Roughly a year into the COVID-19 pandemic in the U.S., the commercial real estate (CRE) market continues to recover from an unprecedented dislocation. A strong pace of vaccination in the U.S., combined with aggressive fiscal stimulus, has brightened the outlook for economic growth and the CRE backdrop. While risks to the outlook persist for certain property types, we expect to see a broad improvement in both fundamentals and transaction activity during Q2.

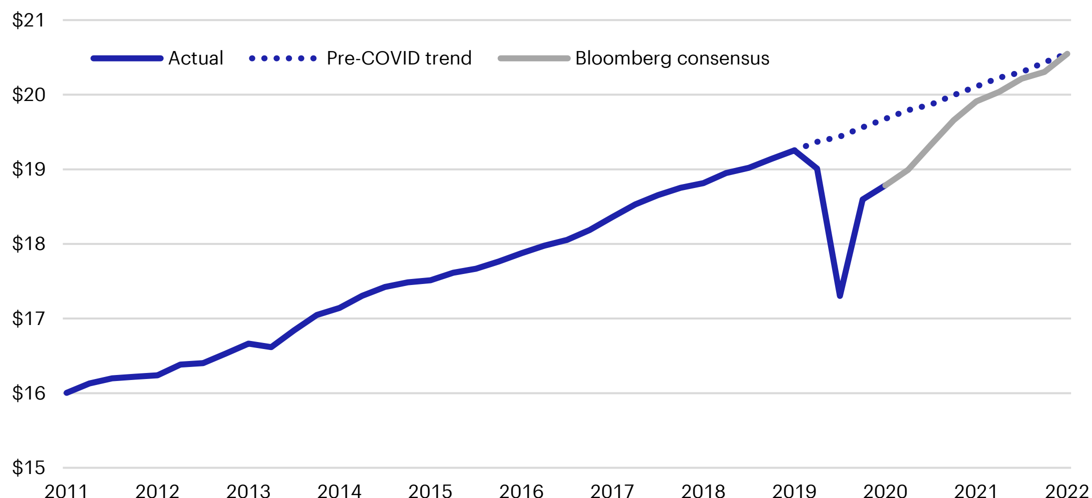
Key takeaways

- Q1 saw significant progress in vaccine distribution, lifting GDP estimates for 2021.
- Property prices continue to rise, though transaction activity remains somewhat muted.
- We expect a recovery in CRE fundamentals, especially for the most impacted sectors, to begin in Q2 and accelerate during the summer months.

Entering 2021, there were signs of optimism around vaccination and fiscal policy support, but an air of uncertainty still permeated the economic outlook. Vaccine distribution had barely gotten off the ground and the country was experiencing its worst surge in the pandemic to date. Fast forward just three months, and the future looks markedly brighter. After a slow start, the pace of vaccination continues to ramp; roughly 100 million people have received at least one dose of a vaccine, and the daily rate has improved to 2.5 million doses per day.[1] At this rate the U.S. could near herd immunity by the end of summer, allowing a return to something resembling normalcy in Q3.

The federal government continued to support the economy through the vaccination period, passing the massive $1.9 trillion American Rescue Plan Act, the third installment in what now amounts to nearly $5 trillion in COVID-related fiscal aid. The bill included $1,400 checks to most citizens, expanded unemployment benefits, extended aid to states and localities, and money for vaccine distribution and school reopenings. The combination of this powerful fiscal thrust and a vaccine-led reopening have induced some remarkable economic estimates—the

U.S. real GDP
$T, SAAR



Source: BEA, Bloomberg Finance, L.P., as of March 31, 2021.

1 Our World in Data, as of March 31, 2021.

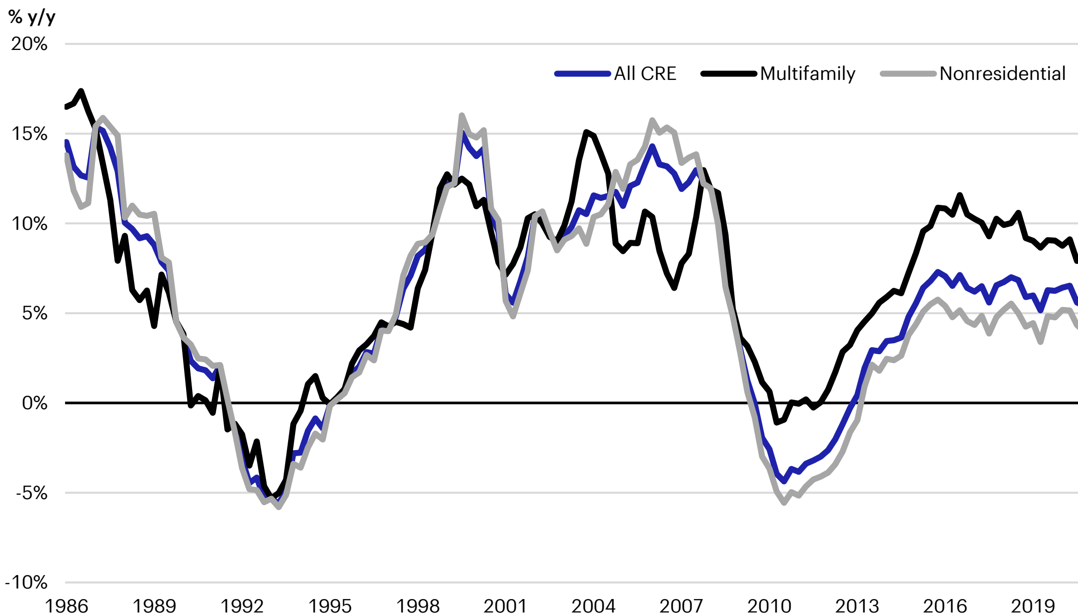
Bloomberg consensus estimates for U.S. GDP growth in 2021 and 2022 sit at 5.7% and 4.0%, respectively, while the Fed expects 6.5% and 3.3%. Both projections would get GDP back to its pre-COVID trend level by the end of 2022.[2]

