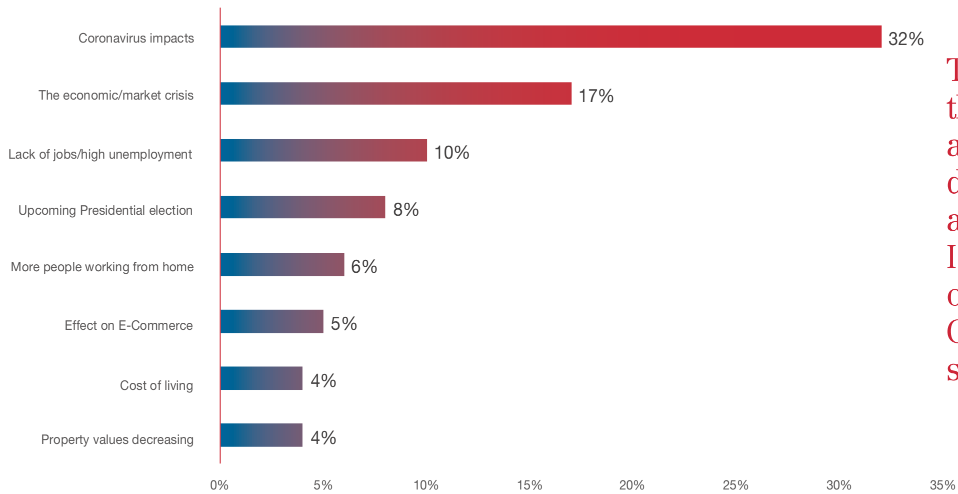
End of Year 2020 Real Estate Outlook

CRE in the Age of a Pandemic

For the second time in 2020, NAI Global commissioned South Carolina-based Regina Corso Consulting, a marketing research firm, to conduct a Real Estate Outlook study by surveying professionals from over 30 U.S. states and a dozen international NAI Offices. The survey was conducted between October 7 and October 29, 2020, with 158 NAI Global real estate professionals completing the survey. The survey gathered responses to market conditions and the impact of the Coronavirus on office, industrial and retail markets, as well as the general economy.

Overview: The economic drivers of commercial real estate in 2021 will be e-commerce, medical facilities and government activity.



There is really just one thing impacting the markets this year, the Coronavirus, and almost all of the other key drivers that will have an impact are an offshoot of that one huge driver. Interestingly, in the fall survey 32% of the NAI professionals cited the Coronavirus impacts whereas in the spring survey it was higher, at 43%.

- Not surprising, 89% said the continued spread of the Coronavirus would have a negative impact in their respective markets for the foreseeable future.
- The majority – 75%, said high unemployment was having a negative impact on their markets, 17% said unemployment figures had no impact on their markets.
- With e-commerce surging, 57% said the "Amazon effect" would have a larger impact on their respective real estate markets, while 33% said it would be about the same and 8% projecting a smaller impact on CRE (commercial real estate). In the spring of this year, 84% said ecommerce would impact their markets. By combining 57% (larger) and 33% (about the same) in the recent survey, the "Amazon effect," which includes business activity from that company as well as Walmart, grocery stores and all other retailers doubling down on their online businesses, the adjusted net number is actually 90%. E-commerce is an enduring trend.
- 84% of responders said there would be more industry consolidation, with the nuance that the majority, or 72%, said consolidation would be only "somewhat more" while 11% believe CRE industry consolidation will be "much more."
- When asked what were the key characteristics and economic factors that would most impact their respective markets over the next year, issues that garnered a response of 4% or greater in either the April or October surveys included:

