2021 — The Year in Review

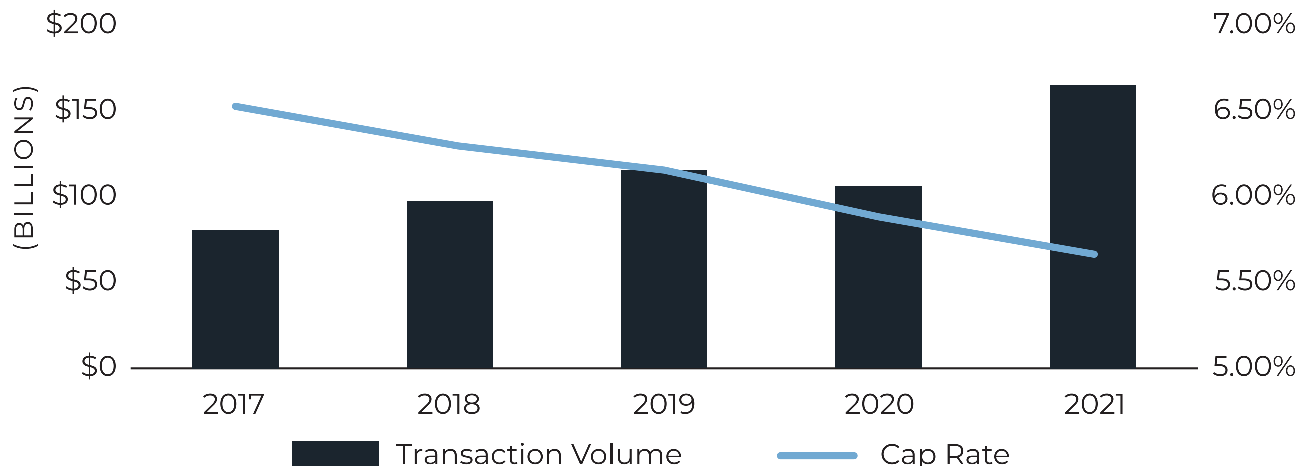
n 2021, the widespread distribution of COVID-19 vaccines, continuing fiscal stimulus from the federal government and supportive measures from the Federal Reserve helped real GDP grow 5.7%, while strong earnings and profit margins drove U.S. equity markets higher for the third consecutive year.[1]

The S&P 500 grew by 27% during the year, the Dow Jones Industrial Average grew by 19%, and the Nasdaq Composite grew by 21%.[2] Commercial real estate also benefited from the economic expansion, low interest rates that motivated investors to search for yield by pursuing alternative assets, and optimism over NOI growth. In 2021, CRE prices increased by a record 23% YOY and transaction volume increased by 88% YOY to $809 billion.[3] The strongest pricing growth occurred outside the primary markets of New York, Los Angeles, San Francisco, Washington D.C., Chicago, and Boston. These markets experienced 17% growth, while secondary and tertiary markets experienced 24% growth. Leading the way in transaction activity were the industrial and multifamily sectors. They accounted for 62% of all deal activity, while optimism over income growth pushed cap rates lower across most sectors and subtypes with the exception of CBD office, where cap rates rose by 20 bps.

INDUSTRIAL

2021 was another strong year for industrial properties as transaction volume increased by 56% YOY to a record $166 billion, the average cap rate fell from 5.9% in 2020 to a record low 5.7%, and prices increased by 29% YOY.[4] Industrial sales also accounted for 21% of all transaction activity during the year, second only to multifamily's 41% figure. Strong e-commerce sales and retailers' desire to maintain inventory to avoid supply shortages contributed to a record 503 million sf of net absorption in 2021, an 8.6% YOY increase in rent growth, and a vacancy rate that hovered near historical lows at 4.2% towards the end of the year.[5]

Moving forward into 2022, industrial's strong fundamentals and the $1 trillion ***infrastructure bill*** that was signed into law at the end of 2021 are expected to contribute to another robust year for the sector.

