

Commercial Market Insights

October 2020

National Association of REALTORS®
Research Group



NATIONAL
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Contents

Commercial real estate transactions continued to contract in August, with acquisitions down 68% year-over-year in August and 36% on a year-to-date basis. Acquisitions fell across all markets, even for industrial properties.

In the apartment market, the average price per unit has fallen by 10% compared to the level in January 2020. In the office market, the average price per square foot was down 7%. Prices have declined more modestly in the industrial property market, by 3%. Meanwhile, prices were up 3% from January in the retail properties market, although prices have started to head downwards since May.

Vacancy rates increased in all property markets. However, rents have remained relatively stable as landlords seek to minimize revenue losses arising from occupancy losses.

Sustained economic and job recovery, and the cure for the coronavirus pandemic, will determine the pace of recovery of the commercial real estate market. As of September, the economy has created 11.6 million jobs, with 10.7 million to recover relative to February. Forty percent of the lost jobs to be recovered are in leisure and hospitality and retail trade.

This issue features two pieces. The first piece looks at office market occupancy trends that show a significant uptick in available office space through 2022 Q1. The second piece analyzes the factors that determine if a retail space should be repurposed based on the three fundamental building blocks of logistics: transportation, warehousing and inventory.

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Commercial Market Overview

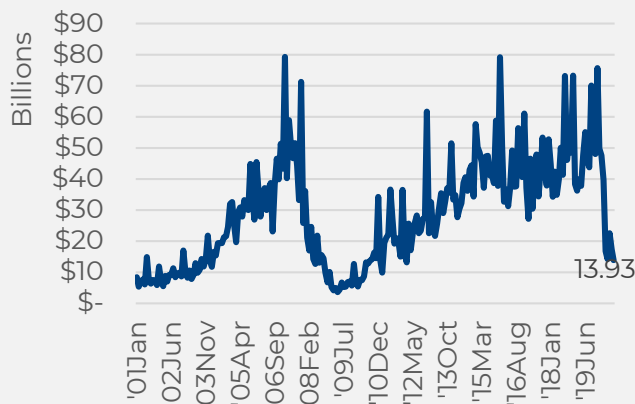
Commercial sales transactions of \$2.5M contract 68% year-over-year in August 2020, hitting all core property types

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 68% in August, according to Real Capital Analytics. Sales in August plummeted to \$13.9 billion, which is below the average of \$45 billion monthly during the first quarter of 2020. During the Great Recession, sales hit a low of \$3.6 billion.

Sales in August declined across all core property types, with the largest year-over-year decline in office and retail: apartment, -65%; office, -73%; industrial, -62%; retail, -73%.

Risk premiums (the difference between the cap rate and the safer 10-year T-bond) have increased across all asset classes since April but were stable in July and August. The apartment property market still has the lowest risk premium, at 4.7%, followed by industrial, at 5.5%. Hotel has the highest risk premium, at 8%, and retail, at 5.9%. Office is in the middle of the pack, at 5.8%. Risk premiums are about the same level during the Great Recession, except for hotel properties.

Dollar Volume of Acquisitions
\$2.5M and Above in Billion
Dollars



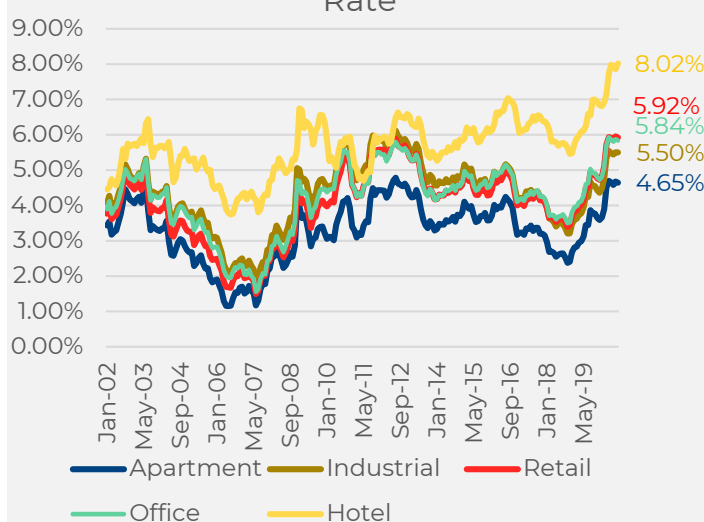
	August '20		Year to Date		RCA CPPI	
	Vol (\$b)	YOY	Vol (\$b)	YOY	Cap Rate	YOY
Office	2.7	-73%	50.6	-43%	6.5%	-0.5%
Retail	1.1	-73%	21.3	-45%	6.6%	-4.1%
Industrial	3.0	-62%	51.6	-3%	6.2%	7.4%
Hotel	0.3	-89%	6.6	-69%	8.6%	-7.8%
Apartment	5.5	-65%	74.3	-37%	5.3%	7.4%
Snr Hsg & Care	0.3	-71%	5.7	-52%	6.3%	
Dev Site	0.9	-43%	12.0	-16%		
Total	13.9	-68%	222.1	-36%		1.6% *

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

Cap Rates are 12 month rolling

Source: Real Capital Analytics

Cap Rates Less 10-Year T-Bond
Rate



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.

Commercial Market Overview

Commercial sales prices still broadly stable

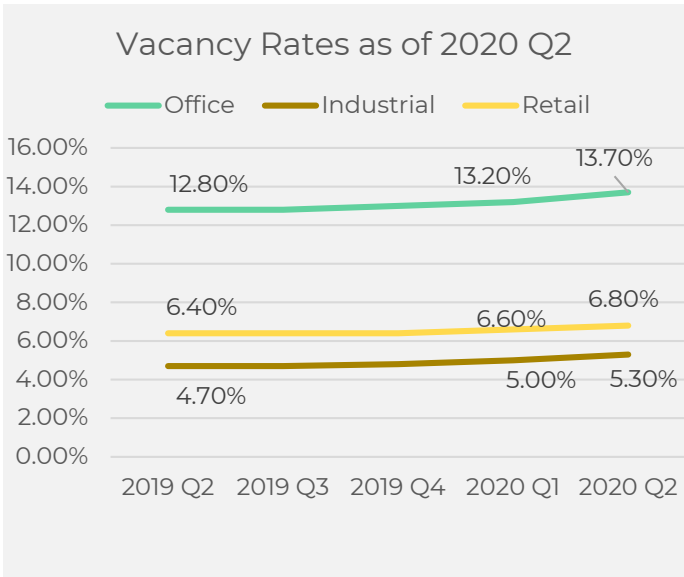
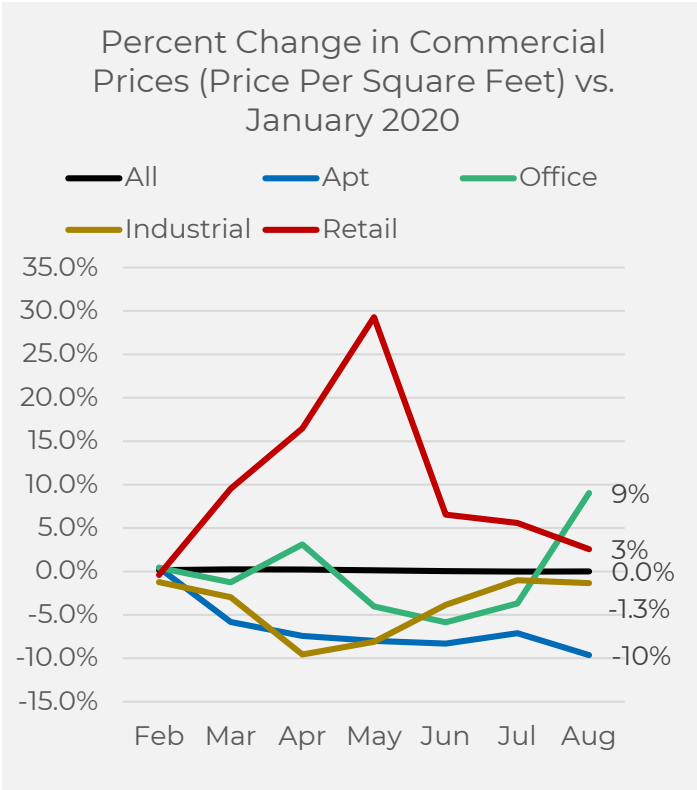
Relative to January 2020, the average price per square foot has fallen by 10% for apartment buildings, amid concerns about renters' ability to pay rent. The average price per square foot of industrial buildings was slightly down by 1.3%. The average price per square foot on office building sales in August rose 9% relative to January, indicating that the sales transactions that materialized were mostly prime properties.

