nerej CELEBRATING 55 YEARS

CRE market after pandemic - by Tom Whiting

July 09, 2021 - Appraisal & Consulting

Tom Whiting

Now that the pandemic seems like it is winding down, what will be its long-term effects on commercial real estate? How will they affect values? Are they likely to affect all commercial sectors the same?

In the office sector there appears to be resistance from employees returning to the office full time. There is a lot of talk of a hybrid work week with employees going to the office 2 or 3 days a week and working from home the balance of the time. Will employers go along with employee wishes? Some already have while others are resisting the change. Will this cause a reduction in demand for office space? If it does, will it cause other effects? Will it cause a decrease in demand for retail space in central business districts? For the Greater Boston market vacancy is approaching 10% while capitalization rates are declining.

The retail sector has already felt the effects of the pandemic, such as restaurants and downtown retail. Will this continue? Many restaurants didn't make it to this side of the pandemic, but for those that did there appears to be a pent-up demand by consumers to get back to normal. Will it continue? The same goes for retail stores. Consumers have gotten more used to shopping online, many for items that until the pandemic were purchased in person such as food and clothing. Prior to the pandemic retail chains were in trouble, for example Sears, Kmart, Dress Barn, and Payless Shoes going belly up. Microsoft closed all their retail locations during the pandemic and does not plan to reopen them. Will other uses be found for these spaces? For the Greater Boston retail market vacancy is low and capitalization rates remain steady and are predicted to remain so by some sources.

The industrial sector has been benefiting from retail trending to online sales before the pandemic and continued during the pandemic. The supply of industrial space, while increasing generally, is declining in certain submarkets. In the submarkets inside Rte. 128 land has become valuable enough for developers to redevelop industrial sites with other uses. Capitalization rates for all industrial market sectors in the Greater Boston area are reported to have declined to historic lows. This trend continued through the pandemic. Rents are increasing as vacancy rates have fallen below 5%. Will this trend continue post pandemic? There is an increasing demand for logistical space with Amazon redeveloping some sites, including repurposing dead shopping malls.

The Greater Boston multifamily sector has another pandemic story. Flight from the core city has increased vacancy from what were once reliable rates of around 5%. In 2020 vacancy spiked to over 8% for the market in general. For some of Boston's neighborhoods vacancy has increased to well over 10%, while in some gateway cities vacancy rates are well below 5%. Despite the bad news of impending evictions, which have had a moratorium for over a year and are expected to start soon, multi-family capitalization rates remain low and steady. For some reason, the perception of risk remains low. Is this trend likely to continue? Zaxia.us tracks small multifamily sales (among other things) in the Greater Boston market and reports a steady increase in prices and a steady volume throughout the pandemic. Vacancy is expected by some experts to remain high in the Greater Boston multi-family market. Is this likely to put downward pressure on rents?

Building material costs have spiked in recent months and reportedly the supply chain has slowed. Is this likely to continue. Will material costs ever go down to pre-pandemic levels? This will most likely influence new development as well as repair and maintenance costs for all sectors. Energy costs have been increasing as demand has increased. Are governmental policies that have recently been implemented likely to affect energy prices further? These items have an effect on developers and landlords bottom line.

Above are just a few of the considerations commercial appraisers now must take into account. Appraisers always must attempt to stay on top of dynamic markets and the post pandemic world has given us that. The market has changed over the last 18 months and many of the changes are likely to remain with us. Our job is to determine what effect these changes are likely to have on value so we can provide our clients with credible results.

Tom Whiting is a freelance commercial appraiser who is sole proprietor of William T. Whiting Appraisals, Lowell, Mass. and also works for Braese Associates, Woburn, Mass.