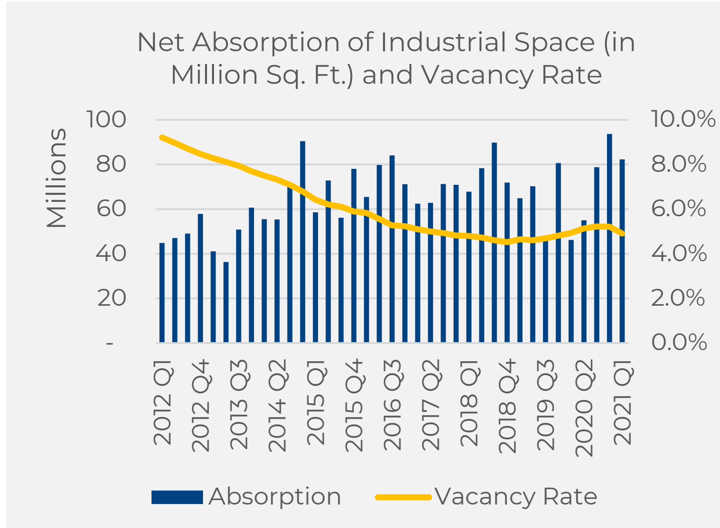
Industrial

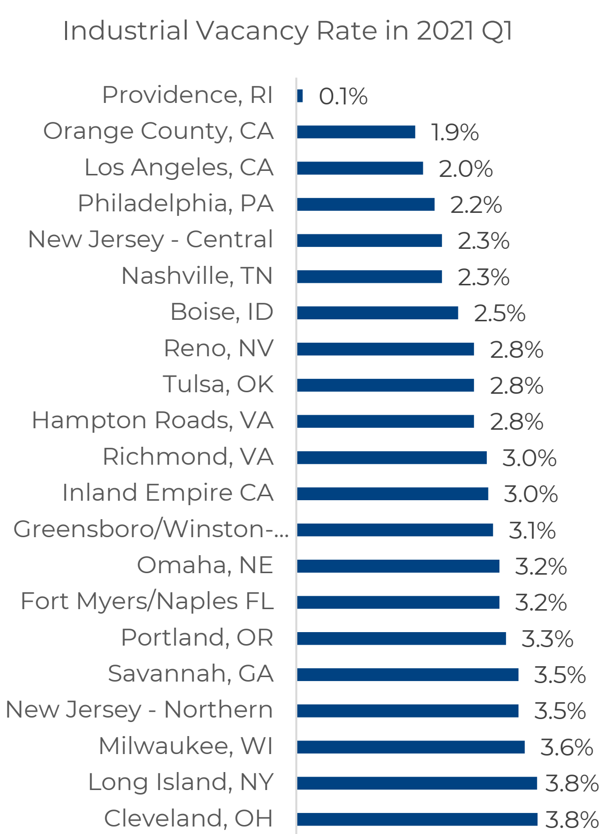
Occupancy increases and vacancy rate falls in 2021 Q1

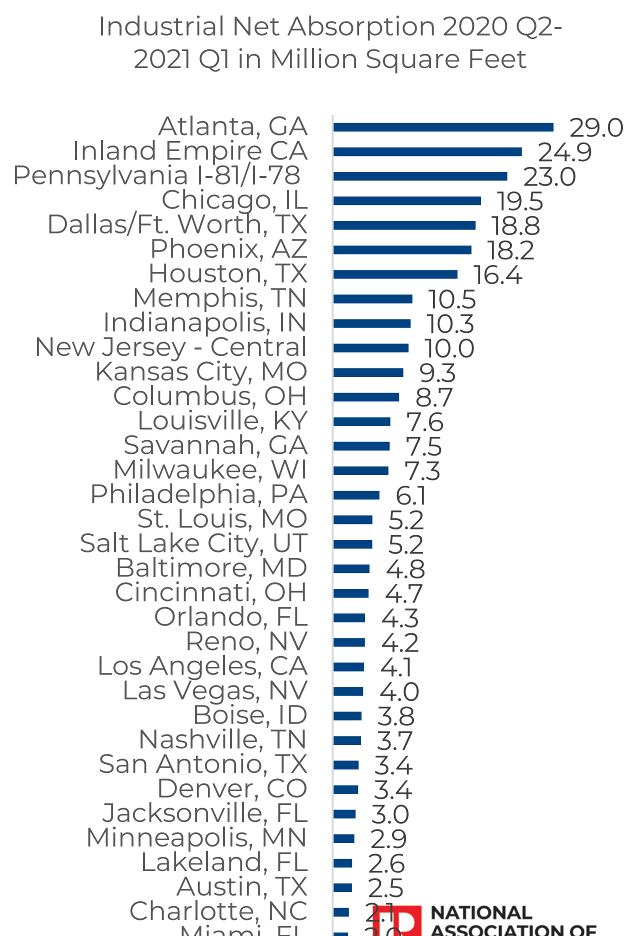
Industrial Occupancy Continues to Increase in 2021 Q1

