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Commercial Classroom: The new normal - by Edward Smith

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This column is offered to help educate agents new to commercial and investment brokerage and serve as a review of basics for existing practitioners.

What can we expect in the future? I do not have a crystal ball, but here are some predictions.

Even when we start to reopen business, social distancing will continue well into the future, this will radically change how office space is laid out. The space saving office “hoteling” concept is effectively dead. Cushman and Wakefield who manages millions of buildings worldwide has developed “The 6-Foot Office” model. Redesigning office space which includes clear shields between workstations, barriers that control the flow and distancing of office workers, and visually displayed foot traffic routing. Similar to the one-way aisles we now see in supermarkets.

Even with this expansion of personal space the overall effect on square footage office requirements will be reduced for most companies, with fewer workers on site. Many employees are now working from home, using video conferencing and employers are finding more productivity and lowering costs. This new normal is working well and will be permanently adopted, either full or part time, by companies. Employees are happy to skip the commute. This is also good for the environment; with reduced traffic carbon emissions are down by over 30% currently.

The impact of the pandemic will be felt most by the retail stores and restaurants, many will close or at best need to downsize. The restaurant industry expects 30% of these businesses will permanently close and those remaining open may see their seating reduced by up to 50% due to social distancing.

Retailers prior to the virus were in trouble. The “forced adoption” of shopping online and with more consumers doing it–and liking it–will put even more of a strain on brick and mortar stores to recapture shoppers. In a recent interview, Barbara Corcoran said, “The only other portion of the real estate market that I think is going to be hit even worse is, of course, the shopping centers, they were half-dead when we came into this whole debacle with them on one leg. The other leg is going to be cut out, so I don’t, I can’t even envision what’s going to happen to the shopping centers. I just can’t imagine.” This is certainly a valid concern. At a meeting this morning, I heard that 46% of retail landlords collected no rent from 50% of their tenants in April, 2020.

Landlords and tenants will need to work together to find solutions. Tenants whose businesses are “temporally” closed are asking for help with their rent obligations, landlords understand, but still have to pay their mortgages

Many standard lease clauses are now open to interpretation; is “force majeure” the so-called act of God escape clause valid in this case? Will Business Interruption Insurance pay the claims? Typically, these policies require physical damage to the property and some specifically exclude viruses. Litigation and evictions will be significantly backed up when the courts reopen. Lease modifications need to be worked out for both sides.

We are getting mixed signals as to future rental rates and what will happen to buildings’ values.

With closures and lease defaults, there is expected to be a lot of space to rent in all sectors office, retail and industrial. Vacancy is the “kiss of death” for landlords. It is in their best interest to work things out with existing tenants, even if they must forgo rent for a few months, it may be a better choice than having vacant space. They can add the months the rent was forgiven to the end of the lease. Tenants can offer to extend their leases for rent deferment too. Also, with all this available space it would mean that new tenants will be in a strong position to negotiate favorable terms and rent. So, we can expect to see rents decrease. With rent decreases we would expect value to decline too.

However, with interest rates going lower and lower, landlords who retain their tenants can refinance, and lower their debt service costs. Other landlords will be tired of the problems and be ready to sell their properties. Some say the lower interest rates will effectively drive values up and reduce capitalization rates.

Who is going to buy? With the turbulence in the stock market many investors may wish to move their money to less risky commercial real estate. Stay in touch with your clients, most are only in an activity holding pattern until this is over.

As commercial agents, the way we do business has changed and will continue to do so. Video conferencing with our offices and directly with our clients is the new normal. Virtual tours of homes are common in residential real estate; this will now become a tool in showing commercial properties too. With office space, realistic renderings based upon social distancing and 3D floor plans are needed. Much of our transactions will be done digitally, subject to a final (first) walkthrough of the building.

The real estate market is “sitting in place” as we are. Many of us have been through market disruptions before, disasters like 9-11, economic recessions in the 80’s, 90’s and 2008. This pandemic is far worse in many ways, but as far as real estate is concerned, we will recover. How we do business may have a new normal, but when this is over there will be many real estate opportunities.

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