The modest recovery in commercial sales transactions in the third quarter halted in November amid a resurgence of coronavirus cases that may have given investors pause in their acquisitions.

Commercial sales transactions fell 57% year-over-year in November, with sales falling across property types, even for industrial properties.

In both the multifamily and office markets, transactions in suburban markets have contracted much less than in CBD markets. Sales prices in suburban markets are also picking up faster than prices in CBD markets. Industrial property acquisitions have contracted year-over-year, but sales prices have increased, an indication that investors continue to acquire properties with good market fundamentals. In the retail market, cap rates remain at a five year high, reflecting the higher risk perception of investors as e-commerce sales continue to accelerate during the pandemic.

This issue looks at the latest trends across the commercial property markets (multifamily, office, industrial, and retail) and features two pieces on hotel sector and cap rate trends. The hotel sector has been struggling the most compared to other industries, but on a positive note, less than 2% of businesses have closed. Across all property markets, cap rates have remained relatively stable even as T-bond rates have fallen, but expect an uptick next year with the distribution of the vaccine and a slight rise in overall yields.
Commercial Market Overview

Commercial sales transactions fall anew by 57% in November 2020

After showing some recovery during June to October, properties or portfolio acquisitions of $2.5 million or more dipped to $21 billion in November, a 57% decline from the level of acquisitions in November 2019. Year-to-date, sales transactions are down 40%, with all sectors showing year-over-year declines on a year-to-date basis and in November alone. On a year-to-date basis, the largest decline in investment or acquisitions in in hotel properties, at -72%.

Transactions-based commercial prices rose 5.7% year-over-year, as price of industrial acquisitions rose 9.5% and multifamily rose 7.6%. However, prices have fallen in hotel (-7.2%), retail (-6.7%), and office (-0.2%), indicating investors are still broadly staying away from these assets.

The difference between the cap rate and the safer 10-year T-bond rate of 0.87% in November 2020—a measure of riskiness for commercial investments relative to the safer T-bond—have declined somewhat since July 2020, except for hotel properties. However, the risk premiums are still elevated compared to pre-pandemic levels. The apartment sector had the lowest risk premium (+4.3%) followed by industrial (+5.1%), then office (5.7%) and retail (5.7%), with the largest risk premium for hotel acquisitions at 7.9%

Source: Real Capital Analytics
Commercial Market Overview

Commercial prices are firming up but still 8% below year-ago levels

Commercial sales prices are slowly recovering but prices are still below year-ago levels. In November, the Green Street Commercial Property Price Index—an appraisal-based index that covers core (apartment, office, industrial, retail) and non-core sectors was up 1.8% compared to October. The index only the core property types rose 1.5%, indicating that the demand for commercial properties is stronger in non-core sectors that covers self-storage, health care, single-family rental, manufactured housing, and data centers.

Industrial and IT-focused REITs have highest returns

As of November, REITS that own and manage data centers had the highest year-to-date return of 17.2%, followed by infrastructure, industrial, and self-storage. The interest of investors in these sectors is being driven by the growth of e-commerce sales, the use of smart technology, Internet of Things (IoT) internet, and social media, and now working from home—all of which require the use of telecommunication infrastructure data centers.

CMBS delinquency rates continue to decline in September

Overall delinquency rates on commercial mortgage-backed Securities declined to 8.28% in September (8.9% in October), according to Trepp. Delinquency rates declined for lodging, retail, and industrial CMBS, but slightly increased for multifamily to 2.95% in 2020 Q3 (2.8% in 2020 Q2) and office to 2.49% (2.28% in 2020 Q2). However, these delinquency rates are modest relative to that of retail CMBS, at 14.33%, and lodging CMBS, at 19.43%.
Commercial Market Overview

(Note: Leasing market data* is updated only quarterly)

Net loss of occupancy in office and retail is offset by increase in industrial occupancy

The office and industrial sector continued to suffer bigger losses in occupancy in 2020 Q3: office: -41.3 million; 64 million YTD; retail:-13.6 million; -21.2 million YTD). However, these occupancy losses were nearly  million). However, these vacancy losses were offset by 113 million in occupancy YTD for industrial space.

Vacancy rates have increased in all sectors, led by office, at 14.5% (13.6% Q2); multifamily, 6.4% (5.7% Q2); retail, 7.1% (6.8% Q2); and industrial, 5.3% (5.1%). On a positive note, these vacancy rates are all below the levels during the Great Recession, as vacancy rates were low before the pandemic hit, unlike during the Great Recession when vacancy rates were rising due to over-building.