A turbocharged economy should help boost CRE fundamentals that were hit hard by the pandemic. Vacancy rates across most property types increased in 2020, with industrial the only exception. Rent growth also stalled for the most part—retail rents declined -2.6% as more shopping moved online, while apartment revenues fell -1.7% as apartment owners offered concessions to attract tenants.[3] Impacts varied widely by geography, with the general rule being that less expensive second-tier cities experienced a more muted hit to fundamentals than gateway cities like New York and San Francisco. Broadly, we would expect vacancy and rents to begin to normalize over the coming year, although it remains challenging to predict what durable changes to space usage the pandemic will inspire going forward.

Transaction activity in the CRE space came out of the gates slower in 2021. After a relatively strong Q4, volume totaling $46.6 billion in January and February was more in line with June–August 2020 levels. We presume the anomalously active Q4 was attributable to a combination of sellers capitalizing on vaccine news excitement and a classic year-end deal blitz. Q1 is typically the lightest-volume quarter of the year, and we would imagine some sellers are holding off to see whether they can drive a higher price once economies reopen more fully and properties see cash flow return. Given the amount of capital available, we could see a rush of deals over the next two quarters as strong economic forecasts actually come to fruition.[3]

Property prices continue their relentless march upward, climbing 1.9% through the first two months of 2021 after rising 7.2% throughout a tumultuous 2020.[3] We have not seen a surge in sales of distressed properties like the one that decimated property values in the wake of the Global Financial Crisis (GFC). Instead, capital availability and a sense that fundamentals should recover rapidly post-pandemic have allowed property owners to retain troubled assets. Additionally, the pandemic has driven a wedge between property types, boosting price growth in some sectors (e.g., industrial, multifamily) while sapping it in others (e.g., retail, hotel).

Outstanding mortgage growth



Source: Federal Reserve financial accounts, as of December 31, 2020.

2 Bloomberg Finance, L.P., as of March 31, 2021.
3 Real Capital Analytics, as of February 28, 2021.

In some ways, debt markets have been the glue that has kept the CRE space together through the pandemic. Liquidity in debt markets has remained strong, and there has not been the type of robust deleveraging that kneecapped the CRE market following the early 1990s recession and the GFC. Instead, commercial mortgages have continued to grow at a healthy 5%–6% annual clip, driven more recently by refinancings.[4] Undoubtedly there remains a significant level of stress that lenders must work through, especially in the retail and hotel sectors. We'll also be watching how rising long-term interest rates impact the cost of debt.

Evidence of the durability of COVID-induced trends should begin to appear in Q2. As vaccine administration progresses and businesses approach normalcy, we should get a better understanding of how firms' views on office space needs have changed. We have held the opinion throughout the pandemic that while work will likely become more flexible, physical space remains an essential asset for most knowledge industries. A recent KPMG survey found that just 17% of CEOs plan to cut down on office space as a result of the pandemic, a drastic shift down from 69% in August.[5] We will also be watching to see how much of the spike in e-commerce sales remains once shops are fully open again.

One area where we are most confident that the pandemic has truly accelerated trends is in the so-called "alternative" CRE sectors. As we discussed in our **5 for '21** piece, sectors such as data centers, infrastructure and self-storage comprise an increasingly large portion of the public REIT market. These sectors were already benefiting from positive secular trends in digitization and the aging of the giant millennial cohort. We would expect that demand in these sectors will continue to increase and the sectors will likely figure more prominently in investor portfolios.

The title "Into the starting gates" is a recognition of the multiple realities facing the U.S. economy and CRE market in Q2 and beyond. After a year of false starts, the economy looks likely to be off to the races before long as vaccines allow consumers to reengage with previously inaccessible activities. This will be an unalloyed positive for properties that sorely need an upturn in cash flow; however, there is still a race to be run and, as any equine enthusiast would advise, races tend not to be predictable. Beyond the obvious economic uncertainty, sectors like office and retail still must contend with the possibility that demand trends have been accelerated or shifted by the pandemic. Additionally, there remains a material amount of stress within the market to work out. With all that said, we expect Q2 will mark an inflection point in CRE fundamentals.

4 Federal Reserve, as of December 31, 2020.
5 KPMG CEO Outlook Pulse Survey, March 2021.

Macro view

Key takeaways
- Vaccination continues to ramp up in the U.S.
- Reopening and fiscal stimulus should combine to generate robust growth in 2021.
- The economic backdrop aids the CRE market, though the employment picture is a concern.

