IDAHO BUSINESS REVIEW

Commercial real estate still assessing effect of COVID-19

By: Catie Clark June 15, 2020 0

Commercial real estate reports vary depending on the firm issuing the data. The latest numbers available include a little of everything: a near-real time snapshot of Idaho CRE trends, a look back at the previous two quarters for the Boise market, and a fascinating set of longterm predictions modeled for use by assessors.

Idaho June 5 Snapshot

TOK issued its snapshot of CRE trends on June 5 for its three major markets in Idaho. Sales activity was down 47% compared to pre-COVID-19 activity and down 7% since its last report issued on May 29. Leasing activity was down 51% compared to pre-COVID-19 conditions and down 5% since May 29. New rent relief requests have now dropped to zero, down from 20% in mid-April.

TOK's three markets are Treasure Valley (centered on Boise), Magic Valley (centered on Twin Falls) and the eastern Idaho I-15 corridor (centered on Idaho Falls).

Boise First Quarter

The economic research group of Cushman & Wakefield posted its first-quarter market results for metropolitan markets, including Boise. The CRE vacancy and rent data for industrial, office and retail are shown in the table below:

Boise Commercial Real Estate		
	Q4 2019	Q1 2020
Industrial		
Vacancy, %	n/a	2.4
rent per sq. ft.	n/a	$7.69
Office		
Vacancy, %	7.2	7.7
rent per sq. ft.	n/a	$19.57
Retail		
Vacancy, %	6.2	6.4
rent per sq. ft.	$14.04	$13.85
Source: Cushman & Wakefield		
Q1 2020 numbers are preliminary		

The numbers show increases in vacancies statewide between Q4 2019 and Q1 2020. Asking rent for retail dropped an average of 1.3%, which probably has more to do with the ongoing retail apocalypse than with the COVID-19 pandemic.

As other recent market statistics have already shown, Idaho CRE markets have been mostly resilient so far to the effects of the stay-home orders during the peak of the outbreak, or the available first-quarter data were gathered too early in the COVID-19 emergency and do not yet reflect the impact of the economic downturn. It is worth remembering the peak of Idaho's COVID-19 cases occurred in the last week of Q1 and the first week of Q2.

CRE Forecasts

Based on unemployment rates by industry sector and on assumptions about economic recovery, Colliers International recently modeled CRE behavior for its assessment and property evaluation professionals. Commercial assessor Andrew Boespflug from Collier's Boise office presented these forecasts at the virtual May 27 Idaho chapter meeting of the Building Owners and Managers Association.

Colliers built two economic models with the aim of giving its assessors robust predictive tools to use in making commercial property valuations. The first model assumed a relatively fast recovery from the pandemic where the spread of the COVID-19 virus continued to decline and did not return at epidemic or pandemic levels. In this short economic slump scenario, Colliers calculated a decline in gross domestic product of 9% and an economic recovery that began during the third quarter of 2020.

Colliers also built a pessimistic model where COVID-19 returned in a resurgence of cases, leading to more quarantines, stay-home orders and non-essential business curtailments. In this long slump model, GDP declined 15% and a return to economic growth doesn't begin until the third quarter of 2021, a whole year later than the short slump model.

Colliers then applied the models to CRE markets to predict what rents and vacancy rates would do under both the short slump and long slump scenarios. Other than the timing of the economic recovery, the model results showed that rents fell anywhere from 2% to 60%, depending on the property type. Multi-unit housing and Industrial Warehouse types had very small decreases in rents (~2%) whereas retail fared the worse (~60%). Office space showed the second-worst performance. The vacancy forecasts showed similar trends with increases in vacancy rates of approximately 1.5% to 3%, where vacancy was usually 1% more in the long slump scenario.

Using multi-unit housing as an example, Boespflug remarked: "Maybe before, you were forecasting 3% to 4% annual increases in rents over the next three years. Now you might be forecasting 0 to 2% rent growth over the next two to three years with the result of higher blended vacancy and a lower or reduced value."

Boespflug explained that even in the long slump scenario, cap rates would likely not change very much.

"Interest rates will be down, but because of uncertainty, equity will go up … with the result that cap rates will not be much different than they are now."

Even with steady cap rates, Boespflug presented several calculations showing that in the longterm slump model, property valuations would drop due to the effects of higher vacancy rates, lower rents and worsening rent collections 6% to 8% lower than pre-COVID-19 conditions. Though the return to economic growth was in either Q3 2020 or Q3 2021, for both scenarios, the models showed that full recovery to pre-recession levels would not be achieved until 2022 or 2023.

Boespflug commented that while nationally, retail and office real estate would fare the worst, that could mean good things for Boise. People shifting from offices to remote work would be inclined to move to less dense and more affordable areas, including Boise. Given Boise's already tight residential, industrial and office markets, that could continue the Treasure Valley's growth trends for CRE.

The Colliers model results are summarized in the table below.

National Commercial Real Estate Model Predictions			
Type	Approximate 2019 Values	Short Slump 9% GDP Decline	Long Slump 15% GDP Decline
Multi-Unit Housing			
peak vacancy, %	~5	6.6	7.7
rent per sq. ft.	>$1,400	$1,374.00	$1,366.00
Warehouse			
peak vacancy, %	~10	11.8	12.9
rent per sq. ft.,	>$5	$4.90	$4.86
Flex			
peak vacancy, %	~10	11.6	12.7
rent per sq. ft.	~$9	$8.64	$8.56
Office			
peak vacancy, %	~18	19.4	20.5
rent per sq. ft.	$26 to $28	$24.95	$24.56
Retail			
peak vacancy, %	>10	12.6	13.7
rent per sq. ft.	$28 to $29	$16.74	$16.47