Pandemic has diverse impact on state’s CRE sectors - by Pete Hayes, Steve Flachbart, & Matt Fair

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The coronavirus pandemic has had a varying impact on different commercial real estate sectors throughout the country, which has been true for Rhode Island as well. Several areas have had strong market performance over the past year, which we expect to continue. Investors still have confidence in medical, multi-family, industrial and pandemic safe retail. Any retail with a drive through, or essential retail with easy pickup options have thrived. Industrial was tight before the pandemic, and current demand is steady. The increase in e-commerce, has supported the need for distribution space. The largest issue for industrial remains the lack of quality supply on the market for either lease or sale.

Medical buildings with long-term leases in place have continued to garner significant interest, highlighted by 1454 South County Trail in East Greenwich selling for $18.7 million. The building was the highest value in Rhode Island in 2020 at nearly $400 per s/f.

There are plenty of examples of both investors and buyers showing long-term confidence in Providence and Rhode Island. Exeter Property Group has broken ground on its $90 million development called Emblem125 at the corner of Clifford and Chestnut Sts. The development will have 248 apartments and roughly 22,000 s/f of ground floor retail on 1.25 acres. The $60 million, 175-room, Aloft Hotel will be over 100,000 s/f at the corner of Dorrance and Dyer Sts. The hotel plans to have restaurants in both the lobby and on the rooftop. Wexford has continued its investments in the Innovation District with a $12.5+ million redevelopment at Davol Sq. The complex has been completely renovated, and it is one of the best stories in Providence. The unique property offers both office and retail opportunities and is a great example of combining the high ceiling, brick and beam loft style of Davol Sq.'s history with modern, high-end finishes.

The weaker sectors have been multi-tenant office and non-essential retail, which investors have avoided. While both have had soft market performance, it is important to note that the bottom has not fallen out of any asset class and the vacancy rates have not changed much. Office leases typically have been long-term, multi-year deals, and this has provided some stability for landlords. Even though much of the office space is being underutilized, most tenants have continued to pay their rent. While plenty of small businesses have been negatively impacted with reduced revenue streams, they are finding ways to cover expenses and have been assisted by government stimulus.

Office tenants have been focused on short term renewals in place, as they have been uncertain of their long-term size and layout needs. Rather than downsizing or closing their offices, most people have been seeking short term extensions. Tenants have been kicking the can down the road, hoping to have a better understanding of their long-term needs after a successful vaccine rollout. Landlords are willing to provide the short-term lease flexibility to keep cash flow in place, especially considering there are not many backfill options.

This stagnant situation has thus far created minimal change in the amount of space on the market. Available office space in Rhode Island increased from 11.1% a year ago to about 12.0% currently, but only a 0.9% increase in availability feels like a small change considering what we’ve all experienced.

Sublease space, which has been a significant issue in larger markets like New York and Boston, has not been a factor yet. Rhode Island has only had office sublease space increase by about 70,000 s/f over the past 12 months, which is only a 0.3% change. Meanwhile, Boston has had around 3.5 million s/f of sublease space hit the market since April 2020 which is a 3.5% increase. This difference highlights how sublease space still has not become a big factor in Rhode Island, which has a smaller footprint, more local tenant base, and the supply is not overbuilt.

The current vaccine rollout and reduction in weekly coronavirus numbers have combined to create a more positive outlook amongst consumers that the end of the pandemic is approaching. The short-term lease deals from the past year should start becoming a factor in the latter half of 2021, as a higher volume of lease expirations combined with an optimistic, more confident tenant base, will most likely make relocations and longer-term commitments more common. Rental rates and concessions will be an area to watch throughout 2021, as tenants begin to have line of site for their long-term space needs, whether its changes to their space layout to incorporate social distancing, downsizing based on a smaller footprint or deciding that more employees will be working from home permanently or via flex time.

Retail business has been hit in a polarizing fashion, as anything with a drive through had strong performance. However, for every drive-through business, liquor store or grocery store that is thriving, there are plenty of locations struggling. Many stores cannot easily adapt to the increase in online spending or changing Department of Health regulations. Hope that the end of the pandemic is near has helped them survive, believing a better business climate is coming soon. While the stats do show an increase in vacancy, the change is relatively small. Since April of 2020, available retail space in Rhode Island only increased from 9.1% to 9.6%, showing retailers determination to persevere through the challenging environment. Overall retail vacancy has been slowly increasing for several years, as the consumer trend of buying more online is not a new one, but it has been accelerated by the pandemic.

The past twelve months have been a challenging time for everyone, and business was forced to adapt. A reduction in commercial real estate activity produced a stagnant market, as people remained uncertain how their business would look in a post-pandemic climate. However, access to vaccines, improved daily coronavirus testing counts and consistent government stimulus have started to produce increased market optimism.

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