About a year after the U.S. economy was effectively shuttered as the coronavirus spread across the country, activity continues to gain momentum. Roughly 100 million people in the U.S. have received at least one vaccine dose, and the daily rate of vaccination continues to climb. The daily case rate, while hardly optimal, has declined rapidly since the end of 2020, and hospitalizations have fallen by nearly 60%. The vaccination effort should continue to accelerate in Q2, allowing the decimated services sector to begin reopening.[1]

If vaccination and reopening stand to be the engine that drives growth in 2021, fiscal stimulus is the afterburner. In March, Congress passed the American Rescue Plan, a massive $1.9 trillion bill targeted squarely at households. This brings total federal COVID relief spending to nearly $5 trillion over the past year, which has led to stellar goods spending and a glut of household savings. The combination of prospective reopening and fiscal spending has led to robust growth estimates—the Fed expects real GDP growth of 6.5% and 3.3% for 2021 and 2022, respectively.[2]

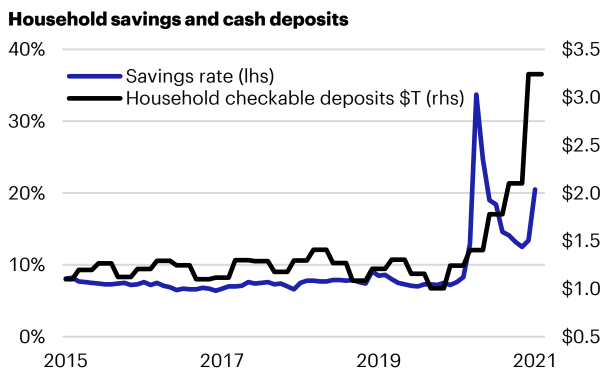
These factors set up the services sector to drive growth in 2021. Consumers, awash with cash but unable to take vacations or go to games or concerts for the past year, instead channeled consumption toward goods. Services spending, which represents about 70% of total consumption, is still 7% below 2019 levels. It remains unclear how quickly and how much households will spend their excess savings, but we do expect a strong recovery beginning in mid-Q2.[6]

All this should support a revival in CRE property fundamentals that were dealt a severe blow by the pandemic, as occupancy declined across most property types in 2020. The office vacancy rate, which fell near a multidecade low in 2019 on the strength of a low unemployment rate, climbed over one full percentage point to 10.9%. The multifamily sector saw vacancy rise to the highest level since 2010 as the urbanization trend reversed somewhat. The industrial sector continued to act as an outlier, with vacancy nearly flat at a low level of 2.7%.[3]

An economic resurgence in 2021 will undoubtedly boost fundamentals for CRE, especially in those hardest-hit sectors like retail and hotels. However, longer-term demand for CRE space will be driven by factors such as the recovery in labor markets and changes in secular trends. The headline jobless rate of 6.2% represents a massive improvement from six months ago but does not tell the full labor market story. Labor participation fell markedly in 2020, and the Federal Reserve estimates the "true" unemployment rate at closer to 9%.[7]

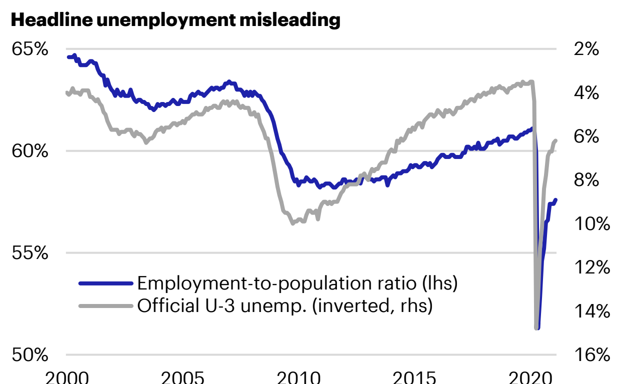
As 2021 rolls along, we will continue to monitor the employment situation, the fiscal policy stance of the Biden administration, and evidence of any shifts in long-term CRE usage trends. With all that said, the U.S. economy appears to be in a remarkably healthy place given where it stood just one year ago, an unambiguous positive for CRE fundamentals.

Household savings and cash deposits



Source: BEA, Federal Reserve, as of March 19, 2021.

Headline unemployment misleading



Source: BLS, as of February 28, 2021.

6 BEA, as of February 28, 2021.

7 BLS, as of February 28, 2021.

Capital markets: Equity

Key takeaways
- Property values marched higher to start 2021.
- Transaction activity remains low but should pick up beginning in Q2.
- Sentiment among market participants has strengthened in recent quarters.