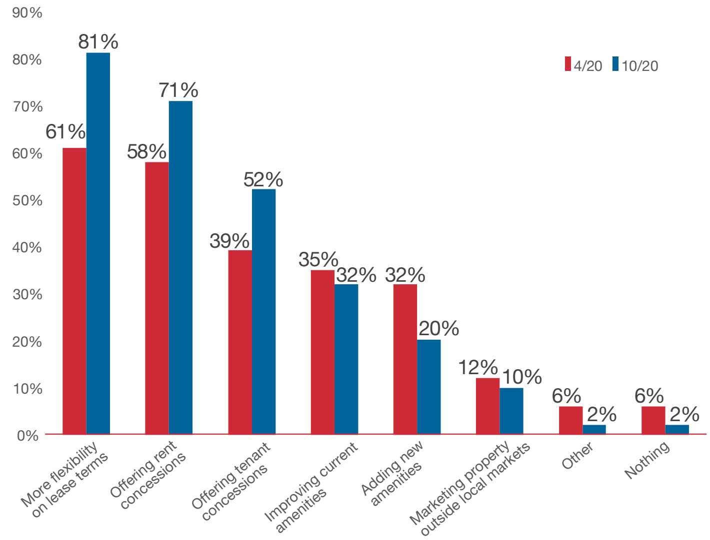
1. Coronavirus and its impacts: 32%. By comparison in April this year, 43% cited this issue.
2. The economy and financial markets: 17%.By comparison in April this year, 9% cited this issue.
3. wwHigh unemployment: 10%. By comparison in April this year, 14% cited this issue.
4. Presidential election: 8%. By comparison in April this year, 4% cited this issue.
5. Business closures: 2%. By comparison in April this year, 9% cited this issue.
6. Declining oil & gas industry: 1%. By comparison in April this year, 7% cited this issue.
7. Decreasing property values: 4%, or no change from April of this year.
8. More people working from home: 6%, or no change from April of this year.

The clear takeaway from these responses, especially in the context of survey responses from six months earlier, is that NAI Global real estate professionals have largely adjusted to living and working during the pandemic. Whether it is called concern, deeply concerning or fear, we've seen what high unemployment looks like and feel less threatened by it. The oil and gas industry is in a deep recession, yet only 1% of responders think it is a major factor in our economy. The Coronavirus is a terrible blow to our economy and way of life, yet the perception of its impacts—while still bad at 32%, is becoming more manageable. Or simply, we have grown accustomed to it. Work from home (WFH) was a novel experiment earlier this year, and we still don't know how, exactly, companies will adjust business operations once we get to a relatively safe post-pandemic period. However with the same level of response for concern – just 6%, it seems to suggest that WFH is not that big of a deal—at least for the real estate market. We're not calling this "the new normal" yet because we are certainly not there, and probably will not be any time soon.

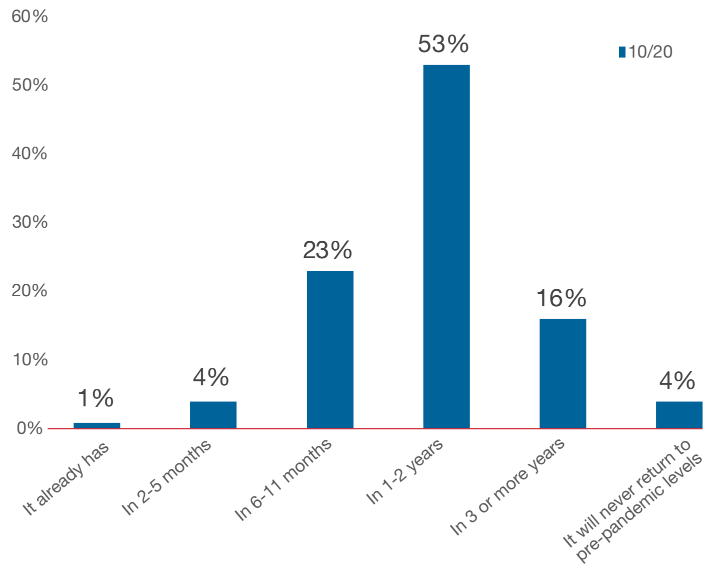
Readers of this report will see forecasts on when we may achieve post-pandemic status – at least in terms of how property markets are expected to rebound.

The State of the Office Leasing Market

Four in five say landlords are providing more flexibility on lease terms to attract and/or retain tenants while seven in ten say they are offering rent concessions in the office market.



While almost everyone says the office market will return to pre-pandemic levels, over half say this won't happen for another 1-2 years.