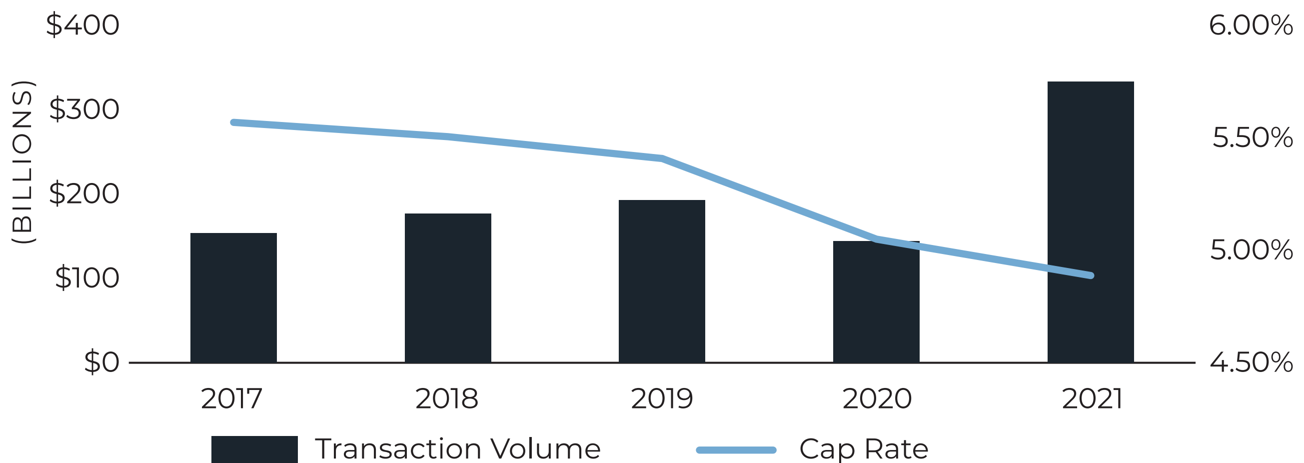


Source: Real Capital Analytics ***www.rcanalytics.com***

MULTIFAMILY

In 2021, spurred by strong demand from renters who were priced out of the home-buying market because of escalating home prices, multifamily experienced 13.5% asking rent growth YOY and the national occupancy rate was above 95% at the end of the year.[6] Multifamily was also the largest, most liquid sector in the commercial real estate market with 41% of all deal activity as transaction volume increased by 128% YOY to $335 billion. Prices also increased by 24% YOY and cap rates declined from an already low 5% in 2020 to 4.9% in 2021.[7] Asking rents grew the most in the South and Southwest regions, reflecting increased migration to these areas due to their lower cost of living relative to expensive coastal markets and the ability of many employees to work remotely instead of in an office. These migration patterns are spurring growth outside of primary markets and contributed to 80% of multifamily's 2021 transaction activity occurring in secondary and tertiary markets. A record number of units were also absorbed during the year. The largest increases in net absorption took place in affordable secondary markets such as Dallas, Houston, Charleston, Savannah, and some metro areas in Florida.[8]

Moving forward into 2022, CBRE is projecting close to 7% growth in net effective rents for multifamily.[9] This projection is supported by the sector's strong fundamentals, particularly its demand drivers. Higher construction costs in 2022 are expected to slow new housing construction, constraining the supply of new homes and boosting occupier demand for multifamily units in the process. Mortgage rates are also expected to rise in 2022, driving up home buying costs and further stimulating occupier demand for multifamily units.