CRE property prices continued on their upward trajectory, rising 1.9% in the first two months of 2021 after climbing 7.2% in 2020. Transaction volume remains low by relative standards, trending back downward after a strong Q4. The industrial and multifamily sectors have driven much of the activity and price growth, though a recovery in retail and suburban office values in the past few months has provided a boost as well. The lack of distressed sales—just 1% of volumes over the past 12 months were in distressed properties—and a liquid debt market have kept property values from experiencing a GFC-style drawdown.[3]

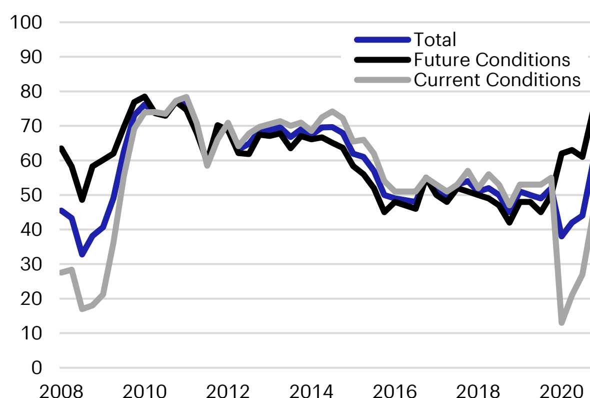
National cap rates have been quite stable through the COVID crisis, with expected dispersion showing across property types. Rising interest rates have caused angst for some, though we believe cap rates are in position to absorb a moderate rise in long-term yields. The spread to Treasuries remains near 450 bps, well wide of historical averages, and a stronger economic backdrop should imply some spread tightening.[3] Additionally, the increase in rates has been driven largely by inflation expectations—real rates remain in negative territory. Should higher inflation indeed come to pass, we'd expect property owners to be able to pass some of the higher financing costs on to tenants as rent increases.

After a challenging 2020, transaction activity should begin to improve as investors observe the pace of improvement in property fundamentals. Foreign investors have stepped back with the rest of the market, accounting for less than $40 billion of acquisitions in 2020 for the first time since 2013. Looking ahead, U.S. economic outperformance, combined with a U.S. dollar that has strengthened YTD but remains well weaker than at any point during 2019, could drive a recovery in foreign flows. Additionally, domestic funds are carrying around $221 billion in dry powder, much of which must be put to work this year, meaning a technical tailwind from flows could help support property values.[3,8]

Additionally, market participants' own outlook for the CRE market has improved markedly over the past few quarters. The overall Real Estate Roundtable Sentiment Index climbed to a 5-year high in Q1, with sentiment around future conditions at its highest since 2010. Last April, 91% of the survey's respondents noted that CRE market conditions were worse than a year prior, epitomizing the deep distress in market sentiment during the early days of the pandemic. In Q1 2021, that same number was just 48%. Participants are also upbeat about the future: 65% of respondents expect property values to be higher a year from now, and 61% anticipate the availability of equity capital to improve over the next year.[9]

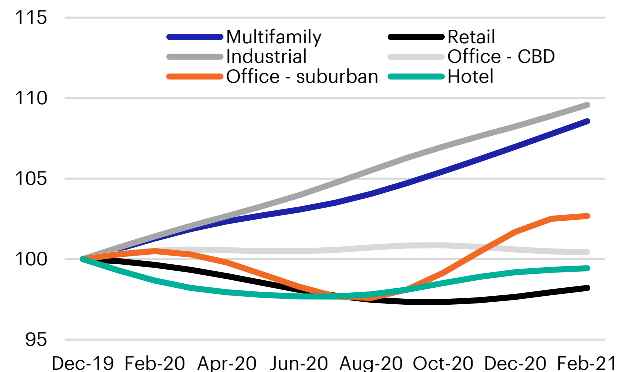
Optimism around vaccination and the economic recovery has bled into the CRE market, and we expect it to lead to an improvement in transaction volumes by midyear. While risks around troubled properties persist, low interest rates and a glut of capital will act as a tailwind for the market.

Real Estate Roundtable market sentiment



Source: Real Estate Roundtable, as of January 31, 2021.

RCA CPPI price growth
Dec. 2019 = 100



Source: Real Capital Analytics, as of February 28, 2021.

8 Preqin, as of April 1, 2021.

9 Real Estate Roundtable, as of January 31, 2021.

Capital markets: Debt

Key takeaways

- Debt market liquidity has bridged the CRE market to the other side of the crisis.
- Delinquencies, while improving, remain elevated due to the lodging and retail sectors.
- Banks are reporting higher demand for CRE loans, a sign of market recovery.

The CRE debt market continues to recover from the COVID downturn, with lenders seeing an uptick in demand for financing as the economy improves. Delinquency rates continue to decline in the conduit CMBS market, albeit relatively slowly. Nonaccruals at banks ticked up to 0.8% in Q4, far lower than the GFC peak of 4.0%, although it remains challenging to get a sense of true stress in bank portfolios given the level of forbearance and modifications offered.[10] With deal volume still depressed, lenders' ability to extend capital for refinancing has been crucial in helping the market avoid a wave of distressed sales.

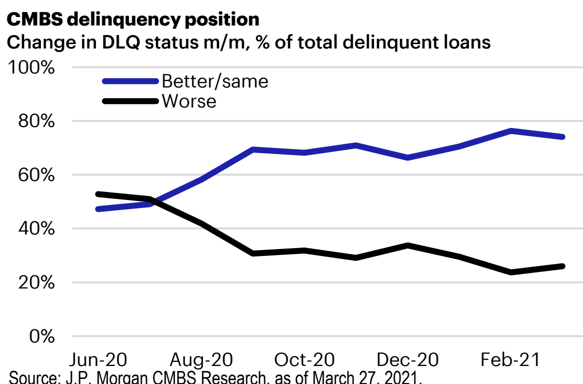
While the economic backdrop is set to improve in the next three months, the shock from the pandemic has left debt markets with a stubborn level of stress to work through. The overall conduit CMBS 60+ day delinquency rate fell below 6.0% for the first time since June, down from a peak of 6.4% in December. The rate of special servicing has also declined to less than $1 billion in new loans per month, a positive sign of fading new stress. Distress continues to be centered in the hotel and retail sectors, although the decrease in overall delinquency in recent months has been principally driven by improvement in those two sectors. We've yet to see a material move higher in rates for office, multifamily or industrial.[11]