- Tenant demand for office space was mostly perceived as flat (49%), whereas 38% of the responders said it was cold in their respective markets while 13% said tenant demand was hot.
- Over the next six months, 59% said the office market would be flat, 18% thought it would heat up yet 8% responded that office markets would cool. By comparison, the spring survey (published in summer), 9% said tenant demand would be hot, 25% said it would be cold and similarly regarding office market conditions overall, six months ago 15% of NAI office brokers thought the market would heat up while 13% projected the office market would cool down. In other words, by fall of this year and compared with six months earlier, the outlook for office market conditions was less pessimistic and was perceived to be more stabilized with potential for greater improvement next year.
- Professional Services dominated demand for office space, at 47%, compared with 60% six months ago, followed by technology and/or growth companies (23%), compared with 36% in spring this year, then medical/pharmaceutical (19%) versus 30% in spring, manufacturing support (5%) compared with 9% and 6% said "other" types of companies were taking up office space, versus 11% six months ago.
- "Small" companies with 2-10 employees continue to be the majority of the demand equation for office space, at 44% versus 39% in spring, "Mid-Sized" companies with 11-100 employees fill 54% of the demand, compared with 57% six months ago while only 2% of "Large" companies with over 100 employees are in the market for office space, compared with 4% in spring.

- On office rents, 6% said rents were rising in their respective markets, 55% thought they were flat and 39% of the brokers said rents were declining. By comparison six months ago, 17% said rents were rising, 21% thought they were declining and 63% perceived office rents to be flat. The takeaway here is a mixed message that indicates more stability than perceptions from the spring survey: According to NAI office brokers, rents are not rising as much as they were six months ago yet rents are declining in fewer U.S. markets in the October survey.

- On landlord activity, NAI brokers said 81% are offering more flexible lease terms (vs. 61% in spring). 71% of landlords are offering rent concessions (vs. 58% six months ago), and to secure new tenants, and 52% are offering incentives (vs. 39% in spring). Landlords seem to be cooling on improving current amenities – or many of them already have made them, with 32% of NAI brokers saying they are making amenity improvements, compared with 35% six months ago, and 20% of the brokers said that landlords are adding new amenities, vs. 32% in spring. These responses reaffirm a trend that started in summer – the office market favors tenants in the current environment.

- Office property sales have declined according to 72% of the NAI brokers that participated in the fall survey, while sales appear to have increased in 16% of their respective markets. The market for selling office assets has declined since spring of this year. Six months ago only 55% of the NAI brokers said sales had declined and 29% reported sales were improving. Analysts and media reports have cited the difference, or delta, between the asking price and offering price for office buildings and portfolios as one reason for fewer office sales, while others have stated investors are waiting for the bottom to fall further and to buy offices opportunistically. Either way, the recent NAI survey finds that office sales are, in fact, slower than usual.

- Most of the buyers of office properties that are sold are business owners/users (36%), followed by institutional investors (32%) and individual investors (27%).

- Regarding office inventory, 17% of the responders thought inventory was low, 37% said supply was adequate and 44% of the NAI brokers reported there was an oversupply of office space in their respective markets. By comparison, only 21% reported an oversupply six months ago, 49% said supply was adequate, while 25% said inventory was low in spring of this year. The inconsistency of these data points indicates a market trend that the changes to the office market due to the pandemic are different in different markets, by region and certainly by cities. As a reminder, the responses to the survey questions largely indicate opinions of market conditions in the responders' respective marketplaces and six months ago 25% said inventory was low – which changed to 17% in October, while over twice as many NAI office brokers reported an oversupply currently compared with spring of this year. When surveying a single market, it's more typical for inventory supply to trend consistently in one direction, whereas the NAI survey reflects different conditions in different markets.

- Even if there is a whiff of optimism for the office market, recovery from the pandemic will take another 1-2 years, according to the majority, 53%, while 23% think the recovery will happen in the next 6-11 months and 16% reported it would take over three years. 4% projected the recovery is closer at hand, or 1-5 months away, while the same percentage – 4% said "it will never return to pre-pandemic levels." Only 1% said the office market "already has recovered."

The State of the Industrial Leasing Market

- As spring turned to summer and then fall, it became clear that the industrial real estate sector was the strongest among the other property verticals. That perception was fully endorsed by NAI Global professionals in the October survey, with 78% of them stating the market for industrial real estate was hot. 20% of responders said it was flat in their respective markets while only 2% said it was cold.

- The agents and brokers also believe industrial will thrive over the next six months, with 82% of them stating the industrial market would remain hot. By comparison in the spring this year, 51% said the market was hot and 50% said it would be hot over the next six months.