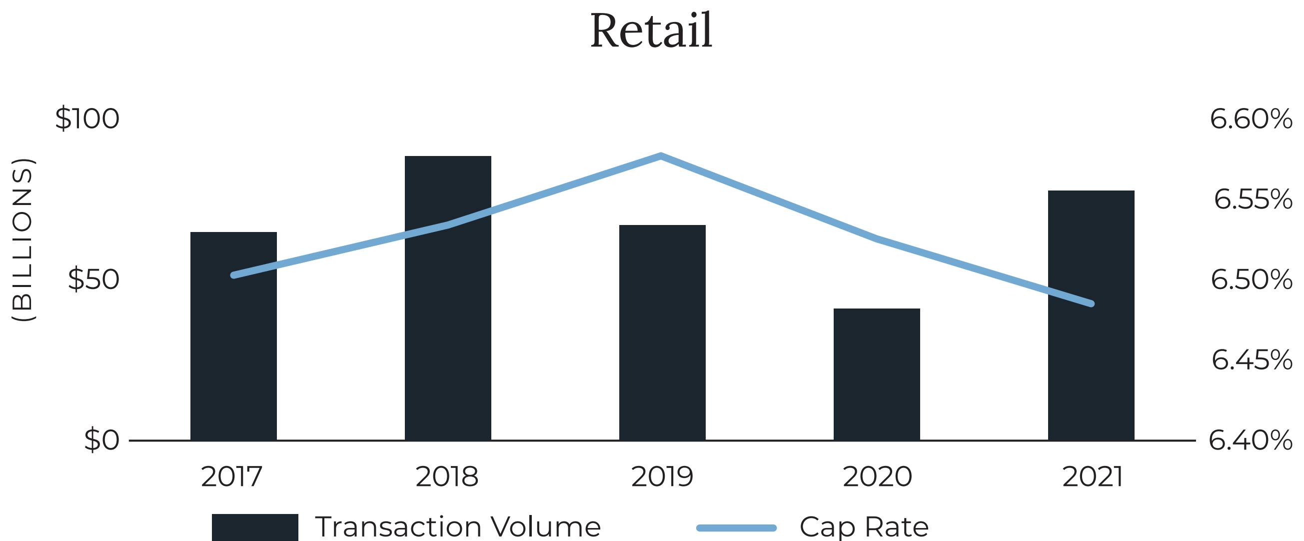


Source: Real Capital Analytics **www.rcanalytics.com**

RETAIL

Early in the pandemic, shutdowns and other COVID-19 related restrictions were expected to cause significant distress in the retail sector. And although bankruptcies did occur, retail loans did not default to the extent originally feared, fewer properties entered foreclosure than expected, and the number of CMBS loans in special servicing declined from 17% in December 2020 to 13% in December 2021. Retail did experience a YOY decline in transaction volume through the end of 1Q21, but deal volume accelerated after that and ultimately increased by 88% YOY to $77 billion by the end of 2021. The average cap rate stayed at 6.5%, prices for retail assets increased by 22% YOY, and leasing activity was on pace to be the sector's highest since 2018.[10] However, despite these positive figures, there was meaningful variation in the performance of retail properties based on their subtype and location. Retail properties in areas with heavy foot traffic that focused on satisfying the needs of local consumers and providing necessities such as food and medicine tended to perform better than outlets that specialized in discretionary goods and were located in areas with less foot traffic. The performance of well-located properties and the positive net absorption that occurred with strip centers, neighborhood centers, and single-tenant retail properties, helped offset poor performances by older malls in challenged markets and retail outlets in areas with little foot traffic.

Looking forward, CBRE is projecting 2% NOI growth for retail in 2022.[11] This growth projection is modest relative to CBRE's outlook for multifamily (8%) and industrial (4%), and is partially due to the ongoing impact of COVID-19. Although vaccines and treatments are now widely available, the virus still presents challenges for retail properties, particularly those that depend on heavy foot traffic and revenue from international tourists. However, aided by government stimulus and a growing economy, U.S. households were able to stockpile nearly $3 trillion in excess savings in 2021 and this will benefit retail properties in 2022 as consumers draw down these funds.[12] Lastly, the bankruptcies that occurred in 2021 have reduced competition in some markets and the retailers that remain in these areas are expected to benefit from this.

