



VIRTUAL ROUNDTABLE DISCUSSION – JUNE 4, 2020

COVID Era Property Acquisitions and Dispositions: Opportunities, Challenges, and Distressed Properties

Introduction

VHB's Virtual Roundtable on June 4, 2020, brought together leaders from across the country to discuss the impacts of COVID-19 on the real estate industry and to explore property acquisitions and dispositions. Participants represented a wide variety of industry touchpoints, including developers, investors, property managers, land use attorneys and brokers who are involved in real estate transactions.

Discussion centered on the state of the market and the impacts to various sectors, including multifamily, office, mixed-use, retail and industrial along the East Coast. The comments below provide a summary of challenges, concerns, opportunities, and creative thinking that were shared during the conversation.

Summary

Roundtable participants are cautiously optimistic that the industry and economy will rebound but are uncertain of the timing or strength. Currently, the Federal Government and Federal Reserve Board are keeping things in check. **Most do not anticipate a financial crisis on par with the Great Recession, but that sentiment could change quickly with a resurgence of the virus in the fall and the lack of a vaccine or effective therapy.** There is talk in the industry about companies de-densifying their offices in the urban core and establishing satellite offices; 'hub-and-spoke' strategies to retain employees and alleviate fears. COVID-19 will have near term and potentially long-term effects on where and how people live, work, and play. Underwriting is complicated now due to uncertainty, not knowing when the dust will settle, and what new paradigms will be in place in the workplace and in our neighborhoods.

The roundtable discussion was robust and leaves us with hope for positive changes that transform the industry. Below are market specific observations and takeaways from the discussion.

Multifamily

Multifamily developers are not seeing a high level of distress at the property level in suburban markets and were surprised at the strength of rental payments and the amount of leasing that continued into April and May 2020. **The distress appears in workforce housing and has impacted collections among lower income brackets, mirroring the unequal impacts of COVID-19 across U.S. socioeconomic lines.** Where cash flow and collections are holding steady, be prepared for this to change when unemployment benefits and federal CARES Act monies dry up. Cycle resistant properties such as affordable, workforce and mixed-income spaces, although adversely affected by the pandemic, are still active. Big cities are feeling the hit, as well. The fiscal environment is unsteady, and budget cuts at the state and city level will put pressure on affordable housing starts in major metropolitan areas like New York City, which need capital subsidies. **Look to public-private partnerships as a solution in the near term.**

Office

Look for innovations in the office market. Perhaps the biggest challenge this sector faces is the move to a **work from home** environment. While corporate America has experimented with telecommuting and flexible schedules for years, the pandemic and subsequent “stay-at-home” orders have impacted how companies are thinking about the workplace of the future. While Industry sentiment indicates that most U.S. workers strongly prefer an office environment to a full-time remote experience, when employees do return expect significant changes (**think flexible space plans and work schedules**). It is a good time to be building from the ground-up as this gives companies the opportunity to think about workflow and the development of unique spaces that allow for interaction and innovation. Large office property assets are being repurposed for new players who seek flexible, collaborative, future-proof spaces that can attract the right demographic. **Identifying high-quality real estate that is an extension of a user’s brand can be a tool to attract talent.** Tenants are affirming that the workplace is a key part of their culture.

Expect developers to remain bullish on suburban office as they are eager to accommodate a millennial workforce that is moving out of the urban core. Flexible work may reinforce this shift. Companies are focused now on how to de-densify and circulate safely in a “post COVID” world. Large firms are considering ‘hub-and-spoke’ strategies in recognition that existing office space in urban locations may not be able to safely accommodate their existing workforce and they may need satellite offices to ease employees concerns about commuting into the city.

Retail and Mixed-Use Environments

Retail and hospitality sectors have been severely impacted by the pandemic. Across the nation, developers are working with restaurants and retailers on a case-by-case basis, with most making plans to open new outdoor dining areas and implement social distancing modifications inside. **New curbside pick-up and delivery models created ideas for how mixed-use shopping centers could evolve in the near term.**

COVID-19 has accelerated the closures of big box anchors, which were on the decline. Mall owners are busy reimagining these spaces and starting a long-term disciplined process

to evaluate redevelopment opportunities. Owners are working with communities on entitlements which will open doors to reposition anchors with a mix of residential, medical office, and fulfillment centers. Communities are open to conversations, because the tax base is important to their revenue and the transformation of these centers is vital to the community.