Asking rents are holding up to the decline in occupancy

Even with the massive loss in occupancy, average asking rents have remained stable or even increased, according to Cushman and Wakefield data. The average office rent rose 2% in 2020 Q3 from 2020 Q2, while rents for industrial and retail space were essentially flat. Meanwhile, the median apartment rent rose 12% in 2020 Q3, to $1,261, according to data from the US Census Bureau.

Lots of industrial and office space is in the pipeline, which can increase vacancy rates

More industrial and office space is in the pipeline. Construction for office properties stood at 132.8 million square feet, representing 2.5% of the current office inventory of 5.4 billion sq.ft. Given the office space being constructed, vacancy rates are likely remain elevated at least in the coming year. Construction for industrial properties ramped up again to 340.9 million square feet in 2020 Q3 after construction declined in 2020 Q2.

Source: Cushman and Wakefield
12.3 million payroll generated from May-November 2020

As of November, the economy has generated 12.3 million jobs, or 56% of the 22 million jobs lost during March and April.

In November, 245,000 non-farm payroll jobs were created, a rate comparable to pre-pandemic level.

By industry, the largest jobs losses are still in leisure and hospitality (3.4 million to recover), education and health (1.3 million), professional and business services (1 million), and retail trade (550,000).

The pace of job creation is likely to accelerate with increased travel and in-store spending in the latter half of 2021.
Acquisitions of apartment properties or portfolios of $2.5 million or over slipped again in October and November 2020 by 27% to $24 billion compared to one year ago.

Year-to-date, the dollar sales volume of apartment acquisitions fell 37% year-over-year. Acquisitions for mid- and high-rise acquisitions fell more (-41%) compared to garden or low-rises (-35%). Garden apartments have three floors or less and tend to be found in suburban areas.

Transactions prices of garden apartments are up 9% year-over-year while prices of mid-high rises are down 9% from one year ago, another indication of investor preference for garden or low-rises. Price of garden apartment buildings started firming up in August and in September for mid/high-rises.

Year-to-date as of November 2020, the most active apartment markets in terms of apartment property acquisitions were Los Angeles (432), Dallas (248), Atlanta (176), Phoenix (174), and NYC Boroughs (170).

Source: Real Capital Analytics data
With the resurgence of coronavirus cases and continued working from home, the dollar sales volume of office property acquisitions contracted 73% in November, with a larger decline for CBD acquisitions (-77%) compared to suburban acquisitions (-69%). Year-to-date, office sales transactions are down 46%, with larger declines in CBD transactions compared to suburban office sales.

Another indicator of the better performance of the suburban office market compared to the CBD market is that commercial sales transactions prices in suburban markets are up 35% from one year ago. However, sales transactions prices in CBD office markets are lower by 14%.

Year-to-date as of November 2020, the most active office markets in terms of office property acquisitions were Los Angeles (143), Atlanta (94), Northern New Jersey (86), Raleigh/Durham (77), and DC VA Burbs (76).
Investor acquisitions of industrial properties or portfolio acquisitions of $2.5 million or over decreased as transaction volume for both flex and warehouse properties totaled $5.5 billion, a $828 million reduction from the prior month. Sales were down by 38% from year ago levels. Year-to-date, sales total $74.5 billion and are also down year-over-year by 26%.

The average price per square foot of warehouse acquisitions increased by $2 from last month to $94/sq.ft., while the average price per square foot for flex properties rose to $164/sq.ft., up from the year-low of $122/sq.ft. realized in June 2020.

Warehouse acquisitions continue to account for majority of the transactions, or 81% of property acquisitions while flex makes up the other 19% of property acquisitions. The demand for warehouse space continues its upward trend as a result of the acceleration of e-commerce as consumers continue to shop online in an effort to mitigate the spread of the coronavirus.

In November 2020, the most active markets with respect to industrial property acquisitions were Chicago (356), Los Angeles (356), Dallas (238), Atlanta (196) and Houston (163).
Commercial sales/acquisitions of retail properties or portfolio acquisitions of $2.5 million or more recorded a reduction of 11% from the prior month to $1.8 billion for November, a record low as travel limitations and the coronavirus continue to constrain deals. November’s $1.8 billion in sales/acquisitions represents a decrease of 73% year-over-year. Shops decreased by 52% year-over-year while centers decreased by 83%.

The average price per square foot for all of retail was $206/sq.ft. with shops averaging $277/sq.ft. and centers averaging $144/sq.ft.

Sales of shopping centers accounted for 41% of retail transactions in November. While cap rates for centers are essentially unchanged from prior month, cap rates remain at a five year high, 7.2%. The increase of online shopping continues to exacerbate obstacles in the retail market. With the holiday shopping season underway and daily online shopping sales records being broken, shopping center woes are likely to continue.

