



## Commercial vs. residential real estate in the pandemic by Kris Lindahl

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Kris Lindahl

COVID-19 has affected every industry on earth, and real estate is certainly no exception. But what I've found most interesting is the gap between its effects on the commercial vs. residential markets.

On the residential side, many markets have remained remarkably strong and resilient. In my company's experience, the busy spring season didn't go away; it simply turned into a virtual market. Many sellers paused, tightening inventories. But buyer activity skyrocketed as more people spent their quarantine months shopping for homes online. People are surprised when I tell them that May

was Kris Lindahl Real Estate's best month since I started the company two years ago, driven by the strongest buyer engagement I've seen in my 15+-year real estate career.

Now we're seeing signs that sellers are also coming back online, as a flood of homeowners want to start the process of listing their homes. After so many sellers hit the pause button, we now find ourselves in the early stages of an inventory surplus, which sounds crazy. But we have to remember that unlike the Great Recession, this crisis didn't originate with real estate.

My company also serves commercial real estate, and that side of the market is clearly facing bigger challenges. Across the country, nearly half of commercial retail rents went unpaid in April and May. That's a jaw-dropping figure that would have seemed impossible as recently as February, but it tells you just how many business owners are struggling. Restaurants and storefronts announce permanent closures each week, while others have moved online or continue to fight through the worst while hoping that a second wave is minimized or never comes.

The pandemic's impact on the commercial market is exaggerated in locations like the Twin Cities, which is coming off an exceptionally strong year where the vacancy rate for industrial space fell to just 6.8% in 2019, the lowest ever recorded. But between April 10th and May 10th of this year, commercial real estate transactions fell between 50% and 80% compared to last year, depending on property type. Buyers are out there looking for bargains, but prices haven't meaningfully dropped yet.

Of course, when you look at restaurant closings and anchor stores leaving strip malls, the domino effect is always a concern. If business owners can't pay their rents, then building owners can't pay their mortgages, which trickles up to banks and eventually to local governments who want to collect property taxes, creating a negative feedback loop.

On the corporate side of the equation, we're all living in a world where remote work is more widespread than ever, so building owners have their own concerns. Larger office spaces will continue to take a significant hit, while the market for smaller spaces will stay strong due to companies adopting a hybrid model of some employees working from home with others coming to the office. The reduced need for square footage in corporate office space is a trend that will be with us for a long, long time.

We have to keep in mind that the longer the pandemic drags on, the more likely the commercial market will impact the residential market. Leading up to 2020, people were flooding back to cities and downtowns to take advantage of stores, bars, restaurants and other entertainment options. But if restaurants and stores continue to close, and live sports and other entertainment options continue to be postponed (or happen without fans), then living in smaller urban homes and condos loses its appeal.

No one knows how the pandemic will play out, how soon we'll have a vaccine or when people will feel safe enough to go "back to normal," so it's too early to make bold predictions. But situations like this tend to spur adaptation and innovation. If retail doesn't bounce back quickly, and if we see

another round of government stimulus for consumers and small businesses, then a range of new ventures will likely move into empty storefronts. Just as fitness clubs and co-working spaces filled empty mall department stores, something will eventually fill the empty fitness clubs and co-working spaces.

Finally, if lenders also continue to tighten their financing guidelines, loans will be harder to come by, and we'll start to see commercial property values fall. Empty storefronts and falling prices generally lead to entrepreneurs and mom-and-pop businesses being able to afford these spaces again, which will hopefully lead to a renewal of downtown and commercial areas.

However things play out, the silver lining will be the long-term trend of renewal following decline. As the saying goes, "Never waste a good crisis." These are hard times for most people, but I look forward to seeing the next generation of innovators and entrepreneurs lead commercial real estate into its next evolution.

Kris Lindahl is the founder and CEO of Kris Lindahl Real Estate, Minneapolis, MN.

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540