Expect sustainability and an emphasis on the public realm and placemaking to change the way consumers experience mixed-use developments post-COVID. Public transit and urban live, work, play models were turned on their head in only a few weeks. [Transportation will need to adapt.](#) Look for more robust bike and walking paths in mixed-use developments to aid in transportation and attract young residents.

Hotels are operating at about 15-percent capacity. Opportunities exist to convert distressed hotels into affordable housing or shelters, although size will be a challenge. It will be difficult to convert large 1,000 room hotels into affordable housing, given community concerns. Developers are working closely with planning agencies to think about the future of these assets.

Industrial, Distribution, and Biopharma

The industrial sector remains strong and **many investors are rebalancing their portfolios and reallocating capital to logistics and life science sectors.** National security issues and [supply chain disruptions](#) will lead to an onshoring of biopharma manufacturing in the United States and growth in life sciences firms who are racing to find cures for diseases. Downtown Boston and Cambridge Life Science markets will continue to thrive. During the onset of COVID-19, manufacturers and businesses needed a place to store goods. Retail centers were not set up to house goods, but the shortage in storage space sparked discussions with retailers who are thinking about new delivery models. Many large retail anchors have gone dark and there is a market for big boxes which can be repositioned as distribution centers across the country. Will consumers want to go back into stores to pick out their goods or will curbside pick-up prevail? Capital investments will continue to be made in this sector to meet the acceleration in e-commerce.

Capital Markets and Bank Financing

Private equity players with liquidity in the market are looking for quality assets. During the past few months, lending institutions have found it difficult to underwrite the future due to uncertainty, but deals are moving forward for high-quality clients characterized by risk-averse leases and quality credit tenants such as build-to-suits for established brands. Banks are funding new preleased office and industrial facilities, but they have temporarily paused on lending for multifamily due to uncertainty about how to underwrite future rents. During previous periods of economic troubles, like the Great Recession of 2007-2009, financial institutions were hit hard, and as a result measures were put in place to avoid severe economic impacts. Banks are holding steady now with no rush to sell assets.

What will debt look like at the back end of the pandemic? Until there is a vaccine, there may not be clarity. **It appears the federal reserve stress tests and capital requirements after the Great Recession have done their job.** Banking systems will weather this storm, but it will still be stormy. Reserves and losses could both escalate in 2021.



Key Industry Takeaways

Prior to the pandemic, some developers were diversifying their portfolios and evaluating the mix of multifamily, office, retail, and residential properties to achieve a greater balance across sectors and asset classes. **Investments were made in growth sectors, including e-commerce/industrial, multifamily, and biopharma/life sciences. Others are investing in key geographies and demographics, such as metro and suburban areas experiencing exponential growth. There is still pent-up demand for residential development, fueled by millennial demographics and historically low interest rates.** Researching and knowing your markets with boots on the ground is a key strategy. Pre-COVID migration to the Southeast and Sunbelt will likely continue and open more opportunities in secondary markets.

Staying positive and coming up with creative ideas for clients with conviction will help steer the industry forward. Developers should consider distressed properties as value propositions, instead. Private equity players will play an important role. Developers want to work with clients who have targeted geographic ‘hub-and-spoke’ strategies. Deals that are keeping developers busy have a longer horizon with no shovel in the ground or construction financing for at least a year. **Continue to pursue entitlements and permitting for properties during the pandemic, as this will better position properties when market demand strengthens.**

Early in the crisis, some complex transactions and deals were paused because due diligence was difficult and markets uncertain. Virtual meetings have met the challenge, and **the industry is seeing better virtual participation rates than in-person participation rates in public meetings** for large development projects. Expect this tool to be utilized long past the pandemic.

Next Steps: Future Discussions

We want to stay connected! VHB will be hosting another virtual roundtable discussion with participants in the fall. Future questions and discussions around this roundtable topic include:

- » In 90 days will there be new stimulus money to propel the economy and help property owners sustain rent rolls?
- » When the stimulus funds run out, how will businesses thrive without the much-needed liquidity?
- » Will offices become more decentralized and adopt hub-and-spoke models (both city and suburbs) to maintain a diverse workforce? How will new “socially-distanced” office standards affect occupancy and how will work be executed in the office?
- » Will multifamily units be redesigned with office space within units or in central spaces that tenants can rent?
- » Will retail malls reposition big boxes with last mile distribution hubs? Multifamily? Entertainment? Medical office or healthcare?



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