In November 2020, the most active markets with respect to retail property acquisitions were Los Angeles (201), Chicago (130), Dallas (128), New York City Boroughs (115), and Atlanta (104).
Hotel Sector: Struggling But Limited Closures Thus Far

The coronavirus pandemic has had a more acute impact on businesses providing accommodation services (hotels, motels, bed and breakfasts) compared to all industries broadly. Small businesses in the accommodation industry (NAICS 7211) continue to struggle financially due to decreased personal and business travel and in-person business conferences or events. The latest Small Business Pulse Survey of the U.S. Census Bureau conducted during the week of December 12 demonstrates the continued adverse impacts of the pandemic:

- A higher fraction—63.9% of small businesses in the accommodation industry — reported a decrease in operating revenue in the past month, compared to 38.9% of all respondents across the various industry sectors. Nationally, the percentage of respondents who reported decreased operating revenue has notably declined, but that has not been the case for the accommodation industry.

- A higher fraction of small businesses in the accommodation industry — 86.3% — reported they obtained a Paycheck Protection Plan (PPP) loan compared to 72.7% among all respondents.

- With travel to recreation centers still below pre-pandemic level, 52.4% of small business in the accommodation industry need additional capital in the next six months compared to 27.9% among all businesses.

With about half of businesses needing additional capital, a survey commissioned by the American Hotel and Lodging Association during November 2-4 found that without further government assistance (i.e. second PPP loan, expansion of Main Street Lending Program), nearly half (47%) of respondents indicated they would be forced to close hotels and more than one-third of hotels will be facing bankruptcy or be forced to sell by the end of 2020.

Source of data: US Census Bureau Small Business Pulse Surveys
Hotel Sector: Struggling But Limited Closures Thus Far

- A higher fraction—68.8% — reported they will return to normal only after six months, compared to only 45.9% among all industries.

**Less 2% of Businesses Have Closed**

Despite the tremendous challenge that small businesses are facing, particularly businesses that provide accommodation services, less than 2% of all small businesses in the accommodating industry and all industries broadly have permanently closed, according to the latest US Census survey conducted during the week of December 12.

The new $900 billion stimulus bill that allows businesses to deduct expenses associated with their forgiven PPP loans will help small businesses, particularly those in travel and accommodation, 99% of which are small firms with less than 500 employees and 84% of establishments have less 500 employees. However, while most establishments are small businesses, the large hotels account for the bulk of the employees, accounting for 60% of total employment. So to prevent massive unemployment, both big and small businesses require financial assistance, which is currently available under the PPP Loan Program (less than 500 employees) and the Main Street Lending Program that can help mid-size companies (seeking more than $2 million in financing and have at least $1 million in 2019 earnings before interest, taxes, and depreciation allowance.

Businesses providing accommodation services are located across the United States, but are concentrated in the big cities, led by Las Vegas, New York, Los Angeles, Orlando, Miami. Chicago, Washington DC, Dallas, San Diego, and San Francisco. This will also be the areas that will have the strongest recovery once personal and business ravel resumes.

Hotel/Lodging: Struggling But Limited Closures Thus Far

Distribution of U.S. Businesses in Traveler Accommodation Industry (NAICS 7211) by Number of Firms, Establishments, and Employment Size in 2017

