CRE Post-Pandemic: The Knowns Now Outweigh the Unknowns?

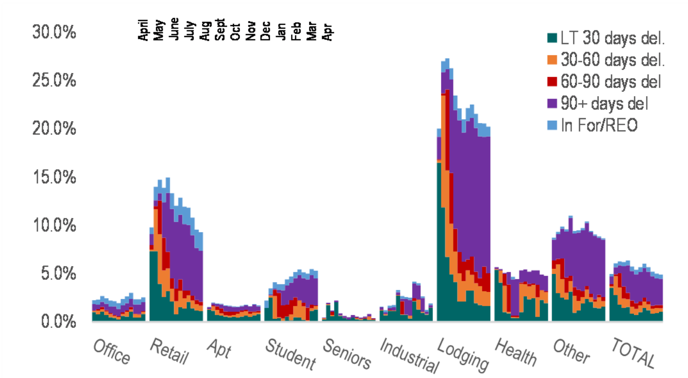
By Jamie Woodwell

Since the onset of the coronavirus pandemic, commercial real estate practitioners have been faced with two fundamental questions: How would properties perform through the pandemic and what would conditions look like on the other side—after the pandemic?

The first question already has been answered for most properties, as the worst of the pandemic subsides. Vaccinations are increasing, states and localities are reopening and there are declines in Covid-19-related case counts, hospitalizations and deaths. The second question is what is driving markets today and will drive them in the coming quarters.

For background, the Mortgage Bankers Association's monthly Commercial Real Estate Finance (CREF) Performance Survey provides insight into how differently property types were affected during the pandemic. Delinquency rates for lodging and retail properties—the two types most immediately and dramatically impacted by the pandemic—jumped in April and May 2020, as people took a vacation from vacationing and business travel and a range of local businesses closed.

Delinquency Status, by Property Type, Share of Total Unpaid Principal Balance (April 2020-April 2021)



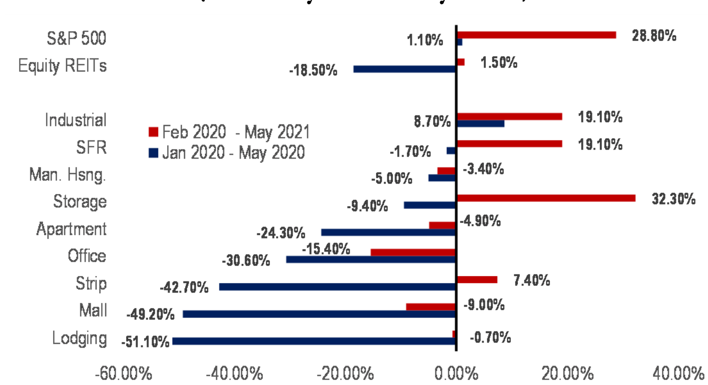
Source: Mortgage Bankers Association

On the other hand, delinquency rates for other property types, especially multifamily and office, remained stable—and muted. For multifamily, this was driven by the strong federal support for households; for offices, by the long lease structures and relatively few bankruptcies by office-using tenants.

Investors' concerns about how properties would perform during the pandemic were evident in REIT pricing last May, during the early fog of the health and economic downturns. According to Morgan Stanley Research, REIT returns last year through May varied markedly by property type, largely following pandemic concerns.

Mirroring what was seen in loan delinquency data, lodging and retail REITs showed the sharpest declines in returns—51 percent for lodging, 49 percent for malls and 43 percent for strip-centers. Uncertainty about office and apartments put those companies in the middle of the pack in terms of returns, and a group of counter-cyclical property types—industrial, single-family rental (SFR), manufactured housing and self-storage—showed either small declines or positive returns.

REIT Total Returns (January-May 2020) (February 2020-May 2021)



Source: Mortgage Bankers Association

Fast forward to now, and the REIT return picture is dramatically different, with concerns about how property types will get through the pandemic giving way to questions (and investors' answers) about the post-pandemic order and how it will affect demand for different types of space.

Driven by investors' current focus on "life after the pandemic," strip-center owners show positive returns between February 2020 and May 2021. And, in a dramatic turnaround, lodging is nearly back to break-even.

On the other hand, concerns about malls, which pre-dated the pandemic, has left their returns in the negative, although at a fraction of the level seen last May. Perhaps most notable is the trepidation that remains among investors about office properties (think "work from home"), which still hold roughly half of the negativity of last year.

It is important to note that there is a long history of divide between public REIT returns and private commercial real estate values. Data from Real Capital Analytics show a disparity between office and retail property values on the one