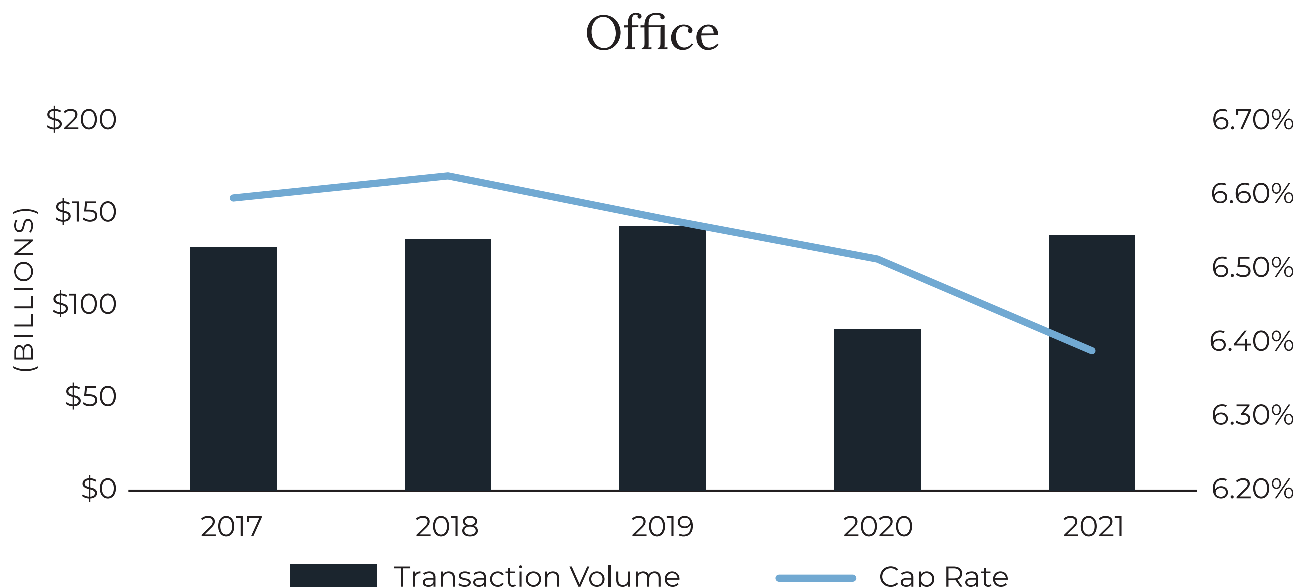


Source: Real Capital Analytics ***www.rcanalytics.com***

OFFICE

Overall, the office sector ended 2021 on a positive note, but a closer look at the data reveals ongoing challenges and varied performance depending on when the asset was delivered and the market it resides in. With 5.4 million sf of net absorption in 4Q21, the office market recorded positive net absorption for the first time since before the pandemic began. Leasing activity also picked up in 2021, resulting in a 15% YOY increase. However, despite 2021's uptick in leasing activity, it is still nearly 30% below pre-pandemic levels and vacancy rates remain elevated, particularly for older product.[13] In 2021, office transaction volume increased by 57% YOY to $139 billion, prices increased by 14% YOY, and the average cap rate fell from 6.5% to 6.4%; although the cap rate for CBD office properties actually increased by 20 bps during the year.[14] Furthermore, the emergence of Omicron towards the end of 2021 presented landlords with new leasing challenges as many employers delayed reopening their offices or renewing their leases because of the new COVID-19 variant. Leasing challenges were particularly acute in primary markets, while secondary growth markets such as Austin, Atlanta, Charlotte, Nashville, Phoenix, and Raleigh experienced leasing volumes closer to pre-pandemic levels. Tech companies accounted for 21% of 4Q21's leasing activity and insurance, finance, and law firms also had strong leasing activity; indicating that these industries are anxious to get their employees back to the office. Lastly, office tenants prioritized newer product as 4Q21's vacancy rates declined for properties that have been delivered since 2015, while increasing for older properties.

Moving forward into 2022, CBRE is forecasting a 1.5% decline in NOI and a double-digit vacancy rate for the office sector as employers try to determine how much office space they will need in the future now that hybrid work and remote work arrangements have become more prevalent. Also in 2022, office product in secondary markets that are benefitting from migration patterns and lower rents that can attract businesses are expected to outperform their counterparts in primary markets. Development is particularly strong in Dallas, Austin, Atlanta, Charlotte, Nashville, Miami, and Salt Lake City, indicating investor confidence in these markets. There is also an appetite to convert suitable office properties to lab science and multifamily properties in markets where demand is high for these products. Boston in particular has experienced an increase in office conversions to life science properties, and Philadelphia and Nashville had some of the highest number of office to multifamily conversions in their pipelines towards the end of 2021.