Since the start of the crisis, roughly $33.5 billion in forbearance has been granted across conduit and SASB CMBS and CRE CLOs. Conduit CMBS, which comprises the bulk, has seen roughly 60% of that temporary relief expire. While some were concerned that expiration would result in a resurgence of delinquency, the incidence of redefault appears low—a little over 10% of conduit loans with expired forbearance have reentered delinquency, while less than 1% of SASB loans have done so. For us, this and the fact that the overall delinquency rate continues to fall are good signs that forbearance for impacted sectors is performing its intended task—namely, to give borrowers time to get current on debt.[11]

While lenders continue to work through problem loans, the outlook for new origination activity has strengthened. Banks report an upturn in demand for CRE debt and have moved toward loosening credit standards, a sign of an improving backdrop. After almost completely shutting down in mid-2020, securitized issuance has improved markedly over the past two quarters. This includes CRE CLOs, which have been more resilient than conduit CMBS throughout the crisis and recently notched their second largest-ever month of issuance in March.[11] The broadening lender landscape has had a positive impact on future sentiment—63% of respondents expect debt availability to improve in the next year, with only 8% expecting it to worsen.[9]

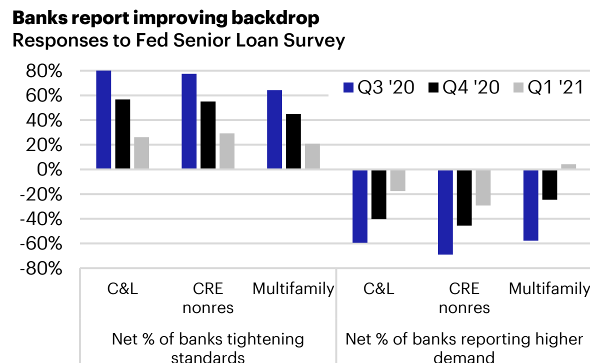
Acceleration in the improvement of fundamentals remains the key factor for both resolving stressed loans and a robust growth in new activity. After guiding CRE through the depths of the crisis, debt capital will be crucial in supporting a robust recovery in deal volume in 2021.

CMBS delinquency position
Change in DLQ status m/m, % of total delinquent loans



Source: J.P. Morgan CMBS Research, as of March 27, 2021.

Banks report improving backdrop
Responses to Fed Senior Loan Survey



Source: Federal Reserve, as of January 31, 2021.

10 FDIC, as of December 31, 2021.

11 J.P. Morgan CMBS Research, as of March 27, 2021.

Multifamily

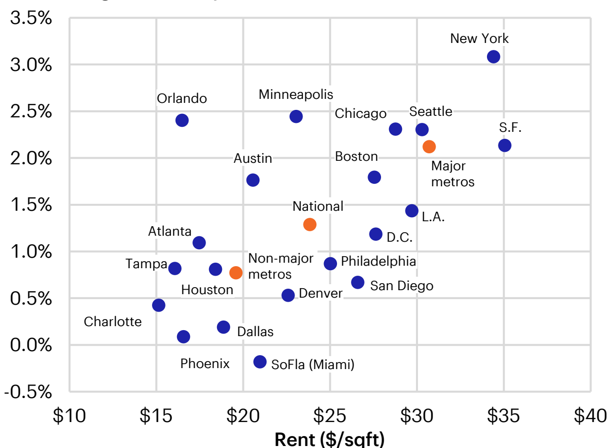
Key takeaways

- The sector should benefit from an improving economic and employment backdrop.
- We expect an uptick in demand and effective rents as the year proceeds.
- The outlook for non-major metro areas looks comparatively brighter.

Multifamily came through 2020 better than most sectors as property prices rose at a solid ~7% pace and conditions remain generally positive as we progress through 2021.[3] This year, apartment prices have climbed at a similar rate as 2020. And while year-over-year transaction volume remains approximately 30% off its average from a year ago, it also has fared comparatively better than other major property types.[3]

Against this backdrop, if our outlook for the multifamily sector in Q1 2021 was cautiously optimistic, it is fair to say our position has been upgraded to optimistic, without the qualifier in front of it, as we head into Q2 and the rest of the year. As noted above, economic conditions appear set to improve markedly in the coming quarters while the Fed is determined to keep short rates at historic lows. Strong economic conditions combined with low interest rates are supportive for all CRE property types but have historically yielded some of the greatest benefits to multifamily.

Pricier markets felt more pain in 2020
2020 change in vacancy



Source: Real Capital Analytics, as of February 28, 2021.

Multifamily monitor

	Level	3-month change	12-month change
Property values		2.2%	7.2%
Volume (3-month)	$46.8B	3%	-32%
Cap rates	5.0%	0.0%	-0.3%
Vacancy	6.9%	0.5%	1.4%

Source: Real Capital Analytics, as of February 28, 2021.