- The biggest market drivers for demand of industrial real estate were companies expanding their existing occupancy levels (48%), companies that want to reduce commute times (35%) and company relocations (29%).

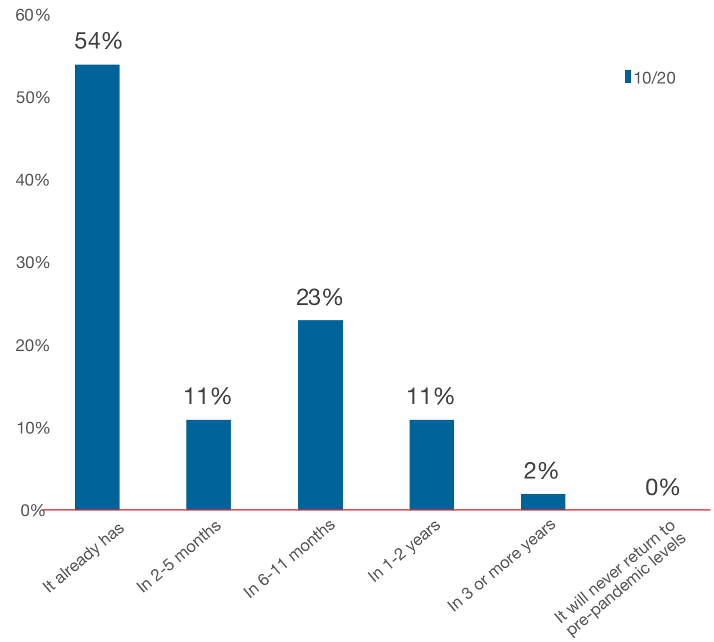
- Consumer products are the biggest drivers of demand for industrial real estate (71%), followed by manufacturing (42%), retail (23%), energy (9%), e-commerce (9%), and distribution/logistics (8%).

- In terms of market activity, leasing dominated inquiries and closed transactions -- 78%, to sales, at 13%.

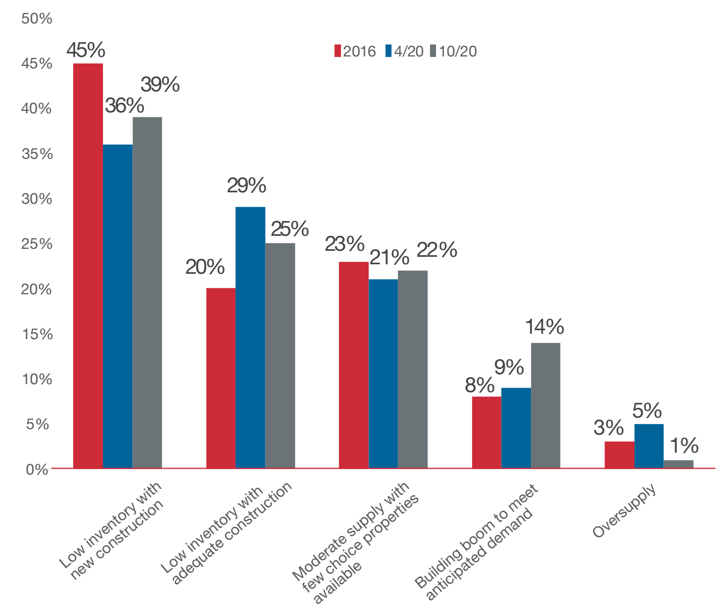
- Regarding existing inventory, 63% of responders said industrial inventory was low in their respective markets, while only 1% stated there was an oversupply of industrial real estate. 14% said there was an adequate amount of new supply pending delivery to satisfy demand in their respective markets.

- Given the responses from the previous bullet points in this section of the report, it's no surprise that a majority – 54%, said their industrial markets had already recovered since the onset of the pandemic, while 11% said recovery would require another 1-5 months, 23% thought recovery would take 6-11 months, 11% stated their markets would need 1-2 years to recover, and only 2% reported the recovery would need 3 years or more.

Over half (54%) of responders say their respective industrial markets have already returned to pre-pandemic levels.



Two-thirds, or 63%, also say industrial inventory is low in their markets.



The State of the Retail Leasing Market

- Based on the number and quality of retail real estate lease and purchase inquiries, the majority of responders – 58%, said their markets were cold, which was comparable to spring of this year when 59% said retail real estate was cold. In the October survey, 34% said the retail real estate market was flat while 8% said their respective markets were hot for retail real estate.