<table>
<thead>
<tr>
<th>Traveler Accommodation</th>
<th>&lt;5</th>
<th>5-9</th>
<th>10-19</th>
<th>20-99</th>
<th>100-499</th>
<th>500+</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Number of Firms</td>
<td>38.20%</td>
<td>15.29%</td>
<td>21.05%</td>
<td>21.18%</td>
<td>13.05%</td>
<td>1.22%</td>
</tr>
<tr>
<td>% of Establishments</td>
<td>20.04%</td>
<td>12.42%</td>
<td>17.21%</td>
<td>18.57%</td>
<td>16.11%</td>
<td>4.85%</td>
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<tr>
<td>% of Employment</td>
<td>1.36%</td>
<td>2.39%</td>
<td>3.98%</td>
<td>16.91%</td>
<td>12.90%</td>
<td>59.63%</td>
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<table>
<thead>
<tr>
<th>Hotels (except Casino Hotels and Motels)</th>
<th>&lt;5</th>
<th>5-9</th>
<th>10-19</th>
<th>20-99</th>
<th>100-499</th>
<th>500+</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Number of Firms</td>
<td>35.05%</td>
<td>15.41%</td>
<td>22.43%</td>
<td>22.69%</td>
<td>13.15%</td>
<td>1.07%</td>
</tr>
<tr>
<td>% of Establishments</td>
<td>27.69%</td>
<td>12.33%</td>
<td>18.06%</td>
<td>19.75%</td>
<td>5.01%</td>
<td>16.95%</td>
</tr>
<tr>
<td>% of Employment</td>
<td>1.47%</td>
<td>2.79%</td>
<td>3.87%</td>
<td>21.06%</td>
<td>14.81%</td>
<td>81.50%</td>
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<table>
<thead>
<tr>
<th>Casino Hotels</th>
<th>&lt;5</th>
<th>5-9</th>
<th>10-19</th>
<th>20-99</th>
<th>100-499</th>
<th>500+</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Number of Firms</td>
<td>4.12%</td>
<td>1.50%</td>
<td>1.12%</td>
<td>10.49%</td>
<td>32.21%</td>
<td>50.56%</td>
</tr>
<tr>
<td>% of Establishments</td>
<td>2.51%</td>
<td>0.91%</td>
<td>0.88%</td>
<td>6.62%</td>
<td>23.06%</td>
<td>66.21%</td>
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<tr>
<td>% of Employment</td>
<td>0.00%</td>
<td>0.01%</td>
<td>0.01%</td>
<td>0.37%</td>
<td>6.01%</td>
<td>93.60%</td>
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<tr>
<th>Bed-and-Breakfast Inns</th>
<th>&lt;5</th>
<th>5-9</th>
<th>10-19</th>
<th>20-99</th>
<th>100-499</th>
<th>500+</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Number of Firms</td>
<td>15.12%</td>
<td>9.17%</td>
<td>5.21%</td>
<td>0.54%</td>
<td>0.13%</td>
<td>69.83%</td>
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<tr>
<td>% of Establishments</td>
<td>15.09%</td>
<td>9.41%</td>
<td>5.51%</td>
<td>1.19%</td>
<td>0.17%</td>
<td>68.64%</td>
</tr>
<tr>
<td>% of Employment</td>
<td>0.00%</td>
<td>0.01%</td>
<td>0.01%</td>
<td>0.03%</td>
<td>0.61%</td>
<td>93.80%</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>All Other Traveler Accommodation</th>
<th>&lt;5</th>
<th>5-9</th>
<th>10-19</th>
<th>20-99</th>
<th>100-499</th>
<th>500+</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Number of Firms</td>
<td>14.13%</td>
<td>7.32%</td>
<td>5.04%</td>
<td>0.57%</td>
<td>0.78%</td>
<td>72.16%</td>
</tr>
<tr>
<td>% of Establishments</td>
<td>13.60%</td>
<td>7.04%</td>
<td>5.67%</td>
<td>0.89%</td>
<td>3.21%</td>
<td>69.58%</td>
</tr>
<tr>
<td>% of Employment</td>
<td>16.32%</td>
<td>10.14%</td>
<td>17.55%</td>
<td>28.47%</td>
<td>3.28%</td>
<td>18.24%</td>
</tr>
</tbody>
</table>

Number of Employees in Accommodation Industry (NAICS 7211) in 2017

Essentially steady cap rates

Any assets' fair-market value is what the seller and buyer agree upon at any point in time. There are three fundamental building blocks of commercial real estate value: current net operating income (NOI), capitalization rate and forecasted NOI – varies according to the macro-economic environment.

Given the current coronavirus pandemic, two components of commercial real estate values are vulnerable, NOI and forecasted NOI, for which, in addition to other variables that are beyond the scope of this article has caused investment activity for commercial real estate properties to essentially pause.

As a result, commercial real estate investment activity has been significantly reduced. While commercial transaction volume remains suppressed at $26.2 billion, down 52% year-over-year contrastingly, capitalization rates have remained moderately stable.

How can this be? Given the current environment, how can capitalization rates remain relatively stable? One reason is that investment transactions are low due to travel restrictions and thus, reduced in-person property tours. Another reason is that there may be a divide between seller and buyer expectations where parties involved may be unable to come to agreement as potential buyers may want incentives/discounts and sellers unwilling to provide them and with

Less deals being closed, the degree of clarity in market capitalization rates is lower. But we can see that cap rates have remained essentially unchanged where some assets are less stable than others, retail and hotel assets.

With low interest rates, low inflation and low 10-year bond yields, nominal cap rates have remained stable for which rewarded investors with a much wider spread between cap rates and the 10 year bond.

While, for the time being, cap rate values will continue to be limited as a result of monetary policy and liquidity, comparative cap rate stability with respect to prior cycles provides some solace in our tough market.

Moving forward, we can anticipate an increase in cap rates pending the distribution of a COVID-19 vaccine and as such, as the economy recovers from the pandemic, the demand will follow.
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