Uptick in vacancy rates

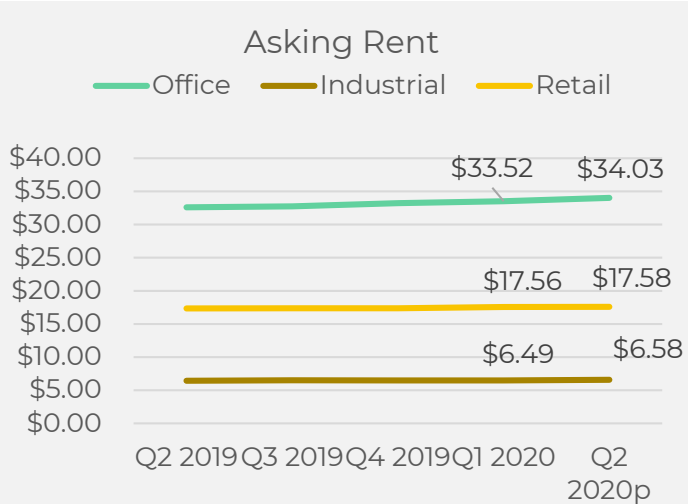
Vacancy rates rose in 2020 Q2 compared to Q1, according to Cushman and Wakefield data. The office sector saw the highest increase in vacancy rates, as the sector suffered a negative absorption of 22 million square feet in 2020 Q2 relative to 2020 Q1 occupancy. The vacancy rates have only increased modestly in the industrial and retail sector since 2020 Q1. Even before the pandemic, the bricks and mortars have already been losing tenants.

Gross asking rents stable

While vacancy rates have increased, average gross asking rents have not fallen, as landlords are likely trying to minimize revenue losses arising from the vacancies by maintaining rents.



Cushman and Wakefield U.S. Office MarketBeat Reports, <https://www.cushmanwakefield.com/en/united-states/insights/us-marketbeats/us-office-marketbeat-reports>



Commercial Market Overview

CMBS delinquency rates continue to decline to 9% in September

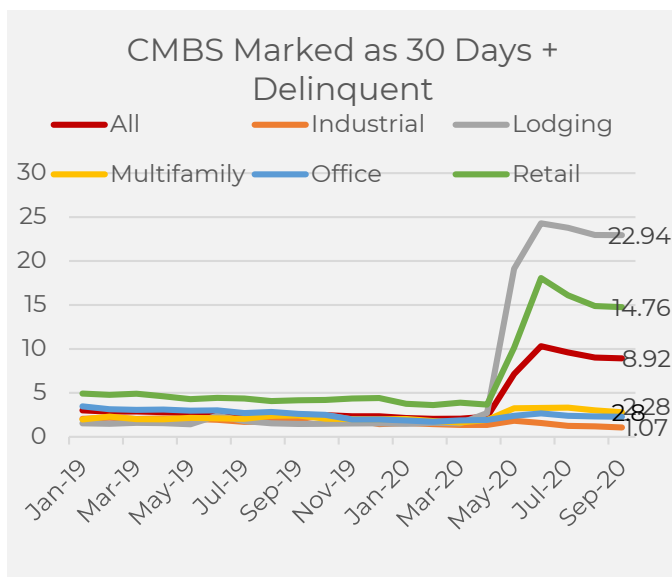
Overall delinquency rates declined in September to 8.9%, down from a peak of 10.3% in June, according to Trepp. Delinquency rates declined across securities backed by multifamily, office, industrial, retail, and lodging properties. CMBS backed by industrial properties had the lowest delinquency rate at 1.1% followed by office, at 2.32%, then multifamily at 2.8%. Securities backed by lodging properties have highest delinquency rate, at 22.94%, followed by retail, at 14.76%.

Construction spending decline reverses, up 1.5% in August

In August, the annualized value of construction spending rose 1.5% on a year-over-year basis.

Construction spending for multifamily rose a strong 8.9%. Construction of commercial buildings also slightly increased by 1.1%. (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 about one in five workers working from home and given the negative net absorption for office space, builders cut back on construction for office properties (-9.8%). Construction spending on lodging declined heavily compared to other property types (-12.8%).



Source: Trepp



Source: US Census Bureau

Commercial Market Overview

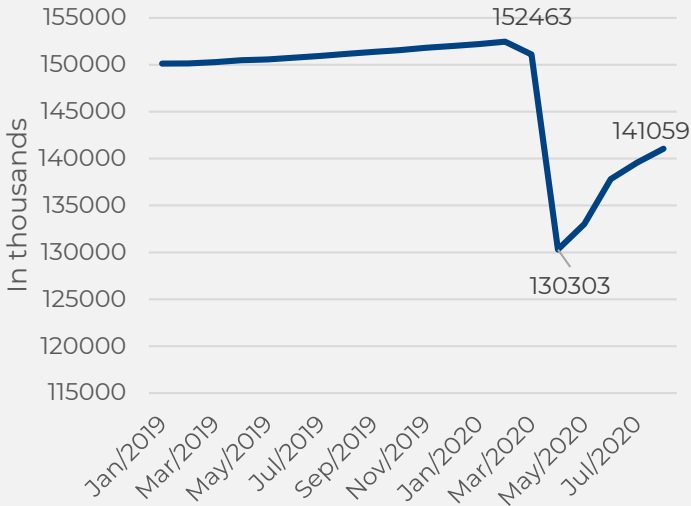
11.5 M Net Payroll Jobs May-September with 10.7 M Jobs to Recover

Sustained job recovery is essential to the turnaround of commercial real estate sales and leasing transactions. Since May and through September, the economic recovery has created 11.5 million net new payroll jobs, with 107 million more jobs to recover relative the level in February 2020.

Fifty-one percent of those gains created in the leisure and hospitality (food services, accommodation, recreation) and retail trade industries.

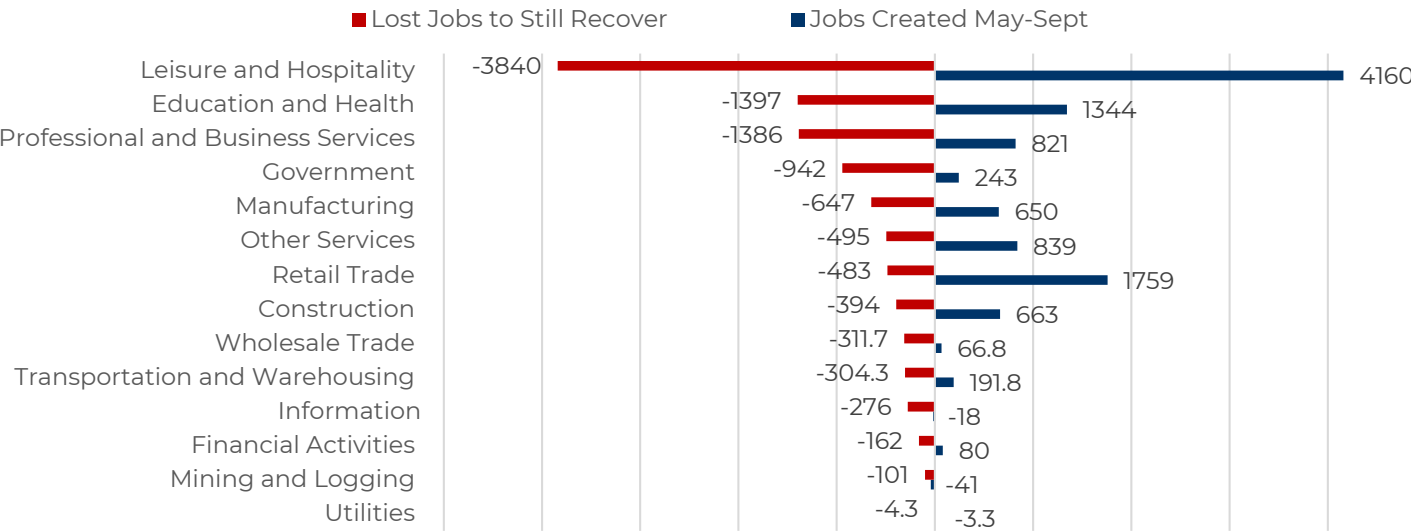
The industries with the largest jobs to recover that have a significant impact on the commercial real estate transactions are leisure and hospitality (3.8 million to recover), professional and business services (1.4 million to recover) , and retail trade (483 million). Vacancy rates for office space and retail brick and mortars will remain elevated until these jobs are recovered.

11.5 Million Payroll Jobs Created During May-September, With 10.7 Million Lost Jobs to Recover



Source: BLS Establishment Survey

Net Payroll Jobs Gains During May-August by Industry and Lost Jobs to Still Recover



Apartment

Prices fall 10% on investor concerns about rent payments

Acquisitions of apartment properties or portfolios of \$2.5 million or over declined 65% in August 2020 compared to one year ago, according to Real Capital Analytics. Year-to-date, sales are down 37%. In August.

Investors appear to be pulling back on apartment acquisitions due to cash flow concerns, with 25% of renters reporting in a US Household Pulse Survey they have no or little confidence they can pay next month's rent.

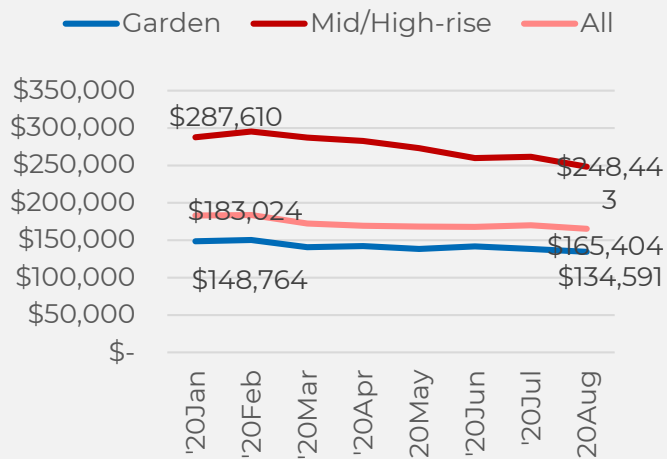
With higher risk aversion for multifamily acquisitions, the average acquisitions price for an apartment unit has fallen by 10% as of August since January 2020, with a steeper 14% drop for mid/high-rise apartments.

