DAILY BUSINESS REVIEW

Commercial Real Estate in the Time of COVID-19

The ongoing economic contraction caused by the 2019 novel coronavirus (COVID-19) has been swift and dramatic. In a matter of months, unemployment has reached Great Depression levels, bankruptcies have spiked, and the U.S. government has scrambled to avoid economic fallout.

By **Steve Vainder** | October 05, 2020

Steve Vainder, partner with White & Case in Miami. Courtesy photo

The ongoing economic contraction caused by the 2019 novel coronavirus (COVID-19) has been swift and dramatic. In a matter of months, unemployment has reached Great Depression levels, bankruptcies have spiked, and the U.S. government has scrambled to avoid economic fallout. For those of us in the real estate industry, the pressing question is how, and to what extent, COVID-19 will affect commercial real estate (CRE). While it is likely that the long-term impact of COVID-19 on CRE will be significant, the short-term effect may be to accelerate sector and geographic trends that were already prevalent before the pandemic emerged.

Retail Sector Trends

Prior to COVID-19, the retail sector was dealing with substantial disruption from online sellers. Department stores were already suffering from low sales volumes. However, the already anemic results fell substantially in the wake of the pandemic. Even "experiential retail" (restaurants, coffee bars, movie theaters, and the like), widely believed to be the savior of brick and mortar retail, has been decimated by COVID-19. In addition to mandatory closures imposed in connection with the quarantine, ongoing social distancing requirements, and the resulting limitations on occupancy, will likely continue to have devastating impacts on these businesses. The viability of these businesses will depend on how long the pandemic requires them to operate at unsustainable levels.

Office Sector Trends

The office sector had also been undergoing shifts prior to COVID-19. Many businesses were opting for more "pods" and open space than traditional closed-door offices to encourage collaboration. However, social distancing requirements and other infection prevention strategies will require businesses to design, or redesign, their space in order to balance the need for collaboration with the health of employees.

Before COVID-19, poor public transportation and worsening traffic congestion made the commute to the office in metropolitan cities a burdensome task for employees. With the imposition of social distancing rules and occupancy limits in elevators, employees face adding significantly more time to the process of getting to the office. COVID-19 will likely result in new impediments to office work such as the fear of getting sick, the requirement to wear masks, and limited food options as a result of restaurant failures and closures.

A lack of technology and a generally negative attitude toward remote work had previously impeded the implementation of structured remote work policies. Even in the short time since the start of the pandemic, there has been a dramatic shift in attitudes towards remote work. Employees have shown they can be as productive, if not more so, working from home as in the office, as collaboration tools such as WebEx and Zoom foster increased productivity and collaboration.

Industrial Sector Trends

Before COVID-19, the industrial sector was benefitting from the rising popularity of e-commerce. COVID-19 super-charged this trend. Warehouse and logistics operations are in high demand as online retailers struggle to keep up with the volume and the consumer expectation for quick delivery. There is also political pressure to repatriate manufacturing operations, particularly in medical supplies and pharmaceutical production. The combination of increased demand and efforts to repatriate signal that the industrial sector is poised to withstand the pandemic, and may even benefit from similar destabilizing events in the future that require extensive logistical and manufacturer support.

Hotel and Leisure Sector Trends

The hotel and leisure sector is perhaps the outlier with regard to the exacerbation of existing trends. Before COVID-19, occupancy and nightly rates were at or close to record levels in many places. As COVID-19 took hold around the globe, the hotel and leisure sector began to experience the earliest and most dramatic loss. Throughout the pandemic, U.S. hotels have lost billions of dollars, and the leisure and hospitality industry has experienced one of the largest industry labor losses thus far. In fact, some experts predict that recovery may not occur until 2023.

In the meantime, the hotel and leisure sector will likely need to adjust to changing consumer expectations about health and safety and prepare to make substantial investments in additional cleaning protocols, advanced check-in technology, and other physical alterations and adjustments, all while occupancy levels and nightly rates are down. These businesses will need to source investment capital or seek alternative financing to cover the additional costs that they may not be able to recoup through operations. As a result, the hotel and leisure industry faces a difficult road ahead.

Geographic Implications

The impact of the pandemic on different geographic regions has been different. As COVID-19 ravaged high-density cities such as New York and Los Angeles, the population started to leave these cities for suburbs and other less dense areas. Even as infection rates have subsided in some of these cities, the flight from the urban core does not seem to be abating. The sustained exodus may be explained in part by the heavy reliance on public transportation in large cities, which is widely viewed as a likely infection vector.

Similarly, the politicization of quarantines, mask wearing and other responses to the COVID-19 pandemic may result in population shifts relating to perceived views of states or regions that are more aligned with the individual's views of the balance between protecting vulnerable portions of the population and individual freedoms.

We may still be in the early days of the COVID-19 pandemic, and its long-term impact on CRE is hard to predict. There are certainly some who believe COVID-19 will result in significant distress in most sectors of CRE, as evidenced by the billions of dollars invested into distressed real estate funds. However, whether the CRE distress that some predict will actually materialize, and if so, when, is anyone's guess.

Steve Vainder *is a White & Case partner in Miami and head of the firm's Americas real estate group.*