With this in mind, we expect a significant bump in apartment demand as employment continues to heal and renters, particularly younger ones, increasingly step out on their own again. Multifamily vacancy rates, which spiked from 5.5% to 6.9% in 2020, should resume their gradual decline, returning toward pre-COVID levels of 4%–5% in 2H 2021 and boosting net effective rental rates.[3] Attractive fundamentals, of course, lead to continued investment and development. To this end, new apartment supply of more than 325,000 units should easily outpace last year's relatively weak supply figure of 285,000 units.[12]

Despite our optimistic outlook, selectivity will remain key as regions are likely to see varying rates of growth. We have written about the pandemic-driven shift from urban and higher-density areas to suburban and lower-density ones, and we believe it will remain in place throughout 2021. However, we would also highlight another demographic shift that appears equally prominent: a migration from larger, older and more expensive gateway cities toward smaller cities in secondary and tertiary markets. With generally more favorable business climates, a quality pool of educated workers and greater affordability, we look for non-major metros to continue outperforming in 2021. The chart to the left highlights this trend in 2020, with major metro regions having experienced a noticeably higher jump in vacancy rates compared to smaller cities such as Charlotte, Phoenix, Tampa and Atlanta.[3]

12 Yardi Matrix.

Office

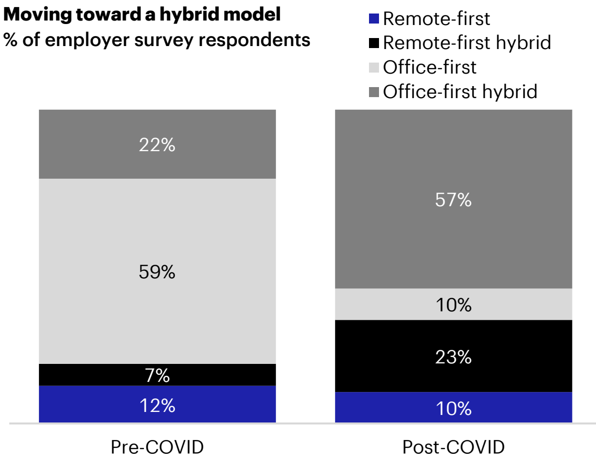
Key takeaways

- We see greater optimism around lower-density office properties.
- CEOs expect minimal decreases in office space needs.
- Demand for life sciences space continues to grow.

With most office-using employees now having worked from home for more than a year, many questions remain about the long-term demand for office space. To this end, winners and losers among office investments have definitely emerged over the past year, with suburban and lower-density office properties most notably looking like winners compared to CBD office properties (much like in multifamily). On balance, however, we believe the bark surrounding the office sector is shaping up to be worse than the eventual bite.

On a national level, rent levels plateaued in 2020 and transaction volume remains at relatively low levels.[3] With that said, anecdotal evidence also points to the largest office-using sectors of the economy, technology and finance chief among them, continuing to embrace the need for office space. Goldman Sachs, J.P. Morgan and Morgan Stanley each have plans to begin returning employees to their offices this summer, while Google announced in March that it would invest another $7 billion in new office and data centers across the U.S. this year.[13] A recent KPMG survey supported these anecdotal datapoints as just 17% of chief executives surveyed plan to cut back on office space, down dramatically from the 69% in the last survey in August 2021.[5] For us, this is evidence that firms' views on office utilization continue to evolve and have generally done so in favor of greater demand.

Moving toward a hybrid model
% of employer survey respondents



Source: Cushman & Wakefield, as of February 28, 2021.

Office monitor

	Level	3-month change		12-month change	
Property values		1.7%	↑	2.0%	↑
Volume (3-month)	$26.0B	40%	↑	-48%	↓
Cap rates	6.5%	-0.1%	↓	0.0%	→
Vacancy	10.9%	0.6%	↑	1.0%	↑

Source: Real Capital Analytics, as of February 28, 2021.

The return to the office is likely to look different as employers and employees increasingly seem to be settling on a hybrid model, with up to 80% of the office-using workforce preferring an office-remote hybrid setup in a post-pandemic world. Notably, we do not view a definitive move toward a hybrid working model as a materially negative development for office demand. According to a Cushman & Wakefield simulation, an average of 1.5–3 WFH days per week would equate to a decrease in annual net absorption ranging from -0.18% to -0.40% of a market's office stock.[14]

Any potential loss in demand could also be balanced out by increasing office needs among life science companies. The pandemic clearly shined a spotlight on the need for lab space, but it was already a growing part of office market demand in recent years, driven by venture capital and private equity investment that amounted to a record high of nearly $18 billion for the year ended June 30, 2020.[15] Cities such as Boston, San Diego and San Francisco still account for a sizable amount of lab space demand, including office-to-lab conversions. But growing markets including Seattle and Philadelphia also have seen notable office-to-lab conversion activity in the past several years.