With higher perception of risk, the spread between the apartment cap rate and the 10-year bond rate has increased to 4.6% from 3.9% in January 2020.

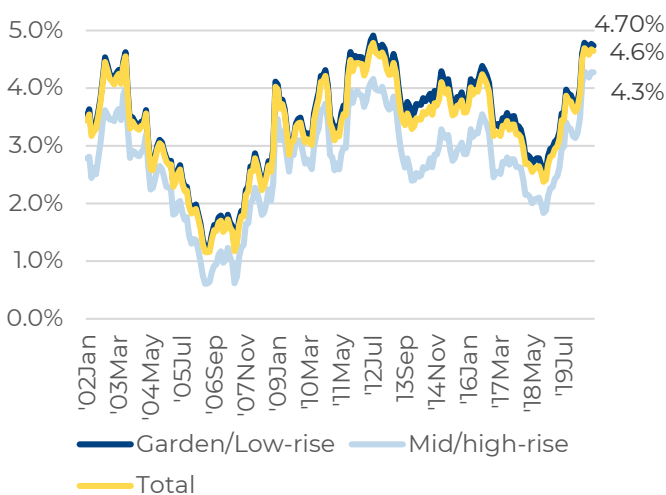
Investor preference has shifted away from garden/low-rise apartments (less than four floors), with the share declining to 66% from 87%. Sales of garden/low-rise apartments fell 75% year-over-year in August compared to a 40% decline for mid/high-rise apartments. This shift may be associated with the tenants' ability to pay rent in the garden and high-rise apartments.

	August '20		Year to Date	
	Vol (\$b)	YOY	Vol (\$b)	YOY
Apartment Total	5.5	-65%	74.3	-37%
Garden	2.8	-75%	51.3	-35%
Mid/Highrise	2.7	-40%	23.0	-41%
Single Asset	4.8	-65%	50.5	-45%
Portfolio	0.7	-67%	23.8	-8%

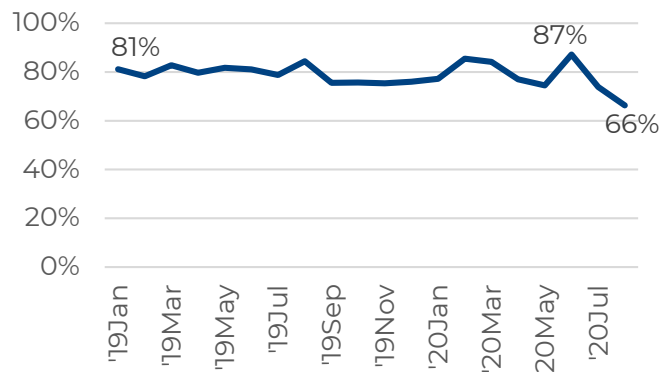
Average Sales Price Per Apartment Unit:
Down 10% Since January 2020



Cap Rates Less 10-Year Bond
Rate



Share of Garden (Low-rise)
Apartments to Total
Apartments



Office

Suburban office sales gaining ground

Acquisitions of office properties or portfolios of \$2.5 million or over declined 73% in July 2020 compared to one year ago.

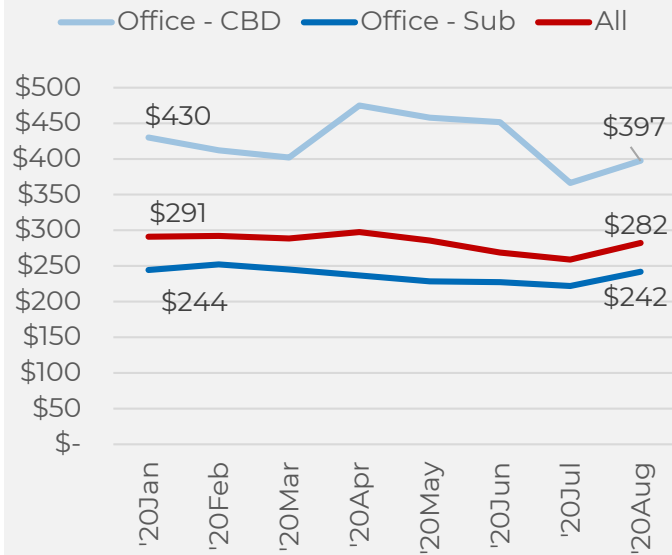
Sales in the CBD market have fallen more than sales in suburban markets. Year-to-date, sales are down 46% in the CBD market compared to 41% in the suburban market. CBD sale just made up 11% of total sales in August.

On average, office transactions closed at \$282 per square foot, 7% below the January 2020 level. Prices of properties in CBD areas have fallen more steeply by 8% compared to a smaller drop of 4% of properties in suburban markets. However, prices have firmed up, relative to July 2020 levels.

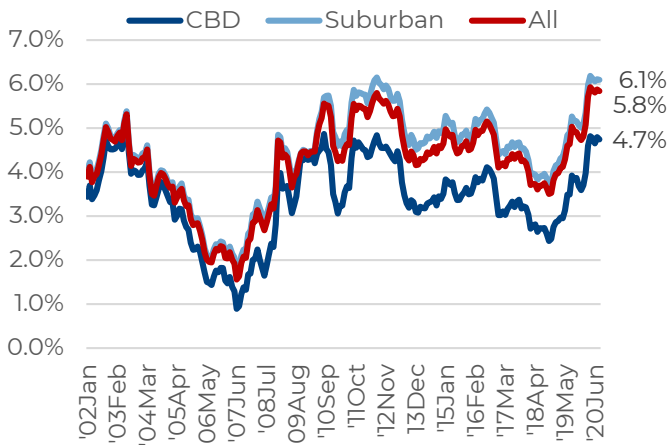
While sales appear to be shifting towards suburban markets, the perceived risk for CBD acquisitions is still lower than the risk spread for suburban acquisitions. The risk spread diverged in 2010 (lower risk for CBD). It will be interesting to see how whether this divergence narrows over time, which will depend on how sizable the work from home workforce will settle over time. Currently, about one in five workers work from home, according to the US Census Bureau's supplemental survey.

	August '20		Year to Date	
	Vol (\$b)	YOY	Vol (\$b)	YOY
Office Total	2.7	-73%	50.6	-43%
CBD	0.5	-74%	17.1	-46%
Sub	2.2	-73%	33.4	-41%
Portfolio	0.6	-73%	11.7	-36%
Single Asset	2.1	-73%	38.9	-45%

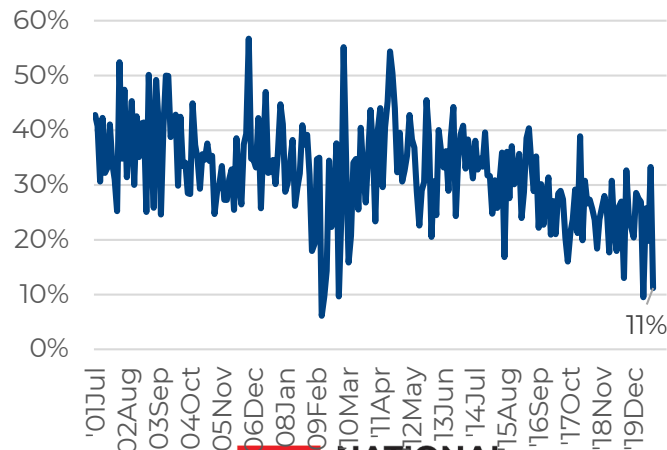
Average Sales Price Per Square Foot for Office Properties



Cap Rates Less 10-Year Bond Rate



Share of CBD Office Units to Total Office Unit Sales



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Industrial

Investor appetite wanes for industrial acquisitions

Investor acquisitions of industrial properties or portfolio acquisitions of \$2.5 million or over fell 62% in August 2020 compared to one year ago. Acquisitions of flex properties fell 52% and warehouse properties also fell 65%.

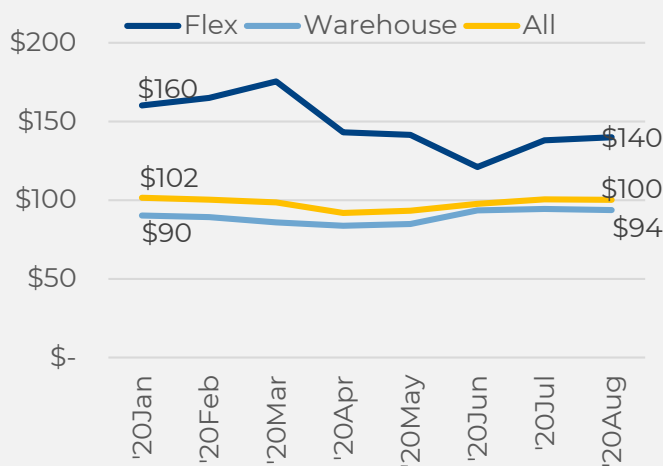
Across both warehouse and flex acquisitions, the average sales price per square foot slightly fell by 2%. Prices of flex industrial properties fell by 12.5%. However, prices of warehouses rose by 4% even as sales declined. This indicates that properties that sold on the market were prime properties.