Industrial vacancy rate declined to 4.9 percent. The areas with the lowest vacancy rates include Providence, Orange County, Los Angeles, Philadelphia, and the New Jersey-Central area, Nashville, Boise, Reno, Tulsa, and Hampton Roads Virginia.

During 2021 Q2 through 2021 Q1, Atlanta saw the largest increase in net absorption of industrial space, followed by the Inland Empire, Pennsylvania I-87/79 corridor, Chicago, and Dallas.







Source of data: Real Capital Analytics

Retail

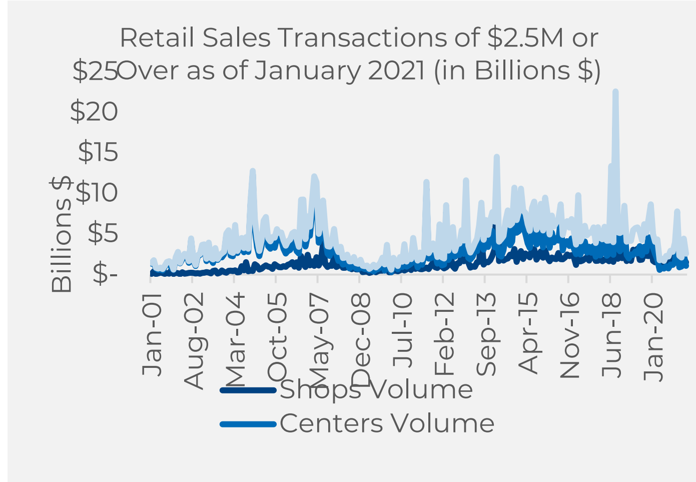
Retail property acquisitions increased dramatically from year-ago levels

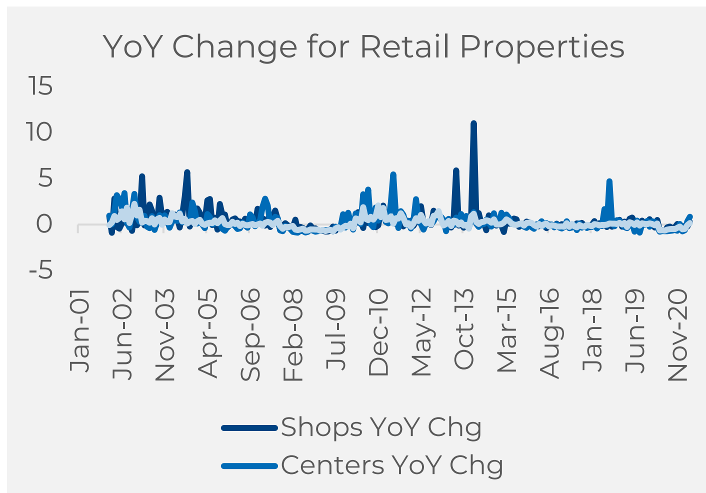
Commercial sales/acquisitions of retail properties or portfolio acquisitions of $2.5 million or more recorded $2.6 billion in April 2021. This represents a year-over-year increase of 46%, but this growth is misleading as investors remain unsure and cautious about the retail property sector. In the upcoming months, retail growth will appear to be quite strong because they are compared to pandemic activity. But looking at pre-pandemic retail activity illustrates weakness in deal activity.

