nerej CELEBRATING 55 YEARS

Today’s headlines all have an impact on the commercial real estate industry - By David De Lise

October 02, 2020 - Northern New England

David De Lise

As the summer winds down and our thoughts turn to the fall and winter months, the continuing threat of COVID-19, the upcoming election and the social justice issues swarming the headlines all have an impact on the commercial real estate industry. These issues all weigh heavily on the minds of business professionals who earn a living as commercial real estate service providers.

There has been a dichotomy taking shape in the real estate universe since the pandemic began. Residential real estate gained a tremendous amount of momentum in the later stages of spring and certainly throughout the summer months. Is this spike in activity pent up demand from everyone being cooped up inside for weeks and months? Or is it due to attractive financing for new home purchases and refinancing of homes? We are all aware of the shortage of affordable living options in the region, but the majority of homes being purchased over the past few months have not necessarily fit into the ‘affordable’ sector. Residential construction all but stopped for several months further depleting an already low inventory in New Hampshire.

The majority of our firm’s 600+ agents are residential specialists. Although we have a growing and very active commercial division, we are known primarily as one of the largest firms in New England. We have a very good pulse on the current market dynamics. Through recent months residential open houses have regularly attracted in excess of 40-60 people. It has not been unusual for multiple offers to be submitted at the open house or shortly thereafter. Offers to purchase have exceeded the asking price; contingencies have been waived (although we always advise our clients against this practice); inspections have been waived; extremely expeditious due diligence and closing timelines have been proposed...this is a very frothy market by anyone’s definition. This is all good news on the residential front, except for the shortage of inventory. Supply and demand drives pricing!

In contrast, a lot of the news surrounding the current and future performance of commercial real estate has not been as rosey, however I wouldn’t categorize the entire commercial sector as doom and gloom. There are sobering numbers and statistics in each sector, however there are asset types that continue to perform well and attract the attention of institutional and private investors and developers. For instance, in the commercial multifamily (5+) sector the National Multi Housing Council, which tracks rent payments from about 11.5 million U.S. households, showed that by August 20, about 90% of households had completed their monthly rent payments. As of September 13, the number dipped slightly showing that 86.2% of apartment households had paid their rent. Occupancy rates at residential properties in N.H. continue to remain above the national average, despite the fact that the rent for a two-bedroom unit is also above the current national average.

The industrial/flex/warehouse sectors have also performed quite well in the region, as manufacturing, assembly and warehousing/storage requirements of occupiers in N.H. continues to drive up rental rates and reduce vacancy rates. We forecast these two sectors of commercial real estate to remain strong performers in the short term as well as long term, post-crisis economy.

The niche sector of self-storage product has continued to perform well, both nationally and regionally despite the impacts of COVID-19. While street rents were down 0.9% over the past 12 months, all of the top markets saw positive rent performance month-over-month. Nationwide, development projects that were under construction or in the planning stages accounted for 8.8% of existing inventory. However, for a number of reasons, self-storage development subsided and projects that were in the pipeline were placed on the back burner. In fact, 33 projects nationwide were abandoned in August. This may signal hesitancy on behalf of developers facing uncertainty, smaller markings for some projects or the impending rise in material and labor costs cutting into their margins. Additionally, lending requirements for all product types have come under increased scrutiny and stricter underwriting. However, the northeast region has performed well in effective rent growth and maintaining or increasing occupancy levels across both non-climate and climate-controlled facilities.

NH facilities have mirrored the national and regional performance measures and remains a favored asset type amongst investors.

Now, for some sobering news...As of July 10, nationwide there were 26,160 restaurants that closed since the start of the pandemic, and 15,770 restaurants have made the decision to remain permanently closed. Locally, a well-known restaurant had 700 employees pre-COVID. During the initial outbreak, when this restaurant had to keep its doors closed, they had little choice but to lay off 600 of their hard-working staff. They have since rehired some of the staff and salvaged their summer season, however now that the colder weather is creeping in, many restaurant establishments are confronted with eliminating their outdoor seating. This will surely impact their revenue stream once again.

Small business has always defined America’s economy, and this is especially true in NH. Since the pandemic hit, more than 100,000 small businesses across the United States have closed forever. James Hammond, chief executive of New Generation Research recently stated: “This will hit everyone, but it will be harder for small businesses since they don’t have a lot of spare cash”. 4.2 million businesses have received emergency loans from the Small Business Administration. This is a small percentage compared to the 30 million small businesses in the nation. A frequent complaint from the small business community has been that Congress' financial rescue is not designed for small businesses, or very small businesses, also known as mi-cro businesses, which have large overhead and operational costs. A micro business is defined as a company with fewer than 10 employees, and the chief economist at Moody's Analytics wrote "It would not be at all surprising if well over 1 million of these micro firms ultimately fail." Congress approved more than $700 billion in relief for small businesses, mostly in the form of Paycheck Protection Program loans and grants.

There are a slew of requirements as they relate to the use of the PPP money. For example, three quarters of the

PPP money received needs to be used on payroll in order for the loan to turn into a grant. Congress designed the PPP program this way to save jobs, but it is causing significant problems when rent or other expenses represent a larger share of a company's overall financial obligations than payroll. Several prominent restaurateurs have opined the federal stimulus isn't working for the restaurant industry. Leaders of restaurant associations across the country have urged Congress to build in some flexibility on how and when the grant money can be utilized. One prominent restaurant chef and owner of a popular eatery firmly believes that consecutive rounds of PPP should be considered for small businesses until there is a vaccine.

Two of the most severely impacted real estate sectors remain retail and hospitality. You can't glance through online or print media channels without news of yet another retailer or hotel/motel chain experiencing dire results from the extended orders and limited re-openings. Within the specialty entertainment sector we need to acknowledge the pain suffered by cinemas and theaters, many of which remain closed across the United States. Iconic retail brands such as J.C. Penney, Lord & Taylor, Neiman Marcus, Century 21, J. Crew, Brooks Brothers and Pier 1 have all filed for bankruptcy protection since the outbreak.

Industry giants in the hotel sector including Hilton Worldwide Holdings, Inc. and Marriott have suffered large setbacks. Hilton reported second-quarter revenue per available room (RevPAR) tumbled 81% from the same period one year ago. The company swung to a net loss of $430 million from a net income of $260 million. Never before in Hilton's 101-year history has the hotel industry faced a global crisis that brought all forms of travel to a virtual standstill. Hilton was forced to play defense by temporarily closing hotels, furloughing employees and implementing other cost cutting measures including salary reductions.

The pandemic has not discriminated, impacting all forms of businesses across the United States, and around the globe. Maintaining positivity during crisis situations creates opportunities-we need to keep our eyes open and be prepared to pivot ourselves and our businesses. The pandemic's punch-to-the-gut has reached all corners of the world, and impacted all forms of business, leisure, travel and entertainment.

Through all of these challenging events, there remains a strong sense of optimism and hope within our industry that 20, maybe 30 years from now, a lot of good will have come from it and created significant opportunities for those with creativity, imagination and a desire to problem solve some of the issues we are confronted with today.

Stay healthy and stay safe. All the best!

David De Lise is the director of the commercial division at Berkshire Hathaway Verani Realty, Londonderry, NH.