Despite waning investor appetite for industrial acquisitions, industrial is still favored by many investors as it has been less negatively impacted than other property types. Industrial deal volume is largely down due to three reasons. First, economic uncertainty. Second, as a result of less property tours due to company travel bans and measures taken to mitigate the spread of the coronavirus, and lastly, because every industrial property is not a logistics property or Amazon.

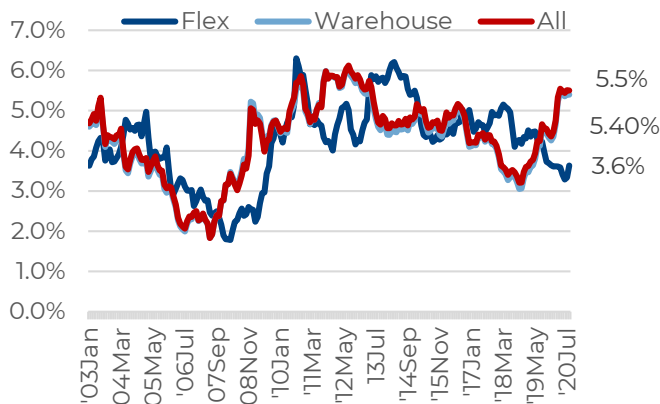
The deal volume is skewed as a result of the larger assets. The smaller assets that are not logistic properties or that do not have an online shopping presence are suffering. Around a one-third of industrial deal volume originates from the sale of distribution warehouses where Amazon and FedEx, for example, have benefited from the surge in online shopping. As a result, Amazon and FedEx have both recorded large deal transactions on numerous occasions throughout the pandemic.

	August '20		Year to Date	
	Vol (\$b)	YOY	Vol (\$b)	YOY
Industrial Total	3.0	-62%	51.6	-3%
Flex	0.8	-52%	9.8	-17%
Warehouse	2.2	-65%	41.8	1%
Single Asset	2.2	-57%	26.9	-28%
Portfolio	0.8	-71%	24.7	54%

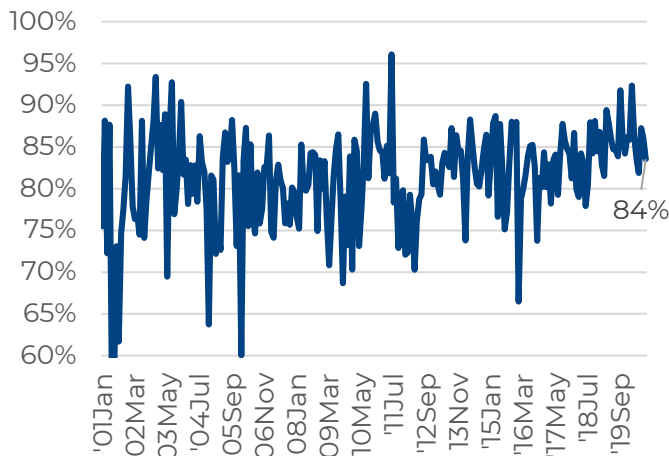
Average Sales Price Per Square Foot for Industrial Properties



Cap Rates as Less 10-Year Bond Rate



Share of Warehouse Unit Sales to Total Industrial Unit Sales



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Retail

Multi-tenant centers hit harder than single-tenant shops

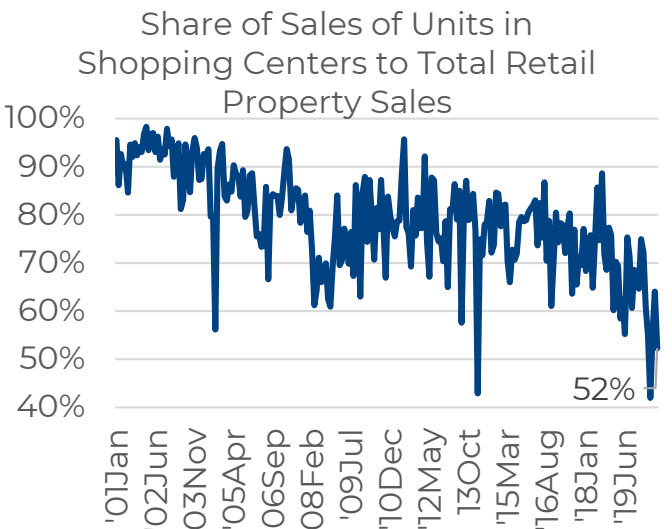
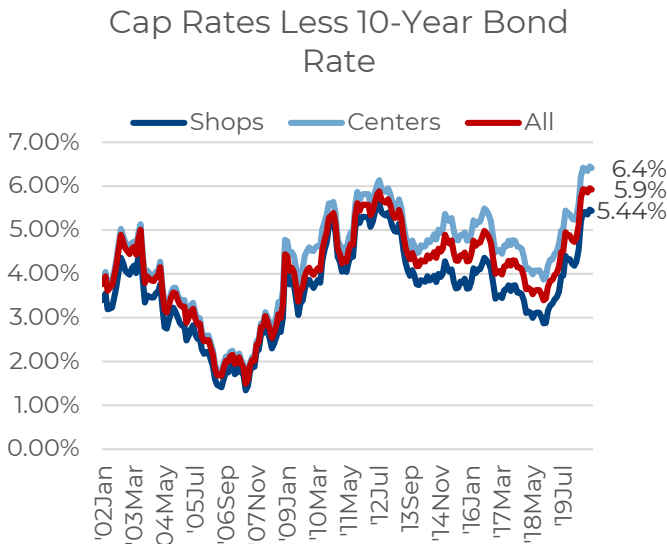
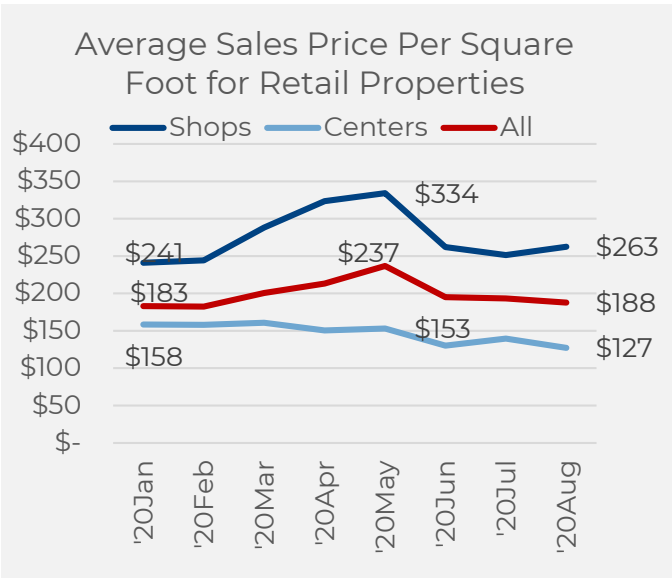
Commercial sales/acquisitions of retail properties or portfolio acquisitions of \$2.5 million or over declined 73% in August compared to one year ago. Year-to-date, sales are down 45%. Investor acquisitions for shopping centers (multiple tenants and 30,000 square feet or more) has contracted more than acquisitions for shops (retail spaces usually occupied by a single tenant and/or under 30,000 square feet).

The average price per square foot for acquisitions of retail properties firmed up in May but prices are trending downwards again. The price per square foot for all property acquisitions was down 21% since May, with prices for shops also falling by 21% and price per square foot of acquisitions for centers down by 17%.

The spread between the cap rate and 10- year T-bond for shopping center acquisitions was 6.4%, a higher spread compared to shops, at 5.4%.

Social distancing and the growth of e-commerce is likely to push investor interest towards smaller single-tenant shops.

	August '20		Year to Date	
	Vol (\$b)	YOY	Vol (\$b)	YOY
Retail Total	1.1	-73%	21.3	-45%
Centers	0.3	-85%	10.7	-48%
Shops	0.8	-56%	10.7	-41%
Single Asset	1.1	-73%	19.0	-42%
Portfolio	0.1	-72%	2.3	-61%



Office Market Occupancy Trends: Elevated Vacancy Rates

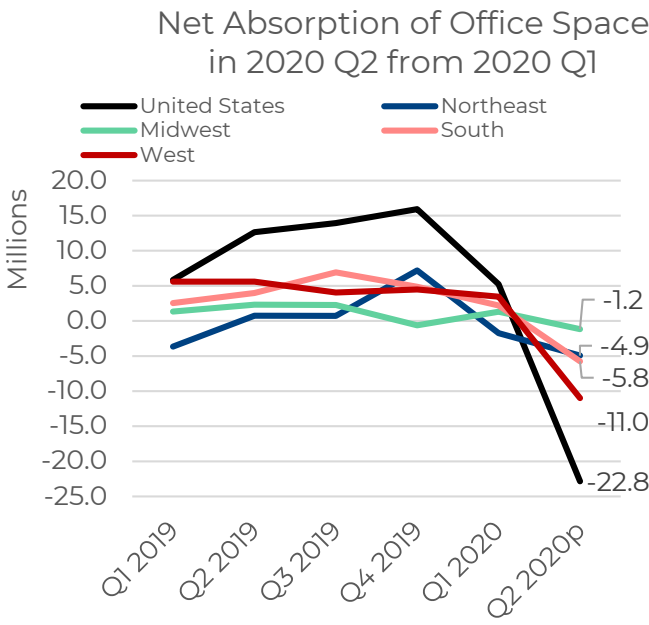
Office Property Market: Lots of Office Space Through 2022 Q1

West and Northwest regions experienced the largest loss of office occupancy in 2020 Q2

Jobs in office-using industries provide the demand for office space. In March and April, the economy shed 2.86 million jobs in the Information, Financial Activities, and Professional and Business Services industry sectors.

