Top 10 CRE Investment Predictions for 2021

It is that time of year again when we predict what might happen in the next twelve months.

A well written article by Joseph J. Ori for GlobeSt.com

By all accounts, 2020 was a shocker. Predictions made at the beginning of the year were, by mid-March, hardly worth the paper or electronic screen they were written on. With a vaccine for Covid-19 now beginning to be distributed, hopes are high that 2021 will be easier to navigate. As such, following a ten predictions for what CRE's investment landscape will look like.

Long Term Interest Rates Will Continue to Increase

The 10-Year T-Note which is up from .49% in March 2020 and is currently at .97% will continue to increase due to the booming economy, deferred consumer demand from the pandemic, low unemployment, and higher inflation expectations. Higher inflation expectations will cause the 10-Year Treasury Note yield to rise to 2.0% by mid-2021.

REIT Returns Will Accelerate

REIT returns for 2020 as measured by the FTSE-NAREIT All Equity Index will most likely be down about -8.0% from 2019 when the index was up 28.66%. Due to the receding pandemic, vaccinations and Covid fatigue, the CRE markets will continue to stabilize and REITs will benefit. I expect the FTSE-NAREIT All Equity Index to increase 8% in 2021 with 3.5% from the dividend and 4.5% from capital gain. Some REIT sectors like hotels and malls will still be distressed, however, this is where there will be significant investment opportunities.

CRE Investment Returns Will Rise

The CRE industry which has suffered dramatically during the pandemic in 2020, is set for a major turnaround in all property sectors. The pandemic caused almost all sectors to suffer nonpayment and forbearance of rent, lease defaults, historic low occupancy, loan defaults and foreclosures. However, there is over $200 billion in real estate equity capital on the sidelines and much of this capital will be put to work in 2021 in all property types. There are also many discounted CRE assets that are ripe for investment including hotels, malls, office buildings and urban apartments.

Apartment Rent Control Will Continue to Spread in the US

New rent control laws were enacted in Oregon, California, and New York in 2019 and will spread to other states in 2021 and beyond. Look for Illinois, New Jersey, Minnesota, Virginia, Massachusetts, Maryland, and other states to adopt new and disastrous rent control laws in the next few years. The apartment market across the country will become bifurcated with Class A tier red states without rent control and pro-real estate policies and the B tier blue states with rent control and anti-real estate policies. Cap rates will rise 1.0%-1.5% in the B tier states due to the negative effects of rent control.

Consolidation in the CRE Service Sector Will Continue

The CRE service sector has four subsectors, brokerage, software, data analytics and apartment listing services. All of these four sectors have been consolidating over the last 10 years to gain scale, provide services on a global basis, diversify the service offering, acquire new clients and customers, and increase revenue, profits, and cash flow. The six largest CRE brokers (CBRE, JLL, Cushman, Colliers, Newmark, and Marcus & Millichap) are all public today and look for one or two of these firms to merge with a larger player. The software sector, which is controlled by the big four of, Yardi, MRI, Skyline and RealPage will see more consolidation as the larger and well-capitalized firms gobble up their smaller and weaker competitors. The same consolidation will occur with the data analytics firms and look for the large software firms to be key buyers of the larger data analytic firms.

Overall Cap Rates for CRE Will Increase

Cap rates for all CRE properties will increase .5% to 1.0%+ due to higher interest rates, the outmigration of residents and investment in blue cities and the large number of distressed assets. The only property sector that may not see an expansion of cap rates is the vaunted industrial market, which has seen cap rates compress about 2.0% from 2015.

The Shadow Lenders Will Take More Market Share from Regulated Lenders

The shadow lending market in the U.S. consists of CRE lenders that are unregulated and include mortgage REITs, private loan funds, private debt funds, hard money lenders and large mortgage bankers. The shadow lending market which typically provides short-term, bridge, permanent, mezzanine and high yield construction loans will increase its market share from approximately 10% of total loans to 15% of total CRE loans. The total volume of new loans originated in 2019 was approximately $500 billion with the shadow lending market accounting for approximately $50 billion of that total.

New CRE Loan and Transaction Activity will be Strong in 2021

In 2019, approximately $500 billion in new loans were originated and overall transaction volume was $750 billion. Although these were very healthy metrics, they were down about 10.0% from the record activity in 2018. The pandemic has significantly reduced this activity in 2020 with the volumes down about 50%. I predict that the 2021 amounts for both loans and transactions will rise significantly and be close to the levels reached in 2019. This is welcome news for the real estate brokerage industry as exemplified by the stock prices of the six public real estate brokers, which are at or near record highs.

CRE Investment will Continue to Decline in Urban Blue Cities

The historic out-migration of residents and businesses from urban blue cities like, San Francisco, New York, Minneapolis, Seattle, Portland, Chicago, Los Angeles, and others will continue. This generational demographic shift has caused high apartment, office and retail vacancies, closures of many retail outlets and less demand for single-family homes and condominiums. CRE investment capital will decline significantly in these cities and will be refocused on suburban areas around these cities and red states.

The Ugly Ducklings of CRE Investment will Shine

The ugly ducklings of CRE investment, malls and hotels will be the favored investment sectors due to large discounts in value, the receding pandemic, and a growing economy. Many CRE investment firms are having a difficult time acquiring industrial, manufactured housing, suburban office and apartments and fully leased food store/drugstore shopping centers at acceptable cap rates. This will cause a flood of new private equity capital into these two distressed sectors and institutional capital into retail and hotel opportunity and distressed investments.