13 The Wall Street Journal.

14 Cushman & Wakefield, Workplace Ecosystems of the Future.

15 CBRE.

Industrial

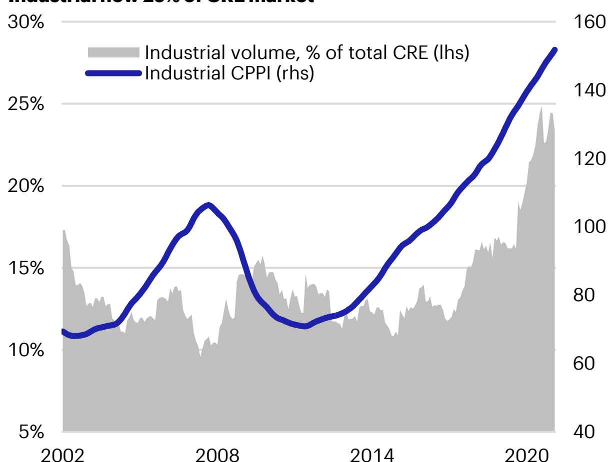
Key takeaways

- Industrial demand has been a constant throughout the pandemic.
- Oversupply is a concern but has not had an impact on vacancy rates.
- Traditional drivers of demand—e-commerce and the goods trade—should support growth in 2021.

Despite the volatility that 2020 unleashed across CRE sectors, the industrial sector remained relatively unscathed throughout the year. Demand continued to be robust as the 2020 spike in online shopping indicates a larger, secular change in consumers' shopping habits. With nearly 90 million square feet of industrial absorption, Q4 2020 was the strongest quarter for absorption in the history of the space.[16] Demand was stoked primarily by massive warehouse and distribution space needs to support e-commerce. Yet a relatively diverse array of sources supported industrial demand throughout 2020, including logistics & distribution centers and third-party logistics providers.

Industrial supply has outpaced demand since 2019 as construction projects have spiked to satisfy the market. Oversupply, however, has not yet had a material impact on vacancy rates. The industrial vacancy rate of 2.7% ticked up slightly in 2020 but remains near record-low levels.[3] Further, new supply in 2020 was generally targeted to the same metropolitan regions where demand has been

Industrial now 25% of CRE market



Source: Real Capital Analytics, as of February 28, 2021.

Industrial monitor

	Level	3-month change	12-month change
Property values		1.8%	8.1%
Volume (3-month)	$34.2B	39%	-35%
Cap rates	5.9%	0.0%	-0.3%
Vacancy	2.7%	0.0%	0.1%

Source: Real Capital Analytics, as of February 28, 2021.

greatest. Against this backdrop, vacancy rates across major metropolitan areas, such as Los Angeles, San Francisco, Austin and Philadelphia, remain below 2%.[3] We've also been encouraged by developers' relatively more conservative pipeline for new industrial construction projects, which should help keep the supply/demand picture generally in balance in 2021. The percentage of speculative construction projects gradually declined last year as an increasing number of projects featured preleased space.[16]

Industrial continues to lead CRE in price growth at 8.3% year over year through February, and the annual decline in transaction volumes has been more muted than in other sectors.[3] The traditional drivers of industrial demand should well support the sector throughout 2021. In addition, we see the potential for increasing opportunities in two more targeted areas of the property type: smaller, last-mile fulfillment centers located in or close to urban centers, and cold storage facility centers. The vaccine rollout has highlighted the importance of cold storage facility centers, but demand for modern cold storage space is primarily driven by the rise of online grocery retailers as well the need to modernize older storage facilities. The average age of the industry's 250 million square feet of cold storage space is 37 years.[17] According to Emergen Research, construction projects on cold storage space globally should provide many new investment opportunities, as it is expected to balloon to nearly $19 billion by 2027 from just $7 billion in 2019.

16 Cushman & Wakefield.

17 Jones Lang LaSalle, as of December 31, 2020.

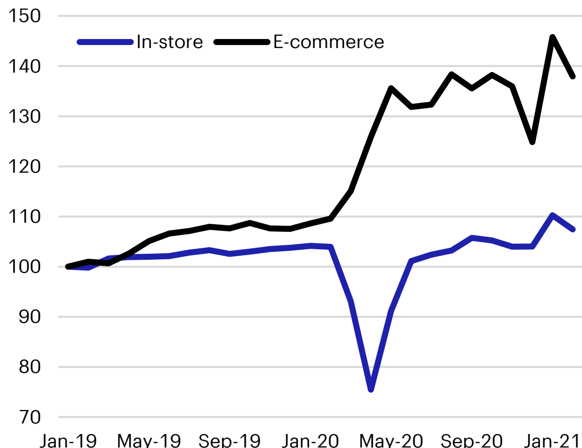
Retail

Key takeaways
- Signs of retail stress remain evident.
- Newfound optimism, grounded in reopening and an expected upsurge in consumption, has emerged.
- Store openings have outpaced closings thus far in 2021.

It is not difficult to find clear signs of distress within the retail sector. Net absorption declined nearly 3 million square feet in Q4 2020, with the annual period recording the largest decline in occupancy ever.[16] Vacancy rates rose to 7.9% at year-end 2020 while rents edged lower throughout the year.[3] E-commerce continues to eat into the viability of many brick-and-mortar retailers, with shopping malls and department stores facing the most acute pressures. The CMBS delinquency rate for retail, 11.8% in February 2021, has been on the decline since June 2020 but remains elevated far above that of all other property types except lodging.[18]

At the same time, however, it is hard not to see a newfound sense of optimism emerging for retail properties amid a broader upturn in economic expectations. In the wake of significant losses in 2020, the public REIT market now reflects this optimism as retail REITs have returned approximately 15% through February and are among the top-performing property types YTD. Additionally, the 3,300-plus store openings in 2021 far exceeds the same period last year and has eclipsed the announced number of store closings this year (approximately 2,700) as retailers, primarily discount retailers, prepare for an explosion in consumption in 2H 2021 driven by a glut of consumer savings combined with the stimulus money that arrived in many Americans' bank accounts in late March.[19] TJ Maxx, Five Below and Dollar General, for example, plan to open approximately 80, 180 and 1,000 new stores, respectively, in 2021.