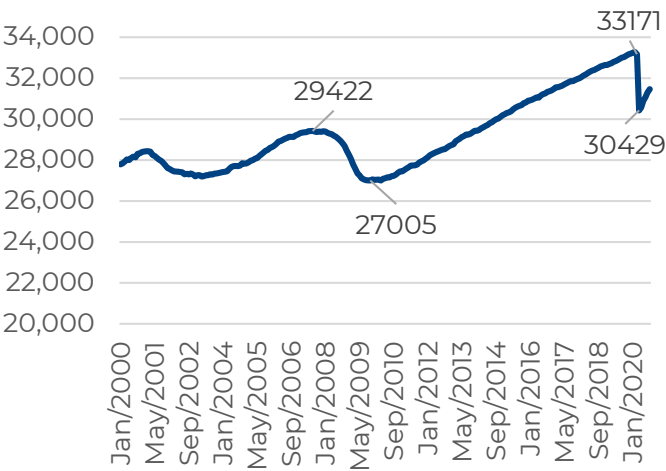
Amid the job losses and business closures, occupied office space fell by 22.8 million square feet (msf) in 2020 Q2 from the level in 2020 Q1 (negative net absorption), or 0.4% of the 5.2 billion in office space, according to Cushman and Wakefield's 2020 Q2 report. In level terms, the West region accounted for half of the loss of occupied space (-10.9 msf), followed by the South region (-5.8 msf), the Northeast (-4.94 msf), and the Midwest (-1.16 msf). As a fraction of the total inventory of office space, the largest loss of space was in the West (0.7% of total space), and the Northeast (0.4% of office space), then the South (0.3% of total space) and lastly the Midwest (0.1% of total space).

More than a million of square feet became unoccupied during the second quarter in San Francisco, New York, Phoenix, Dallas, and Los Angeles.

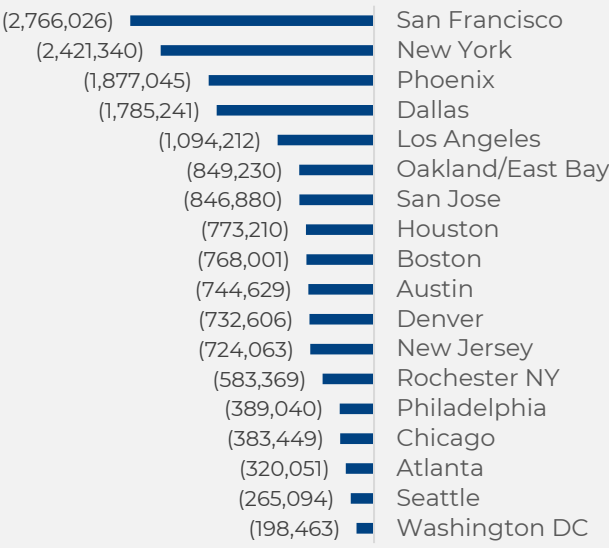


Source: Cushman and Wakefield

Payroll Employment in Information, Financial Activities, and Professional & Business Service Industries (in thousands)



Net Absorption of Office Space in 2020 Q2 from 2020 Q1



New York covers Brooklyn, Downtown, Midtown, Midtown South. New Jersey covers Central and Northern New Jersey. Source: Cushman and Wakefield

Office Property Market: Lots of Office Space Through 2022 Q1

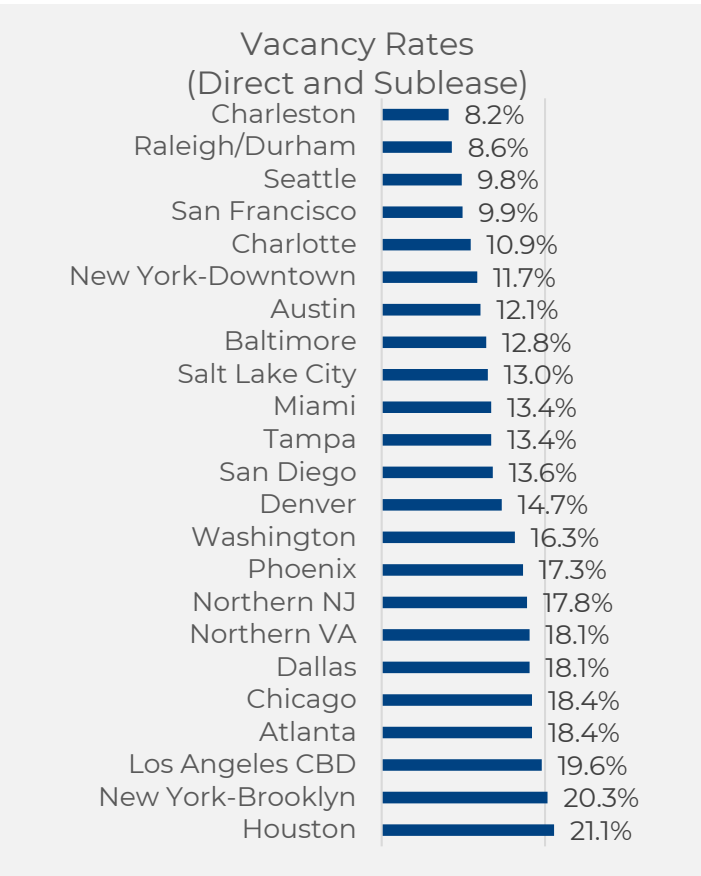
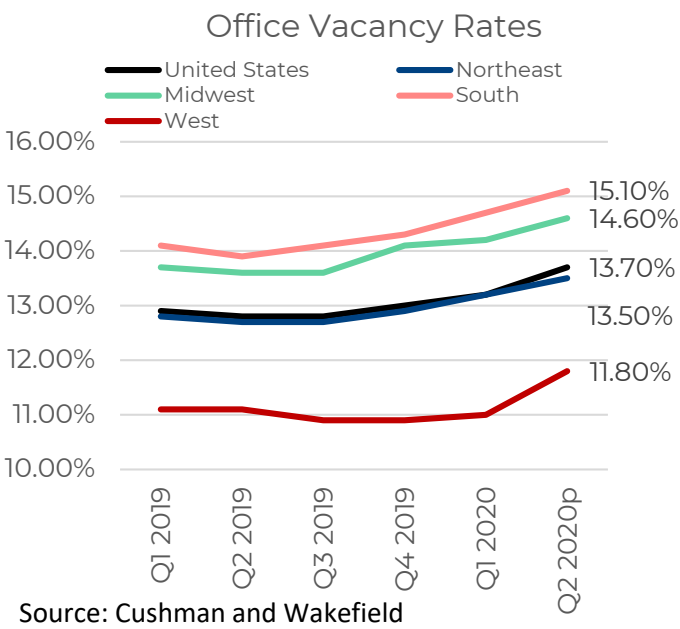
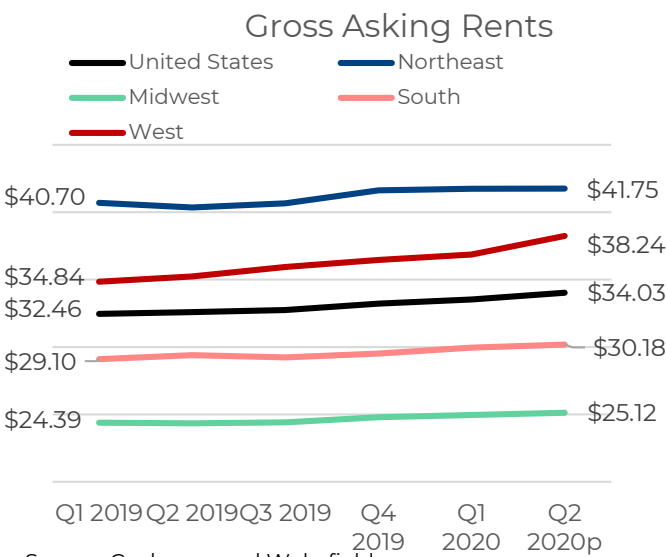
Vacancy rates rose on all regions, with the highest rates in the South and Midwest

With the loss of office occupancy, office vacancy rates has increased in all regions. Nationally, the vacancy rate rose to 13.7% from 13.2% in 2020 Q1, the largest q/q increase since 2009. Vacancy rates have been historically higher in the Midwest and South regions where there is more land for new construction.

Among the large metro areas with the highest vacancy rates are Houston (21.1%), NY-Brooklyn (20.3%), Los Angeles (19.6%), Atlanta (18.4%), and Chicago (18.4%), Vacancy rates are relatively lower in Charleston, Raleigh, Seattle, and San Francisco (even with the large negative net absorption), at less than 10%.