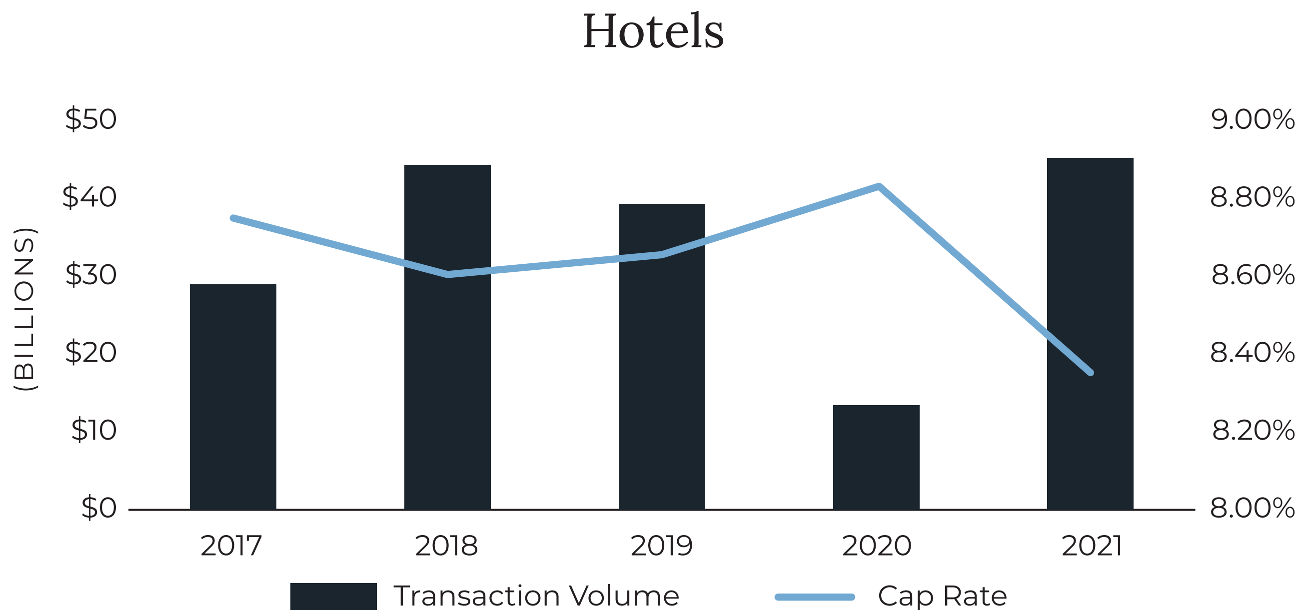


Source: Real Capital Analytics **www.rcanalytics.com**

HOTELS

The shutdowns, travel restrictions and other COVID-19 related measures that were implemented when the virus first emerged had a devastating effect on the hotel industry. In 2020, the industry's occupancy rate and revenue per available room (RevPAR) were the lowest ever recorded by the research firm STR, and the average daily room rate (ADR) was the lowest figure reported by STR since 2011. Anticipating that a wave of foreclosures and bankruptcies in the sector would provide a rare opportunity to acquire quality hotel assets at depressed prices, investors poured money into distressed hotel funds. However, widespread distress never occurred, largely because of extensive government stimulus and lenders' willingness to work with borrowers to avoid default and foreclosure. Even so, the hotel sector was still the poorest performing of all the major real estate asset classes in 2020. And while the sector is not out of the woods yet, it did improve in 2021 as COVID-19 vaccines were released, state and local governments began to loosen or eliminate restrictions on movement, and the pace of leisure travel accelerated. These factors helped increase hotel occupancy from 44% in 2020 to 58% in 2021, RevPAR from $45 in 2020 to $72 in 2021, and ADR from $103 in 2020 to $125 in 2021. The percentage of CMBS loans in special servicing also fell from 24% in December 2020 to 14% in December 2021, the sector's transaction volume increased by 238% YOY to $45 billion, the average cap rate declined from 8.8% in 2020 to 8.3% in 2021, and prices increased by 17% YOY as much of the capital that was raised to acquire distressed hotel assets found itself chasing the same pool of well-performing resort properties, extended-stay hotels, and leisure-focused hotels in drive-to markets.

Moving forward into 2022, well-located, leisure-focused, extended-stay, and resort hotels are expected to continue to outperform full-service hotels in urban markets that are more dependent on group sales and business travelers for revenue. There is some pent-up demand for business travel after two years of virtual meetings, but it is not expected to return to pre-pandemic levels during the year. Labor costs are also a concern for full-service hotels that require many employees to operate. Labor shortages led to double-digit wage increases for leisure and hospitality workers in 2021 and additional wage increases may occur in 2022.[15]



Source: Real Capital Analytics **www.rcanalytics.com**

CONCLUSION

The economic expansion that began in the second half of 2020 is expected to continue into 2022. The Federal Reserve has forecast real GDP growth of 4% and while it has also signaled that it will raise its benchmark federal funds rate multiple times this year, interest rates are still expected to remain low relative to historical levels. In addition, according to S&P Global Market Intelligence, the fiscal and monetary stimulus that the government used to respond to COVID-19 helped generate excess liquidity of approximately $3.7 trillion in the banking sector by mid-2021. And although COVID-19 continues to challenge certain markets and property types, forecasted economic growth, attractive risk adjusted returns for quality assets, the search for yield in a low interest rate environment, significant lending capacity in the banking sector, and the potential for inflation hedging from investments in properties with strong rent growth, all bode well for commercial real estate growth in 2022. This is particularly true for the industrial and multifamily sectors as these properties exhibit the strongest fundamentals of the major real estate asset classes.

ENDNOTES

1 **https://www.bea.gov**
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FOR ADDITIONAL INFORMATION

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