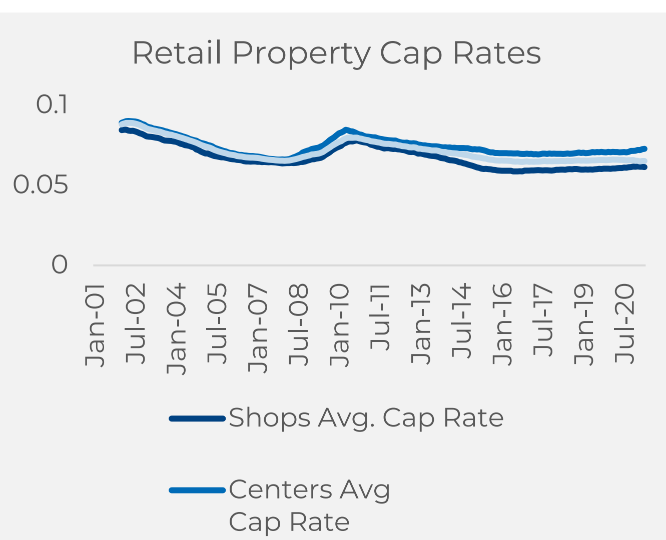
The average cap rate for all retail remains unchanged for all of 2021 at 6.5%. Cap rates for centers are moving upwards to 7.3% while cap rates for shops came down from the prior month, 6.2%, to 6.1% for April 2021.

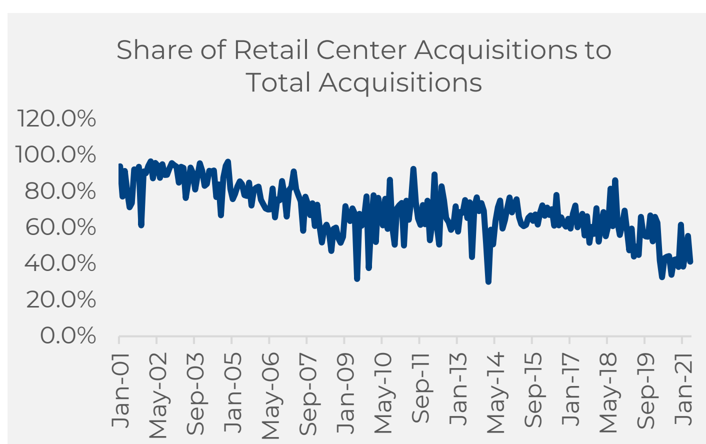
The average price per square foot of retail increased in April 2021 to $183, up $6 from the prior month and down 14% from year-ago levels. Center cap rates were $145/sq.ft. while shops averaged $252/sq.ft..

YTD through April 2021, the most active markets with respect to retail property acquisitions were Phoenix (25), Atlanta (24), Dallas (23) and Houston (18).









Source: Real Capital Analytics

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Retail

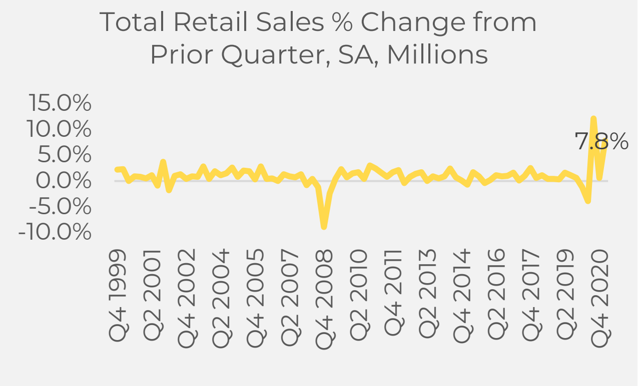
Quarterly E-Commerce Sales

Census Bureau of the Department of Commerce estimates seasonally adjusted U.S. retail e-commerce sales increased 39% year-over-year in Q1 2021 as consumers received economic impact payments, saw multiple vaccines came onto the market with increasing distribution, declination of COVID-19 rates and easing of pandemic-related restrictions. With increasing consumer confidence and more money in their pockets, consumers spent more as Q1 2021 total retail sales and e-commerce spending outpaced that of the same period last year.

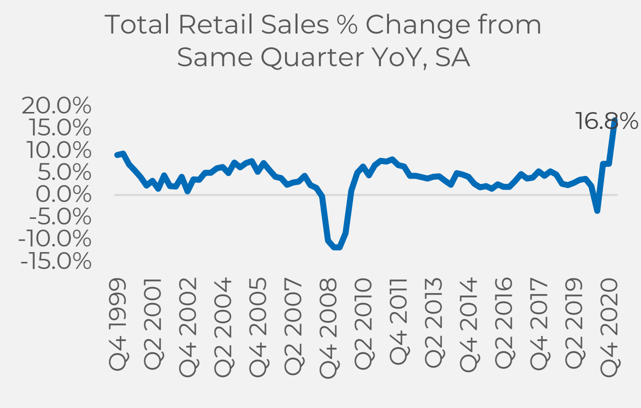
Total U.S. retail sales were estimated at $1,581.4 billion in Q1 2021, up 7.8% from Q4 2020 and up 16.8% on a year-over-year basis. Q1 2021's 7.8% quarter-over-quarter is the second largest increase for any quarter for which is only behind Q2 2020's historic 12.1% change as the global pandemic caused a significant increase in e-commerce demand as retailers widespread were forced to cease store operations in an effort to mitigate the spread of the coronavirus.