Rents Have Remained Stable as Landlords Minimize Revenue Losses

While vacancy rates have increased, gross asking rents have remained at about the same level as in 2020 Q1 and are still higher compared to year-ago levels. With revenues already falling from loss of occupancy, landlords are not lowering rents to minimize the revenue loss.



Office Property Market: Lots of Office Space Through 2022 Q1

Metro areas with the largest vacancy in subleased space

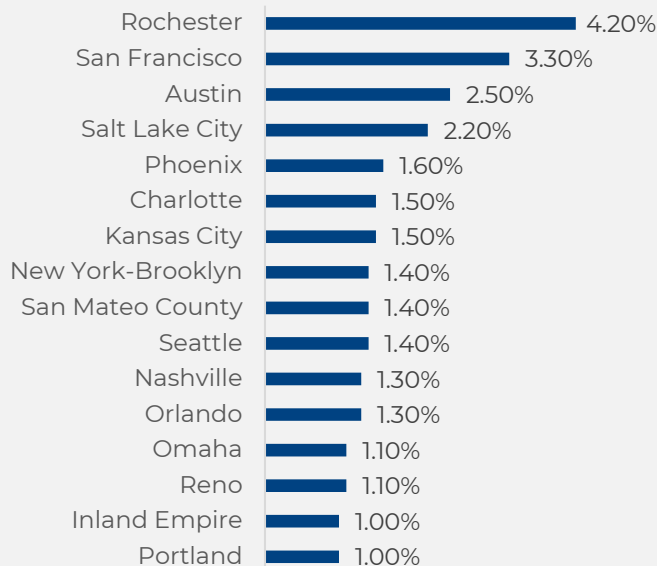
The demand for subleased spaces — generally associated with hot/open desks or co-working — has fallen as workers work from home and practice social distancing. The metro areas that have been most impacted are areas associated with tech workers—such as Rochester, San Francisco, New York, Austin, Salt Lake City, Phoenix, Charlotte, Seattle, Nashville, Inland Empire, and Portland.

The demand for flexible space will heavily hinge on institutional occupiers seeking short-term lease and ready-to-move-in office spaces, typically new businesses and small businesses who may not want to invest in large upfront construction cost.

Elevated Vacancy Rates with New Projects Under Construction

Vacancy rates will remain elevated with 143 million on office space currently under construction, according to Cushman and Wakefield data. The negative net absorption in 2020 Q2 of 22 million and the 143 million under-construction office space amount to 3% of current inventory. This will take about 16 months to exhaust, assuming office-using jobs grow at 50,000 monthly, the pace during 2010-2019. This will mean little development that will break ground on top of what's underway. Rents will tend to remain flat over the next 12 months at least.

Vacant Subleased Space as a Percent of Total Office Space



For questions on this article, contact Gay Cororaton at scororaton@nar.realtor.

Vacated Space and Office Space Under Construction: 3% of Current Inventory

	New vacant space arising from negative net absorption in 2020 Q2 / 1	Under construction as of 2020 Q2 / 1	Total new vacant space as of 2020 Q2	Total new vacant space as percent of total inventory (MSF) in 2020 Q2	Average office-using jobs generated per month 2010-2019 / 2	Months to exhaust new supply
United States	22,840,352	134,486,095	157,326,447	2.9%	49,000	16.05
Northeast	4,941,168	31,284,776	36,225,944	2.9%	7,000	25.88
Midwest	1,163,523	14,456,615	15,620,138	1.9%	8,000	9.76
South	5,751,864	45,731,604	51,483,468	3.0%	21,000	12.26
West	10,983,797	43,013,100	53,996,897	3.5%	13,000	20.77

Notes:

/1 Source of data: Cushman and Wakefield 2020Q2 Office MarketBeat Report (Kenneth McCarthy)

/2 Sum of payroll jobs in Information, Financial Activities, and Professional and Business Services based on BLS data

/3 Assumes 200 per sq feet of space per employee

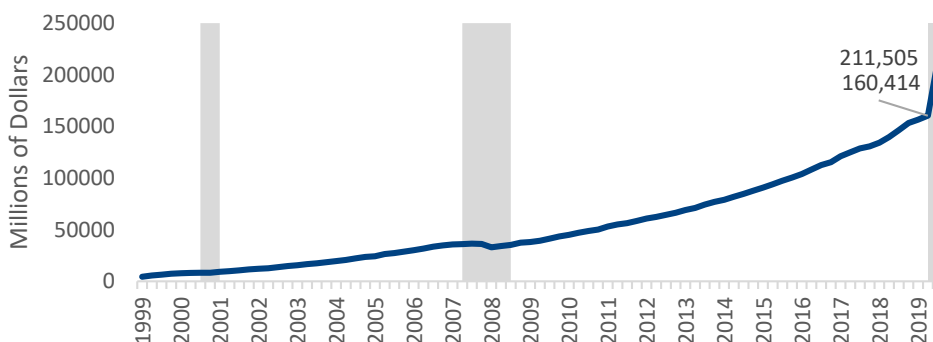
E-commerce Growth and Adaptive Reuse

E-Commerce Trends

E-Commerce Trends

U.S. e-commerce has been experiencing an increasing upward trend since the late 1990s according to U.S. Census Bureau data. The total percent of e-commerce retail sales with respect to total retail sales has increased from .06% in 1999 to 11.3% at the conclusion of 2019 while increasing throughout each recession. However, the measures taken to mitigate the coronavirus pandemic functioned as a catalyst for the acceleration of e-commerce growth. The major contributing factor towards the shift to online commerce was due to shelter-in-place policies. With the majority of brick-and-mortar retail assets closed and households minimizing outdoor activity, online sales significantly increased although total retail sales had a historic decrease in April.

E-Commerce Retail Sales, Quarterly, SA

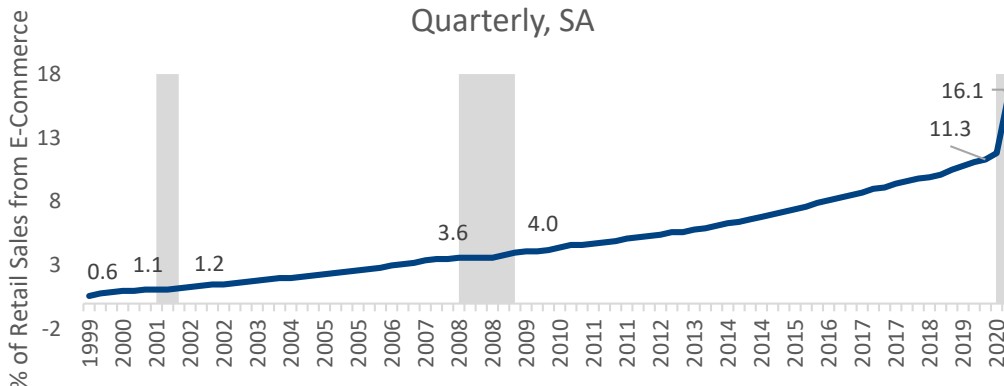


Source: U.S. Census Bureau

Note: Recession Shading (grey area)

Second quarter estimated e-commerce sales were \$211.5 billion, an increase of 31.8% from first quarter while total retail sales for the second quarter of 2020 were estimated to be \$1,311.0 billion where e-commerce sales in the second quarter of 2020 accounted for 16.1% of total sales. The magnitude of the increase from pre-COVID levels of 11.3% at the conclusion of 2019 to second quarters 16.1% represents a historic spike of e-commerce penetration within a span of three or four months as increases in non-store retail sales, which includes e-commerce was the primary driver.

E-Commerce Retail Sales as a Percent of Total Sales, Quarterly, SA

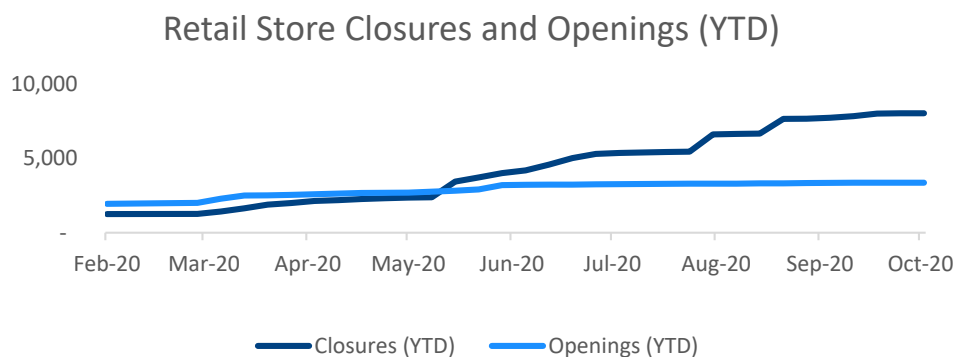


Source: U.S. Census Bureau

Note: Recession Periods (grey area)

