Market Report

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International Realty Valuation, Inc.

United States

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In this Report:

Investment Barometer

Let's get it all on the table – COVID Chaos. There is no other way to describe the once in a lifetime pandemic (the last one was Spanish Flu 1918) that shuttered the real estate windows. And in 2021 the shutters will slowly open and allow some fresh air to rush in with some needed sunlight. The problem is, as we fill our lungs and take a breath, the sunlight will likely illuminate the systemic issues in real estate. We may not like the light that shines on reduced rents, higher vacancies, and lower values. Landlords and owners can pretend that you are immune – but the vaccine is not an elixir – it is a preventative measure. The real estate patient may still have underlying issues. 2021 will be the year where an ounce of prevention may be a pound of cure. Take needed small steps in getting healthy again.

The US government has provided a stopgap with unprecedented financial stimulus and lower interest rates to nearly everyone and every business. It will not last, and real estate will have to respond to fundamentals.

According to REIT Sector Returns 2020 saw:

Residential - down 13.1%
Retail – down 28.3%
Office – down 19.9%
Lodging – down 27.2%

Recovery will occur, but it will be erratic per sector with some improvement in mid-2021 and into early 2022.

The survivors:

Industrial – up 9.8%
Data Centers – up 17.2%
Self-Storage – up 8.2%

2021 will need the second shot to keep the shutters open.

By the Numbers

The markets have been on hold. The numbers prove that buyers, sellers, and tenants have been paralyzed to make any significant moves in 2020 and early 2021. The outlook for 2021 is generally optimistic, with a great deal of shake-out for the weaker real estate classes. Trends in past 3 years are flat.

According to **CoStar**

Office – Cap Rates

2020 - National: 7.30%

2019 - National: 7.30%

2018 – National: 7.20%

Retail – Cap Rates

2020 - National: 6.70%

2019 - National: 6.90%

2018 – National: 6.80%

Industrial – Cap Rates

2020 - National: 7.00%

2019 - National: 7.00%

2018 - National: 7.00%

Multi-Family – Cap Rates

2020 - National: 6.00%

2019 - National: 6.10%

2018 – National: 6.00%

Office – substantial sublet space on the market unmasks this sectors vulnerability.

Retail – increased bankruptcies in vulnerable categories and significant repositioning will occur.

Industrial – will be the safe haven for 2021. Watch for over-supply due to new construction.

Multi-Family – WFH will normalize this asset class even in the backdrop of continued concessions for less desirable urban corridors as many exodus for the suburbs.

Unlike the Global Financial Crisis (GFC), CRE companies had generally strong financials at the start of the pandemic and debt markets remain sufficiently liquid. Yet troubled loans are rising; banks, fearing higher delinquencies are tightening lending standards…

Along with evolving financial landscape, the pandemic has resulted in tectonic shift in the way people live, work, and play, which has put unique pressures on certain property sectors.

Deloitte Insights – 2021 Commercial Real Estate Outlook

International Realty Valuation, Inc.

Schizo-Real Estate

Lance W. Doré, FRICS, MAI

“It looks like 2021 will be the first year of a new phase of real estate history, wherein value movements are driven not by yield compression, which lifted capital values through much of the past cycle, but by fundamentals; in other words, the ability of real estate assets to generate, sustain and grow income.”

—PGIM Real Estate – January 2021

Schizophrenia is a disorder that affects a person's ability to think, feel, and behave clearly. It is characterized by thoughts or experiences that seem out of touch with reality and disorganized.

Investors and advisory firms say Reevaluating – I hear *we are guessing.* They say Softening Operational Fundamentals – I hear *we are in trouble.* They say Organic Resilience– I hear *we are losing our talent pool.* They say Positively Disruptive – I hear *we do not know what to expect.*

The market participants are rightly out-of-touch and disorganized because what happened in 2020 has reset the investment clock. Real estate has been reset. Occupiers of real estate have been reset. Investment assumptions have been reset.

Here is what we think we know in this Schizophrenia real estate market.

Office - the new acronym is WFH. I am sure some employers think it is WTF. But **W**orking **F**rom **H**ome is the new norm. It is here and it is our new real estate paradigm. Estimates are that from 15% to 25% of the office employment force will work from home. Employers and employees alike have made the financial commitment and the emotional adjustment.

Urban office is not dead, but wounded and crippled. And can still be a Hub. Suburban office is a growing need and serves as the Spoke to the Hub. Medical Office is preferred. Prediction: Less office space required with more office amenities.

Retail – continues to evolve, transform, and deconstruct. Retail is not for the faint of heart. There is pain in boutique and specialized centers. There is growth in repurposing retail, and you need to flee from Fluff Space and gravitate to Staple Space. Brick and mortar retail must meet fundamental needs and show fundamental profits to survive. Prediction: Collapsing out-of-touch retail and expanding retooled retail.