Q1 2020's total retail sales as a percent change from the prior quarter is significantly higher than Q1 2020's -1.2%. Q1 2021's percent change is notably higher than even pre-pandemic numbers. On a year-over-year basis, total retail sales 16.8% change is the highest year-over-year increase for any quarter ever recorded. Q1 2021's historic increase is more than eight times the 2.0% growth rate recorded in the first quarter of last year and more than double what was recorded in Q2, Q3 and Q4 of 2020. To put into perspective, Q1 2021's growth from the same quarter a year ago is more than the growth realized in every quarter in 2020 combined, although, there was a dramatic decrease of -3.6% in Q2 2020.

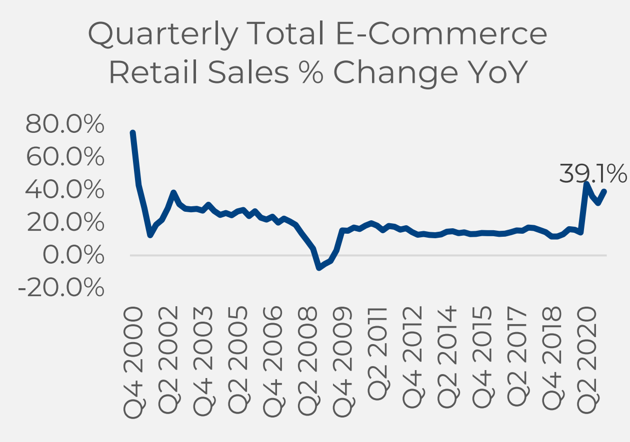
E-commerce growth across the first three months of 2021, 39.1%, is the almost three times the amount of growth recorded in Q1 2020, 14.0%, which caught only a couple of weeks' worth of retail spending once the national emergency was declared. As a result of consumers staying in and retailers being forced to close dependent upon if they were deemed an essential or non-essential business, e-commerce significantly ticked upward to a historical 43.8% year-over-year increase in Q2 2020. Q1 2021's 39.1% growth rate is the second highest pandemic period increase, only behind the Q2 2020 peak.
It is also the fourth-highest recorded rate ever and the second-highest rate for any Q1, only behind the 42.9% recorded in Q1 2001.



Source: U.S. Census Bureau



Source: U.S. Census Bureau



Source: U.S. Census Bureau

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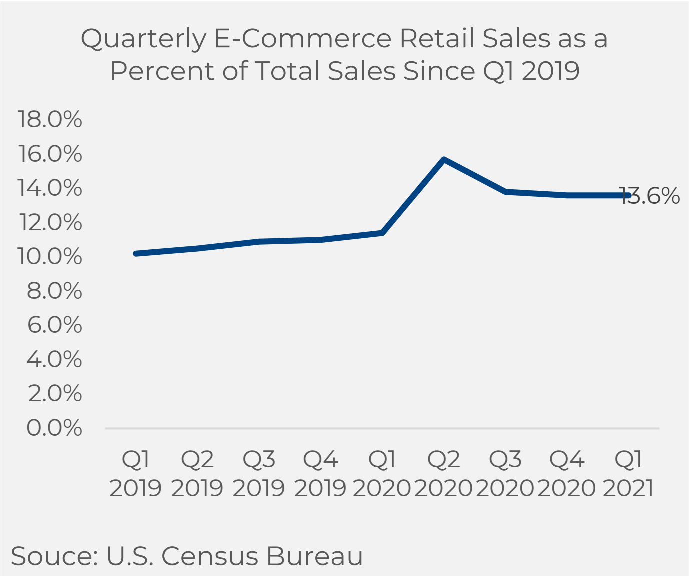
Retail

Quarterly E-Commerce Sales Continued

E-commerce retail sales totaled $215.0 billion in Q1 2021 as it captured 13.6% of total retail sales. E-commerce's portion of total retail sales saw a significant uptick towards 15.7% in Q2 2020 as consumers continued to get more comfortable and acclimated to purchasing online and as retailers tweaked e-commerce operations in an effort to provide consumers with the goods they seek in a more quick and efficient manner. The pandemic has only accelerated those trends that were taking place. But, every quarter after Q2 2020 has seen a decrease with current e-commerce as a percent of total retail sales plateauing at 13.6% for the past two quarters.