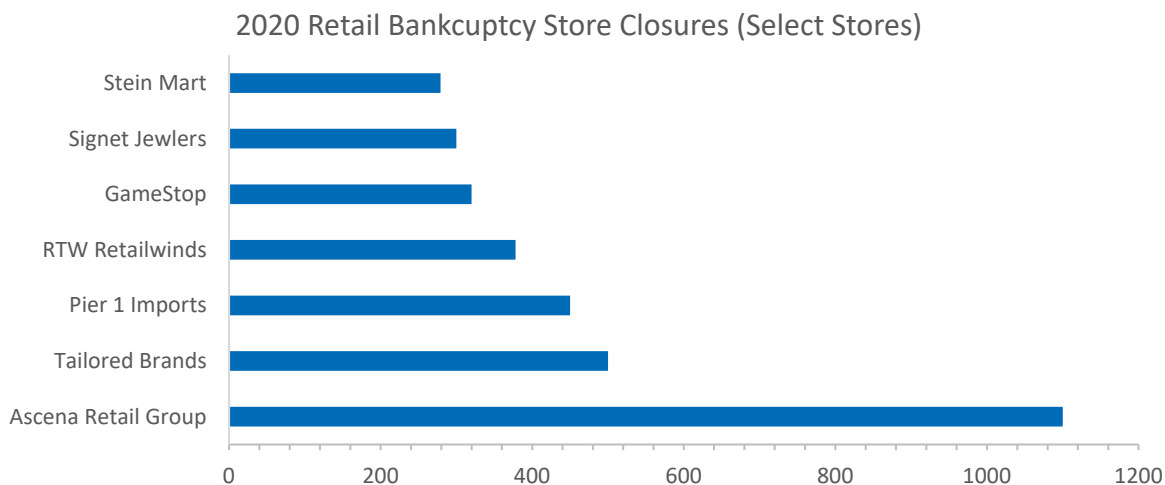
E-Commerce Trends

The ongoing coronavirus pandemic has brought about numerous large-scale retail closures and bankruptcy filings, despite the improvements in retail and increasing demand for industrial warehouse space. There is substantial coverage on the potential to repurpose vacant retail space for industrial purposes, but one cannot automatically assume that because a retail space has become vacant or inactive that it is a great candidate for repurposing into industrial warehouse space.



Source: Coresight Research

As of October 2, more than 8,016 retail stores shuttered year-to-date according to Coresight Research. Many of these shuttered retail stores are housed in malls as anchors stores which occupy a large amount of square footage. Macerich public filings indicate that their malls have 27 JCPenney (whom was rescued by Simon and Brookfield Property from bankruptcy), 5 Sears, 2 Neiman Marcus, 3 Lord & Taylor and many more big-name stores who have filed for bankruptcy. Retail bankruptcies are on a record pace this year with more than 35 retailers and restaurant chains filing for bankruptcy according to company press releases. There have been more bankruptcy filings year-to-date than all of 2019 as the coronavirus pandemic impacted brick-and-mortar retail properties ability to generate revenue as retailers experienced significant reduced foot traffic.



Source: Company Press Release and Filings

Adaptive Reuse

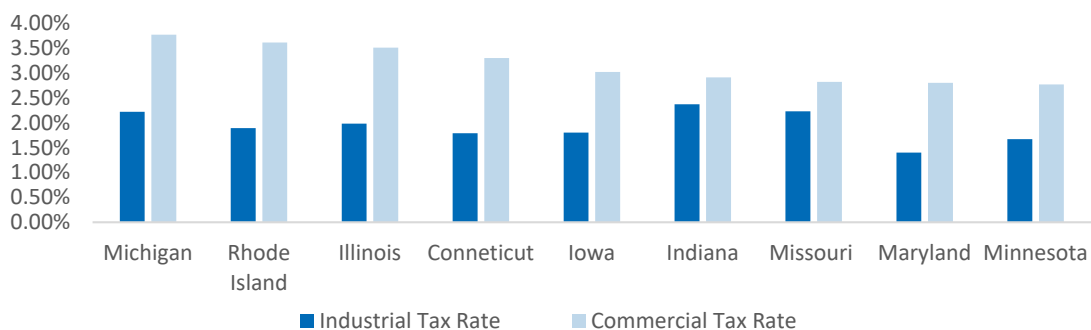
Teardown vs. New Construction of Warehouse Space

In recent reports, we have discussed why industrial properties were the more favored property type during the COVID-19 pandemic and discussed how industrial warehouse/distribution centers have reaped the rewards from the shift towards e-commerce. According to real estate logistics and supply chain logistics firm Prologis, online retailers need more than three times the logistic space of brick-and-mortar retail stores in order to generate similar sales because online order fulfillment requires more warehouse space as inventory is stored within warehouse space as opposed to brick-and-mortar retail store shelves. While e-commerce growth underpins the increase in demand for industrial warehouse/distribution space, as e-commerce continues to increase, demand for logistic space will continue to increase at an elevated rate.

Considering the coronavirus pandemic has forced many retailers to file for bankruptcy for which vacant retail storefronts were left in its wake, coupled with pre-pandemic vacant malls and the shift towards e-commerce...if industrial is performing well considering the economic climate, should all retail space be torn down in favor of constructing warehouse space? There are a few explanations as to why a complete teardown faces obstacles. First, complete teardowns increase development costs, require additional time for acquiring permits followed by completing the demolition. Once demolition is complete, associated building costs are incurred where the end return on investment with respect to all costs incurred may not be economically feasible. Secondly, the developer has to overcome zoning issues.

Warehouse/Distribution property developers cannot merely build industrial buildings in an area that was zoned for commercial use. In order to do so, developers must have the area rezoned for industrial use for which will add additional time to the development provided their plans are approved.

Industrial vs Commercial Property Tax Rate Comparison



Source: Lincoln Institute of Land Policy
Note: Selected States

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Lastly, there is little incentive for state and local governments to approve of the rezoning of an area and/or asset for industrial use if it is currently zoned for residential or other commercial use, given that property tax assessments have the propensity to be less for areas zoned for industrial use as illustrated by the Lincoln Institute of Land Policy, 2020 50-State Property Tax Comparison Study that reflects taxes paid in 2019. Thus, state and local governments would collect less tax revenues. If a complete teardown is not an economically viable option, is repurposing?

In the [August 2020 Commercial Market Insights](#) report, it was noted that Simon Property Group Inc., the largest mall operator, who is currently redeveloping vacant mall space into ghost kitchens in some of their malls, was in talks with Amazon to repurpose some of the vacant space remaining from ailing retail stores into distribution and fulfillment centers. Amazon would not be venturing into uncharted territory as they have already converted some vacant and/or declining mall sites in Ohio into fulfillment centers as covered in the [2020 Case Studies on Repurposing Vacant Retail Malls](#) report. Amazon and e-commerce as a whole have performed well throughout the coronavirus pandemic notwithstanding the economic environment.

As discussed in prior CMI reports, the fulfillment center option between Simon and Amazon makes sense. This is a viable option considering there would be no costs associated with completely tearing down the existing anchors as they would be repurposed and neither Amazon nor Simon would have to go through the process of rezoning from commercial use to industrial use. Amazon would hold a lot of negotiating power as it pertains to rent considering Simons other option...a significant amount of vacant space left as a reminder from shuttered anchor tenants. While rent collected would be lower for Simon on Amazon's fulfillment center when considering other mall tenants, in this economic climate, lower rental income is better than no rental income. Benefits for Simon would come in the form of some rental income, and leasing vacant anchor space would help Amazon meet increasing demand while reducing shipping times as malls are in close proximity to more dense populations while state and local municipalities would continue to tax Simon at the commercial rate.

In addition, according to their financial statements, they had 18 pre-Covid vacant anchors in centers owned and not owned by Macerich. Public filings for Simon Property Group, the largest mall owner and operator in the nation, show their malls have 63 JCPenney, 12 Neiman Marcus, 11 Sears and 9 Lord & Taylor anchor stores all of which floor space would be of interest to Amazon.

While in this instance, repurposing seems to be a viable option, but not every retail property that houses a brick-and-mortar retail tenant that is suffering is a viable candidate for repurposing into industrial use. So how would one identify where and which retail properties should be repurposed as industrial space? For the final portion of this report, we shall establish a criterion by looking at retail tenants that have filed for Chapter 11 bankruptcy and identifying key aspects of retail space occupied by ailing retail tenants that would make for a viable option for converting retail space.

