Questions That Matter

Commercial Real Estate | Is The U.S. Out Of Office For Good?

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The U.S. commercial real estate market, already hammered by retail and lodging woes, may face more long-term damage if the pandemic-related population-shift away from larger cities, work-from-home arrangements, and corporate cost-cutting strategies stick.

How this will shape 2021

Current pockets of credit distress in retail and lodging could spread. The office and multifamily markets in particular will suffer if there is a longer-term population shift away from densely populated gateway cities, forcing a pricing reset. The future availability of effective vaccines remains the wild card that could partly revive office culture in high-cost cities. What's more, since office leases are typically for longer terms of 10 years or more, any potential distress would likely take time to materialize.

Office and multifamily property fundamentals and values may deteriorate. We've already seen some evidence that multifamily rents have declined in certain large cities. Rents in downtown areas have fallen by more than 6.0% from the March 2020 peak and have been falling at a rate of about 1.0% per month since June, according to Costar data. Values for both offices and multifamily properties have declined a little less than 10% versus the pre-COVID-19 period, according to Green Street.

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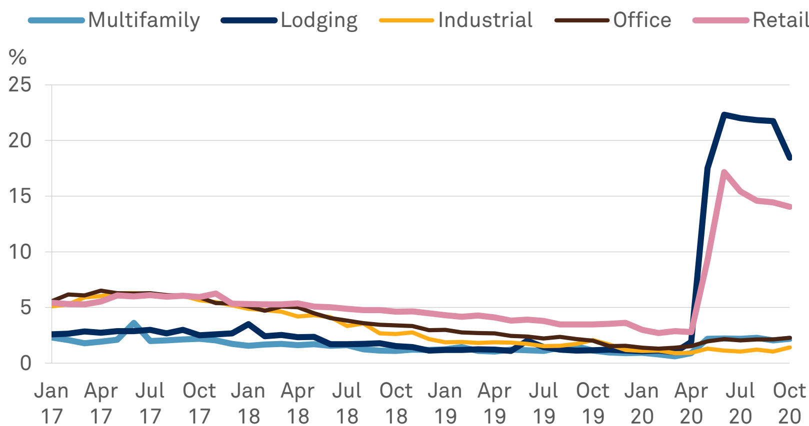
What we think and why

The securitized (CMBS) sector is a lens showing where most current distress lies. As of October 2020, the overall CMBS delinquency rate was around 7.5%. The lodging late payment rate reached a recent peak over 20%, and now sits around 18%, while retail stands at around 14%. The other three major areas—office, multifamily, and industrial—remain below 2.5%. An additional 7% of this universe of loans can be classified as either in forbearance or currently requesting forbearance relief, and 85% of that is due to lodging/retail-backed loans.

Chart 16

CMBS Delinquency Rate By Major Property Type
Delinquency Rate By Property Type



Source: S&P Global Ratings:

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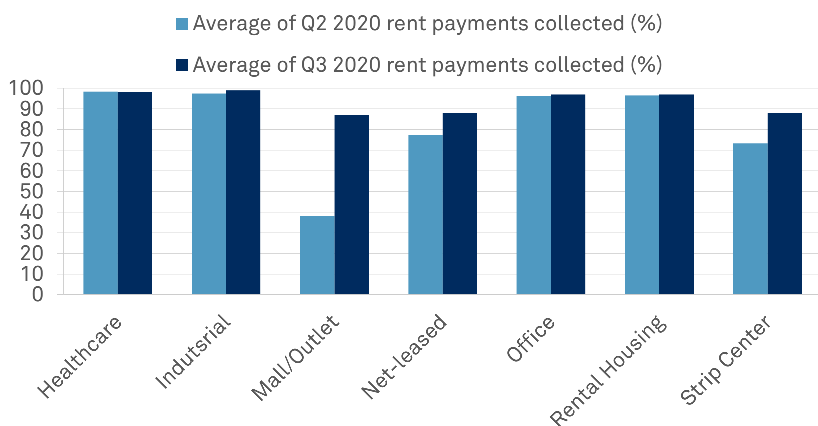
Despite some recent improvements in delinquency rates, risks are on the downside. Even within the lodging and retail sectors, we've seen some recent improvement in the overall delinquency and forbearance rates. Rent collection across retail REITs have sequentially improved as stores reopened; they collected over 80% of rent in third-quarter 2020, while other sectors have been relatively steady. However, credit distress remains elevated, and risks are likely to the downside, especially heading into the winter months.

Chart 17

REITs Cash Rent Collections By Sector



Source: S&P Global Ratings

What could go wrong

Weakness in office may be hidden from the current data. Transaction data is scarce amid the pandemic, making valuations tough to estimate. Meanwhile, higher quality tenants are making good on their rent payments, keeping overall delinquencies low. But businesses are undoubtedly calculating their optimal footprint, which may involve less space at renewal, or moving some operations fully remote or to lower-cost cities. We've already seen increases in sublease activity, and concessions to face rents.

A material deterioration in CRE risks could impact other sectors. For instance, eight of the 11 banks we rate with over 30% exposure to CRE loans have negative outlooks, partially reflecting their large CRE exposure. In our rated U.S. bank universe, the median exposure to CRE is roughly 19% of loans and 139% of Tier 1 capital. Positively, construction loans remain about 40% below the 2008 peak.

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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