As the pandemic significantly impact discretionary retail such as dining out, entertainment and traveling with the implementation of pandemic-related restrictions, consumer spending shift to more goods than services. Considering governments are loosening pandemic restrictions, increased vaccines, stimulus checks and sharply increasing consumer sentiment towards current business, labor market conditions and economic outlook, consumer spending habits may shift back to pre-pandemic trends where Q2 e-commerce sales data may illustrate a different, but familiar retail environment.



Hotel

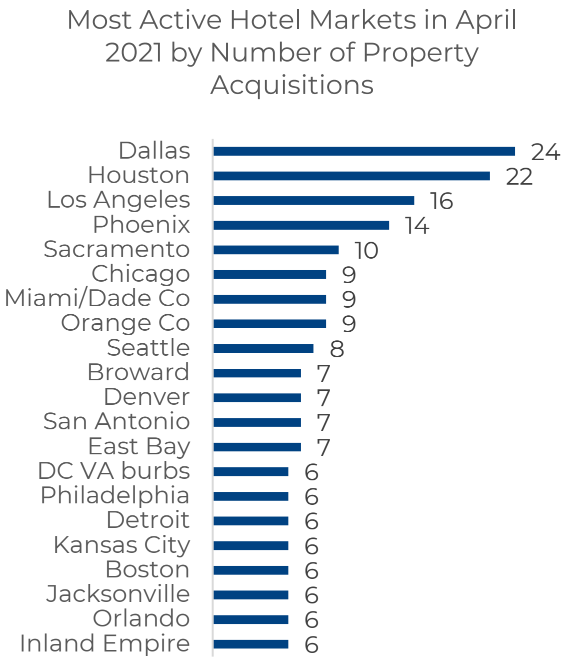
Acquisitions rose 13% in February 2021, with investor preference leaning towards full-service hotels

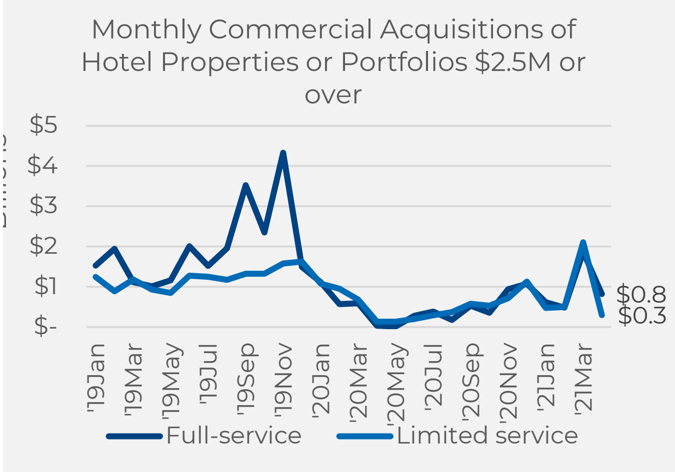
Acquisitions of hotel properties of $2.5 million or over rose 39% in the first four months of 2021, as acquisitions increased for both full-service (64%) and limited-service hotels (19%).

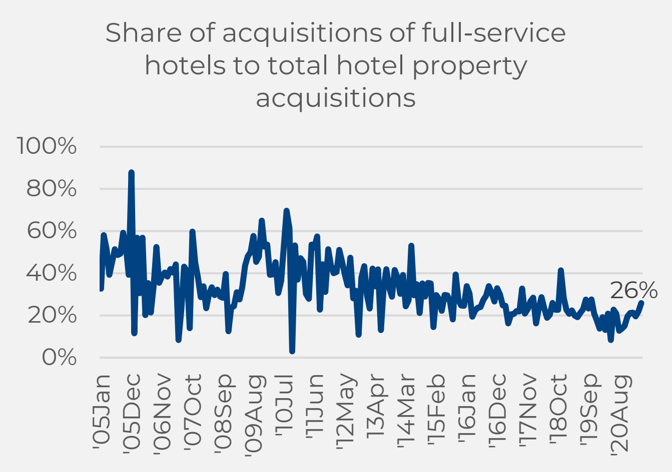
During this pandemic period, investors seem to be turning their interest towards full-service hotels. Full-service hotels may be more attractive to investors because they offer more revenue segments (convention facilities, spas, restaurants/bars) that are likely to do well once personal and business travel picks up after most of the population is vaccinated by the end of summer.