- The prospects for changing the current status for retail real estate are not great, with 46% of survey responders stating the sector would be cold over the next six months – yet that is an improvement from spring of this year when 61% thought retail real estate would be cold over the next six months. 14% said demand for retail real estate would get hotter in the next six months.

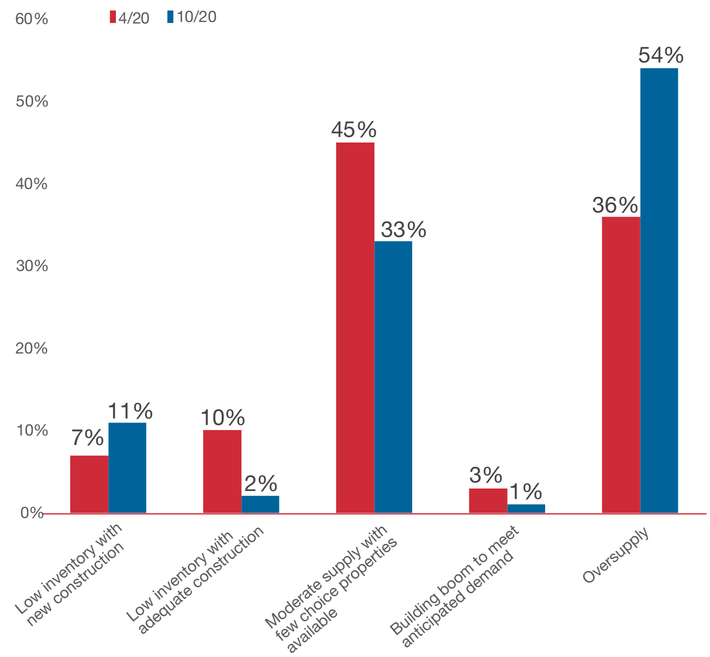
- In terms of supply, the majority stated their respective markets were oversupplied with retail real estate (54%) while only 12% expressed that inventory was low for retail real estate. 33% said supply was adequate in their markets.

- Local brands and chains were the primary drivers of retail real estate, at 60% -- which was up from 49% six months earlier. Regional brands and chains drove 43% of demand for retail space, compared with 49% in spring this year, while retail real estate demand by national chains and brands fell in the fall survey to 36%, down from 47% earlier this year.

- Rental rates are performing as expected and with demand down and supply up, 52% of responders said retail real estate rents were decreasing in their respective markets, compared with only 26% in the spring of this year. 42% reported rents were flat in October, compared with 60% six months earlier, while only 6% expressed that rental rates were increasing in their markets, versus 14% in the April survey.

- Accordingly, landlords are offering rent concessions in most markets at 77%, up from 59% six months earlier. Flexibility on terms also increased, to 76% from 62% and new tenant incentives increased to 55% from 45% in spring of this year. 21% stated that landlords have increased marketing efforts outside of their local markets and traditional demographics, while 15% said that landlords are improving existing amenities and 10% were adding new amenities.
- Other than the hospitality sector, retail real estate is suffering the worst among the property verticals and prospects for recovery are not good. 50% of the survey responders that are knowledgeable about retail real estate and retail in general said it would take 1-2 years for their markets to recover while 22% stated recovery would require three years or more, and 12% responded that retail “would never return to pre-pandemic levels.” Only 3% said their retail markets had already recovered or would in the next five months. While most agree that vacation and business travel will recover to pre-pandemic levels eventually, the retail industry is clearly in the midst of a transformation and it will take a few years for retail operators to change and adapt to how people shop, and adjust their real estate requirements accordingly.

Over half of those knowledgeable about the retail market say there an oversupply in their market up from over one-third who said this in April while one-third say there is moderate supply with few choice properties available, down from almost half.



NAI Global is a leading global commercial real estate brokerage firm. NAI Global offices are leaders in their local markets and work in unison to provide clients with exceptional solutions to their commercial real estate needs. NAI Global has more than 375 offices strategically located throughout North America, Latin America, Europe, Africa and Asia Pacific, with over 6,000 local market professionals, managing in excess of 1.15 billion square feet of property and facilities. Annually, NAI Global completes in excess of $20 billion in commercial real estate transactions throughout the world.

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