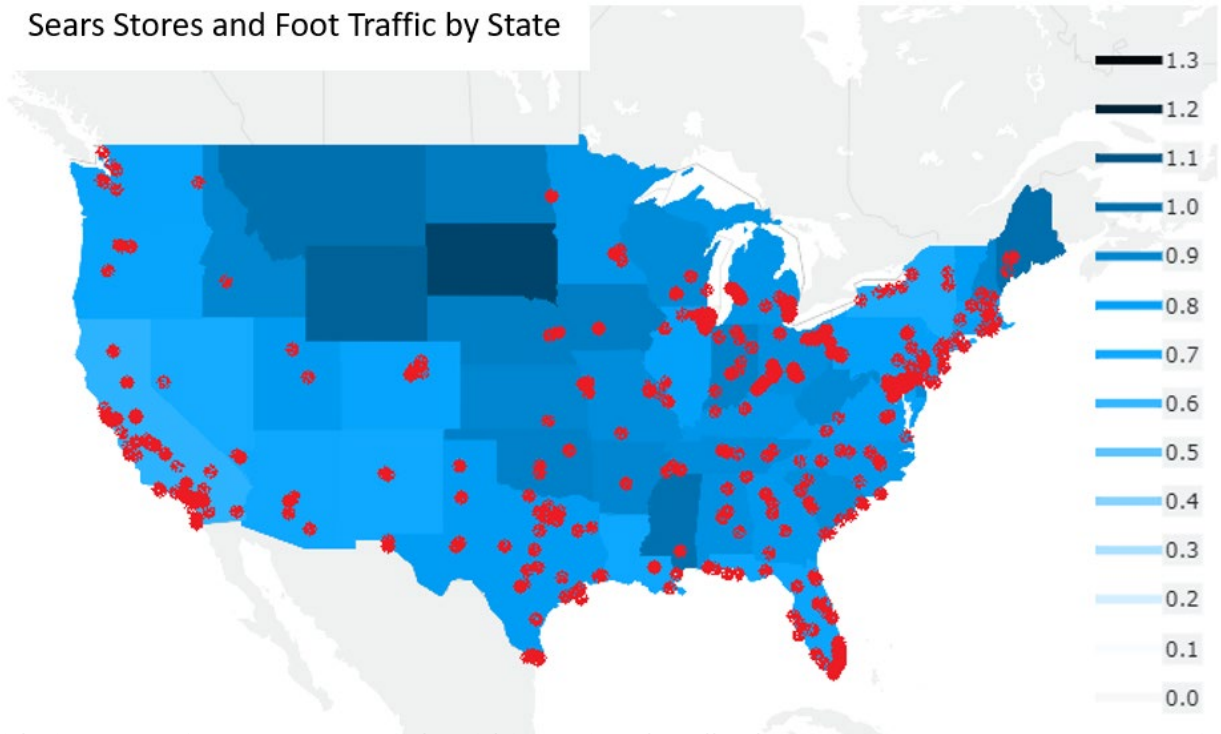
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Sears

Sears was the Amazon and Walmart of its era. Having been founded 134 years ago, Sears made its name via its catalog business for which they sold mass-produced goods all across the nation in what was essentially non-brick-and-mortar commerce. When the mid-20th century came around, Sears was the largest private-sector employer in the nation, with Sears anchoring malls and seeing accelerated growth. But Sears, not unlike many department stores, had to maneuver through difficult times. Sears has been hemorrhaging money since 2011 which was the year after they stopped being profitable and so, they filed for Chapter 11 bankruptcy in October 2018.

In 2019, a judge approved the sale of most of Sears assets in what allowed for 425 stores open and retained 45,000 employees. Of the remaining Sears stores, approximately 62% reside within regional malls. The map below illustrates Sears stores where SafeGraph Patterns, a dataset of foot traffic counts and visitor insights on 5 million points-of-interest provides insight into retail foot traffic where the darker shaded areas represent increased/close to normal foot traffic as of September 1, 2020, with lighter areas representing reduced foot traffic. As it pertains to whether or not people are returning to shop in brick-and-mortar locations, the map below suggests foot traffic is still reduced as people are still cautious of COVID-19 given that a large share of Sears stores is located in states with higher COVID-19 cases.

Sears Stores and Foot Traffic by State



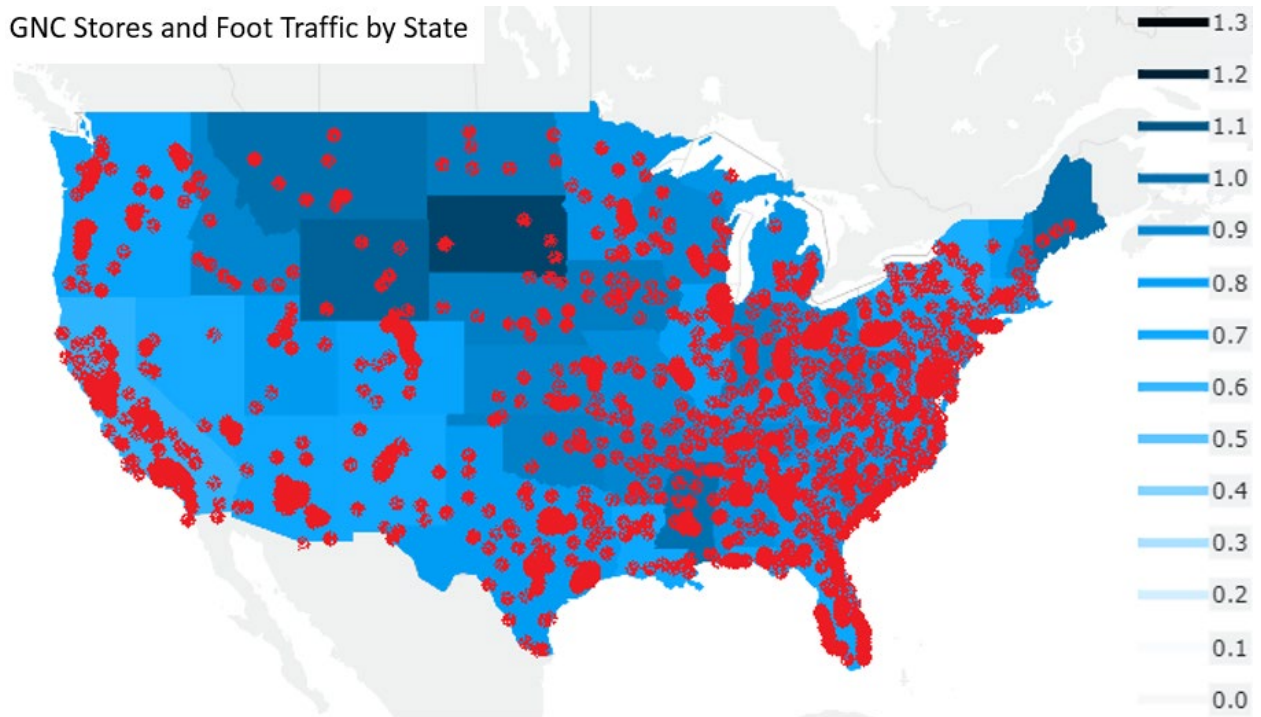
Considering 62% of Sears stores reside within regional malls, the option to repurpose commercial space into industrial fulfillment centers is an economically viable option when considering the supply chain logistics as regional malls are quite large-with online retail needing more space to store inventory and its close proximity to major freeways.

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GNC

GNC, a global specialty health, wellness and performance retailer that sells performance, health and nutrition related products was founded as Lackzoom Health Store in 1936 and became GNC in 1959. GNC reported a \$200 million loss in May 2020 as sales decreased up to 60% at brick-and-mortar locations as COVID-19 forced many of their stores to close. GNC filed for Chapter 11 bankruptcy on June 24, 2020, announcing its intent to close between 800 and 1,200 stores while GNC actively searched for a buyer. In September, a Delaware bankruptcy court will allow GNC's sale to Harbin Pharmaceutical Group (HPG) for \$770 million.

GNC Stores and Foot Traffic by State



In December 2018 GNC operated more than 8,400 stores globally. Between then and March 2020, store count was reduced to 7,300 with shopping mall locations being the primary closures. GNC has approximately 5,200 United States locations across all 50 states and the District of Columbia. There are two principal differentiators between retail spaces that house GNC and Sears. First, 61% of GNC's U.S. locations are in strip centers and the remaining 28% are located in malls. U.S. GNC stores are between 1,000 and 2,000 square feet which is significantly smaller than that occupied by Sears, 152,600 square foot locations.

Based on these two principal differences, it is unlikely that space currently occupied by a retail tenant such as GNC would be appealing for a conversion into a fulfillment center destined for industrial use. In any event, after canceling their bankruptcy auction, GNC is expected to emerge from Chapter 11 proceedings in early Q4 2020 with a new owner who was already its biggest shareholder at 40%, HPG. This GNC example was discussed in this report to reiterate the point that one cannot simply assume that because a retail property has become vacant that it is an obvious or prime candidate to be repurposed into industrial use.

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Guiding Principles for Repurposing Retail Space

We have established that e-commerce sales underpins the increase demand for distribution/warehouse and was accelerated by the COVID-19 pandemic. We also determined that a complete demolition of retail space with the intent to construct industrial space poses various obstacles and may not be an economically viable option for which makes it unappealing for developers or those who would operate the distribution/warehouse space.

But the driving factor of determining if retail space should be repurposed as industrial space was touched on in our Sears and GNC examples-supply chain logistics. There are three fundamental building blocks of logistics: transportation, warehousing and inventory and these building blocks must be addressed. Through the analysis of these building blocks, many pertinent questions are answered but our focus is on the consumption end of new supply chain logistics that capture new requirements being generated from e-commerce for which there are four primary areas, last touch (last stop before product is delivered to consumer doorsteps), city distribution (quick shipping to a large market), multi-market (service multiple markets with the right balance between locations and functionality) and gateway (multi-market building with access to major seas and ports).

The primary factors for operational efficiency are location and functionality. For instance, in the case of the potential Simon and Amazon deal, the repurposed retail space would be within/close proximity to urban areas with increased levels of demand that warrants the operation of a fulfillment center. For a multiple market gateway use facility, a large Sears for example will work as they average about 200,000 square feet, but the space typically occupied by a GNC is too small and not within close proximity to ports for which repurposing into an industrial warehouse/distribution center is unjustifiable. Therefore, if the repurposing of retail space into industrial space is justified, the location and final use are the determining factors of whether vacant retail space is repurposed as industrial space.

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COMMERCIAL MONTHLY INSIGHTS REPORT

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