Fiscal stimulus lifts all ships
Retail sales, seasonally adjusted, Jan '19 = 100



Source: U.S. Census Bureau, as of February 28, 2021.

Retail monitor

	Level	3-month change	12-month change
Property values		0.8%	-1.4%
Volume (3-month)	$10.7B	12%	-48%
Cap rates	6.4%	-0.2%	-0.2%
Vacancy	7.9%	0.4%	1.3%

Source: Real Capital Analytics, as of February 28, 2021.

Retail growth has been taking place in other ways as well, as traditional big box retailers expand into street-side stores with smaller footprints, allowing them access to more desirable, walkable locations as opposed the mall and department store locations that have borne the brunt of retail's decline. Target continues to open smaller-concept urban stores while Burlington, Dick's Sporting Goods and Kohl's, all accustomed to 70,000–80,000 square foot stores, have opened stores in the 25,000–50,000 square foot range. Moving in a similar direction, fashion retailer Express, traditionally a mall retailer, has announced expansion plans of its own in an attempt to diversify its retail fleet.

18 Trepp, as of February 28, 2021.

19 CoreSight Research.

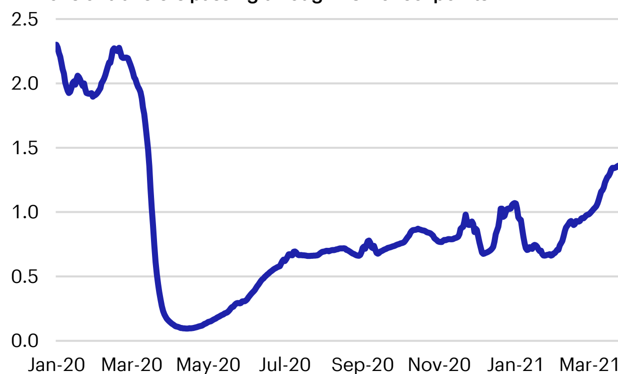
Hotel

Key takeaways
- Lodging, a relatively small CRE sector, represents an outsized portion of market stress.
- Hotels should be among the first to recover.
- Limited-service properties in drivable locations should lead the rebound, though airline traffic has continued to improve.

Against the backdrop of a broadly more optimistic outlook across the CRE market, mobility data paints a brighter picture for hospitality, the most beaten-down of the major CRE property types. For example, Google's retail and recreation high frequency tracker, which shows trends for places like restaurants, cafes, shopping centers, museums and libraries, climbed to within 6% of its pre-pandemic baseline. A similar tracker for public transport hubs such as subway, bus and train stations also has been on an uptrend to within 16% of its pre-pandemic level.

The U.S. hotel occupancy rate for the week ended March 13, 2021, reached its highest point since the pandemic began at 52.1%.[20] As has been the case throughout the pandemic, drivable southern markets such as Daytona Beach and the Florida Panhandle have led recent growth in occupancy, which has been reflective of further reopening around the country. Looking beyond occupancy rates, the percentage of the 163 national hotel markets tracked by STR considered to be in depression (defined as less than 50% of 2019 revenue per available room, or RevPAR) edged down from Q4 2020 levels from approximately 30% to

Daily airline passengers
Millions of travelers passing through TSA checkpoints



Source: Transportation Security Administration, as of March 29, 2021.

Hotel monitor

	Level	3-month change		12-month change	
Property values		0.5%	↑	0.8%	↑
Volume (3-month)	$3.7B	3%	↑	-71%	↓
Cap rates	7.7%	-1.2%	↓	-1.0%	↓
Vacancy (Mar. 20)	41%	-19%	↓	-29%	↓

Sources: Real Capital Analytics, STR, as of February 28, 2021.

20% in March 2021.[20] The markets in recovery mode (i.e., at 80%–99.9% of 2019 RevPar) have seen a corresponding increase. Fitch projects that national hotel RevPAR could maintain as much as three-quarters of 2019 levels throughout this year, with the most notable and sustained recovery taking place in 2H 2021.

As with other property types, however, selectivity remains key as we remain more optimistic about the recovery prospects for smaller, limited-service hotels in drivable vacation spots. While hotels in nearly all states have seen rising demand in recent weeks, Florida and Texas have by far seen the greatest increases with occupancy rates in Alabama, Arizona and Mississippi also notching notable gains. On the opposite end of the spectrum, full-service hotels in urban centers that cater primarily toward business and convention crowds continue to face a difficult path. San Francisco and Boston, for example, stand out as markets that continue to have occupancy challenges. While we still expect markets such as these to rebound, we are likely to see a phased recovery.

20 STR, as of February 28, 2021.