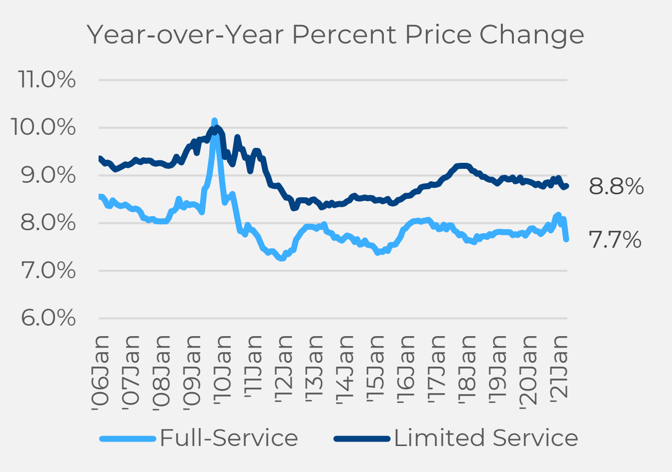
The average cap rate among full-service hotel acquisitions has been treading downwards, to 7.7%. The average cap rate among limited-service acquisitions has remained stable at nearly 9%.

Acquisitions in the six major metros (New York, Chicago, Boston, Washington DC, Los Angeles, and San Francisco) accounted for 19% of properties acquired.









Source of data: Real Capital Analytics

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Hotel

Adaptive reuse of vacant hotels/motels into multifamily housing

The conversion of vacant hotels/motels is one way to help ease the housing shortage, according to NAR's report *Case Studies on the Conversion of Hotels/Motels into Multifamily Housing*.

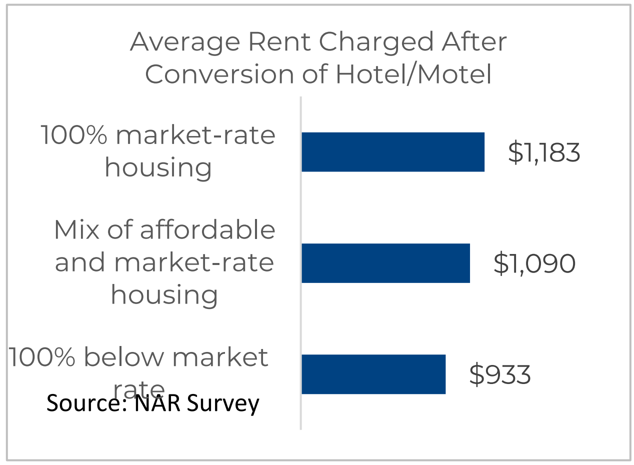
The study documents cases of hotel conversions using two methods: 1) a survey of NAR commercial members about their transactions that involved hotels/motels that were planned to be converted into multifamily housing; and 2) five case studies based n secondary research of hotel/motel conversions from company websites, SEC filings, and county records.

Adaptive re-use is not only economical, but also can be more environmentally-friendly in comparison to new commercial developments as adaptive re-use emissions for example, are lower. In addition, new commercial construction costs more than re-use by about a two-thirds on a per square foot basis. Conversions can be purely done by private financing. Where public funding was required, the Low- Income Housing Tax Credit (LIHTC), Historic Tax Credit (HTC), and tax abatement were the common sources of federal/local funding. The case studies underscore how developers need to address the zoning requirements to avoid project delays and get community buy-in early on.

This study was undertaken upon the recommendation of the Commercial Real Estate Research Advisory Board under 2021 Chair Dawn Aspaas and Vice-Chair Beth Cristina.

NAR survey results based on 29 reported conversions:

- 82% of the hotels/motels converted into multifamily housing were located in the suburbs, small town, resort, or rural areas
- 54% of the hotels/motels were acquired at a cost of $50,000 /room
- 53% and converted at a cost of $25,000 per room
- the average rent after conversion was $1,090
- 55% of the hotel/motel conversions required rezoning



Source: NAR Survey

Name of Hotel/Motel	Year Converted	Number of Hotel Rooms	Rent charged after conversion	Financing
Residence Inn by Marriott (Winston-Salem, North Carolina)	2020	88	$975	Private
Days Inn (Branson, Missouri)	2020	341	$495	Private
Luna Lodge (Albuquerque, New Mexico)	2012	28	$507	Public/private
Red Lion (Kissimmee, Florida)	2020	339	$850	Private
Ann River Motel (Mora, Minnesota)	2017	23	$495	Private

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