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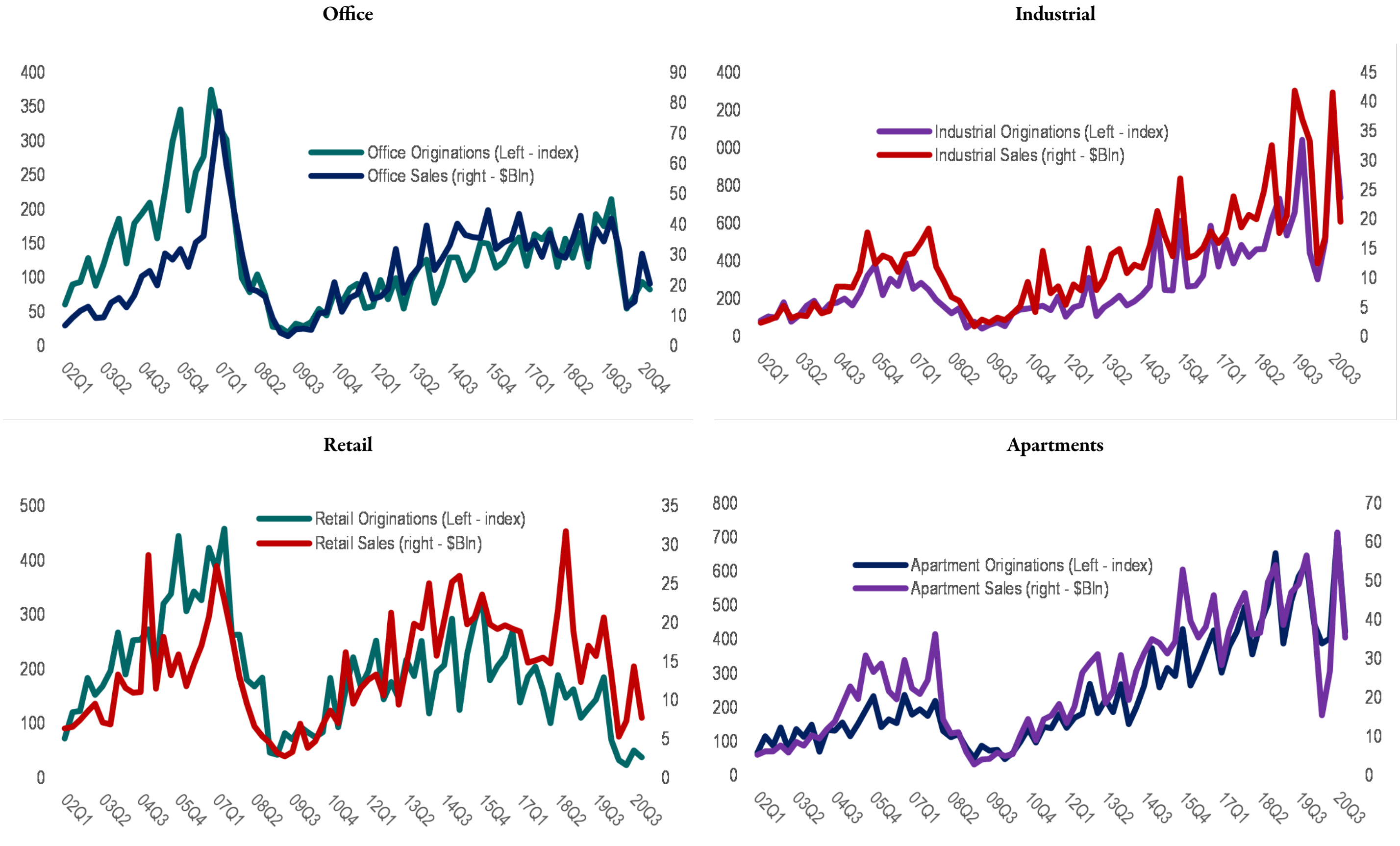
Commercial Real Estate Sales and Mortgage Originations



Source: Mortgage Bankers Association

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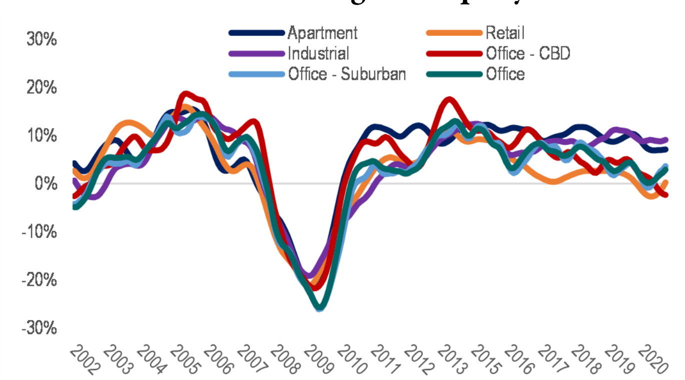
hand and industrial and multifamily values on the other, but far more moderate changes. Retail values have overcome previous declines to hold roughly flat in March from a year earlier; values of downtown, or central-business district, offices are down 2 percent, while suburban office prices are up 3 percent. Real Capital data show that multifamily values are up 7 percent over the year, while industrial is up 9 percent.

Year-Over-Year Change in Property Values



Source: Mortgage Bankers Association

This greater certainty is a positive for commercial real estate markets and the ability to get deals done. But the outlook for different property types continues to shape the market.

MBA's first-quarter 2021 mortgage originations index shows borrowing and lending were down 14 percent from a year earlier. Not great, but a far sight better than the 48 percent and 47 percent declines in last year's first and second quarters, respectively.

Following the same narrative seen above, borrowing and lending backed by industrial properties grew 66 percent from a year earlier to a new first-quarter record. Multifamily borrowing hit the second-highest first-quarter level ever, second only to last year. On the other hand, office originations were down by one-third, and retail originations were down by 45 percent—for retail, volume was even lower than the lowest level seen during the Global Financial Crisis.

Just as the uncertainty about how different property types would fair has faded as the pandemic passed, questions about the post-pandemic impacts to different property types are already beginning to be answered as the economy reopens.

It will take time for the impacts to work their way fully through trailing 12-month operating statements and longer-term lease structures. But operators, investors and lenders are all (happily) moving from a period when uncertainty ruled to one in which the knowns will once again outweigh the unknowns. ■

Jamie Woodwell is vice president of commercial real estate research at the Mortgage Bankers Association.