Industrial - is the clear winner and has been for several years. It continues to be the golden child of the real estate property sector with emphasis on warehouse, distribution, and logistics. This sector represents that fundamental proposition of meeting demand for basic needs. Industrial is not sexy – and never has been – but it is the backbone of how our digitized, car loving nation has evolved. The new (technology) and old (transportation) have developed into a co-dependent symbiotic relationship. On the forefront are data centers and self-storage. Prediction: Increased emphasis on just-in-time delivery and last mile focus with smaller in-fill development. Labor force Shortages may occur.

Multi-Family – has phantom value and imaginary stability. The reality is that most tenants were impacted by Covid and job losses were significant. With regulations freezing any evictions due to non-payment of rent, and stimulus money filling in gaps – the true impact on the multi-family market is in limbo. The true impact of non-payment, or delayed rents to landlords will be a ripple effect as landlords delay mortgage payments and look for forbearance. This one sector of real estate is frozen in time – the fundamentals were established in 2020 and are largely the same in 2021. If this can this be sustained is the big question. Watch for shifts into secondary and tertiary markets because of the WFH permanent shift. Prediction: Senior housing is favored, and Student housing is suspect.

Overall – the favored markets include Austin, Salt Lake City, Nashville, Denver, Portland, Charlotte, and Seattle. Exposed markets include Detroit, New Orleans, Hawaii, and New York – again.

National Debit is High – Interest rates are low – this is not sustainable.

Regardless of the sector the key features to look for are:

- Proptech escalation
- Multi-generational consideration
- Green advances

Real Estate will be Schizophrenic – 2021 will be disorganized and erratic.

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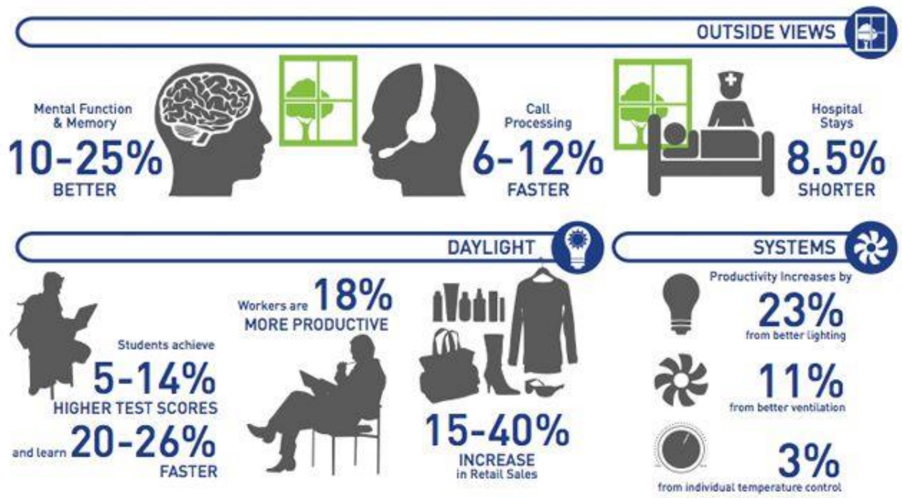
Rise of Green

We have heard for years the benefits of Green Buildings. We are also very familiar with LEED certification that promotes and establishes Green Building credentials. The mantra is reduced utility costs, social responsibility, reduced carbon footprints, and expected higher values. However, the one most prevalent benefit that has now come to the forefront that may have the most significant impact, and reasons for going all in for green buildings is Safe Air. If we are to get the WFH crowd to transition into brick and mortar (office, retail, hotels, and industrial) – it will be imperative to set the highest standard for safety as the pandemic transitions into an epidemic. This will have short- and long-term benefit as everyone can feel and be healthier and more productive in any real estate.



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As a Founding Partner and President of International Realty Valuation, Inc., Lance values a wide variety of conventional and complex properties, serves as litigation support to public and private clients, and provides expert advisory services. His geographical expertise is focused in the western U.S., and his professional expertise is focused in energy facilities, investment property, lands and special purpose.

About IRV, Inc.

International Realty Valuation, Inc. (IRV) is a global network of independent and highly competent professionals committed to providing expert financial reporting, forensics, consultation, and valuation services for both tangible and intangible assets to the most discerning of public and private clients. With a number of affiliate firms in several countries, our team has cumulative cutting-edge knowledge of global and regional markets, as well as international standards and requirements. This enables us to complete a wide variety of assignment, including valuation of large portfolios with multiple locations, in a thorough, objective, timely, and cost-effective manner. We serve major national, regional and international banks, lenders, developers, investors, governmental agencies, public and private companies.