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These CRE Assets Have a Track Record of Resiliency in Economic Downturns

Some examples include select apartments, nursing care and assisted living facilities.

Amid the backdrop of economic uncertainty and high-interest rates, Keyway released a new report on how commercial real estate sectors have performed historically during an economic downturn.

Looking back at the Great Recession of 2008, Keyway uncovered trendlines about commercial real estate sub-sectors that performed best then and how they could again given the current economic environment.

It pinpointed B and C apartments, nursing care and assisted living facilities, medical office buildings, and warehouses.

Keyvan Ghaytanchi, CIO, BEB Capital, tells GlobeSt.com, “Certain real estate sectors are resistant to economic downturns because demand for these assets remains stable (e.g., student housing or healthcare facilities).

“Operation of the niche real estate sectors are typically more specialized so there is less competition which may also contribute to higher returns.”

Michael J. Romer, Managing Partner of Romer Debbas, tells GlobeSt.com, “During challenging economic times, investors look toward recession-proof asset classes such as medical & nursing, warehouses & industrial, senior housing, and assisted living as well as multifamily.

“Simply put, these are asset classes based primarily on needs, not wants,” Romer said. “People also need medical services, food/essentials as well as affordable housing and investors are savvy enough to follow consumer needs.”

Patrick Ward, President of MetroGroup Realty Finance, tells GlobeSt.com that from a lending perspective, in representing several of the major life insurance, multifamily, and bulk warehouse have always been the better-performing asset classes in their portfolios.

“Medical office, as opposed to general office, is also considered a well-performing asset class due to longer average lease term,” Ward said.

For example, MetroGroup is currently financing a medical office building in Laguna Niguel, Calif., whose average lease term is 19 years compared to the average term of a general office lease in the US of 4.3 years.

“Most of the major life insurance companies have been selective in financing nursing and assisted living facilities in that in their opinion the operators need to be experienced in providing medical assistance, food service, as well as hospitality,” Ward said.

“The need to provide these services in the opinion of most life insurance companies takes them out of the category of a pure real estate loan. So not surprisingly the asset classes that have performed well in recent downturns have also passed the test of time for many decades.”

Multifamily’s Class B & C and Workforce Housing Attractive

During the Great Recession, nearly 10 million people lost their homes to foreclosure, creating a glut of renters. In this housing downturn, there is a glut of renters – not necessarily due to home foreclosures – but due to persistently unaffordable home prices and limited supply.

“Given this market dynamic, there is strong demand and growth for Class B and Class C multifamily properties,” Keyway’s report said. “When we look at ‘months of negative estimated revenue growth’ for multifamily properties in a downturn, we have observed certain types of properties rise to the top as stable investments. For example, Class B properties showed only eight months of negative growth from 2011-2022 — compared with 30+ for other property types.

This is because residents during tough times often “move down a rung” on the property ladder, going from A to B or B to C.

Jay Lybik, national director of multifamily analytics at CoStar Group, tells GlobeSt.com that Class B apartments currently hold a very enviable position in the multifamily market as the current rent growth leader by price point.

“Given that the majority of new supply deliveries are at the highest price points, Class B assets are more insulted than ever from oversupply threat,” Lybik said.

“Decades ago, if there was an oversupply of new units, developers would just slash rents and/or offer high concession packages to pull up rent households from cheaper existing properties. But due to the large gap between Class A and Class B rents that exists today – $600 per month nationally – Class B residents don’t have the financial means to make that jump. Therefore, Class B assets can be well positioned to outperform during an economic downturn today.”

Brian A. Sidman, founder and principal of BAS Holdings Investments, which is developing affordable housing in Opa-locka through Redwood Dev Co, said that multifamily workforce and affordable housing have proven resilient.

“We believe multifamily workforce and affordable housing is the best performing commercial real estate asset class during a time of financial turmoil,” Sidman said.

“Our firm has researched a multitude of real estate asset classes with a focus on historical performance during recessions and concluded that workforce and affordable housing utilizing federal subsidies assists tenants to ensure they have quality housing at affordable rents and ultimately creates predictable income for landlords.”

Derek Graham, Principal and Founder of Odyssey Properties Group, tells GlobeSt.com that although most of the commercial real estate market typically freezes during economic downturns, smaller, private multifamily transactions continue to take place.

Small, private multifamily properties often trade hands for reasons that are not economic," he said. "Death, divorce, and partnership disputes are three common reasons that smaller assets continue to sell when the rest of the market is frozen.

"Real estate is cyclical, and downturns are foreseeable. Though the broader multifamily sector often outperforms many other sectors during a downturn, not all multifamily properties will fare the same.

"The delta between Class A and Class B/Class C rents has never been larger, so small-scale, Class B and Class C properties are expected to outperform. Historically, vacancy rates for Class A product increase during a downturn, while Class B and Class C remain near average, a trend many say is expected to continue over the coming years."

Jon Morgan, Co-Founder and Managing Principal of Interra Realty, tells GlobeSt.com that while workforce housing is a solid investment during times of economic expansion, it is also very resilient to recessionary periods.

"Undersupplied residential options for working families has increased demand for these apartment communities in general, and that demand only intensifies when downturns create challenges for homeownership," Morgan said.

Healthy Exit Rates at Nursing Care, Assisted Living & Residential Care Facilities
Nursing care, assisted living, and residential care facilities — especially skilled nursing facilities and residential facilities for intellectual and developmental disabilities — showed a much healthier exit rate through the last downturn, Keyway found.

"These properties have relatively low exit rates, making them attractive long-term investments," according to the report.

Lucia Hedke, JLL Managing Director – Healthcare, tells GlobeSt.com that Florida was the fastest-growing state in 2022 and has the highest percentage of the population over age 65.

"That alone is a recipe for increasing demand for healthcare services despite an economic downtown- and within that, we're seeing a tremendous push for more outpatient care," Hedke said.

"It's all about convenience and being treated near home within your community. The advances in medical technologies are creating a safer environment and the rapid addition of procedure codes enables patients to seek even more care in an outpatient environment.

"Thus, the demand for more medical office buildings (MOBs) and ambulatory surgery centers (ASCs) both at an increased rental rate in the biggest metros, Miami, Tampa, and Orlando. These respective markets have experienced the most absorption and occupancy increases over the last couple of years with all three markets now outperforming the top 50 metro aggregate."

Clarion Partners' Chief Investment Officer Jeb Belford tells GlobeSt.com that age-restricted apartments continue to be an increasingly compelling investment opportunity.

"In recent years, many soon-to-be or fully retired Americans have opted for a higher-end niche within the AR format called "Active Adult," which offers residents a low-maintenance, carefree lifestyle and community-oriented living," Belford said.

Per Yardi Matrix data, "both average age-restricted rent growth and occupancy trends appear to have surpassed traditional multifamily over the past decade. The segment has historically been undersupplied relative to the scale of potential senior renters and has been becoming more popular as of late."

Doctors' and Dentists' Offices Always in Demand

The sweet spot for both physicians' and dentists' offices is the mid-sized, regional practices that have 5 to 100 employees, according to Keyway.

"These practices generally remain in their locations, creating long-term stability for their landlords," according to the report.

For example, dentists' offices with 5-99 employees have an exit rate of only 0.7%. Interestingly, dental practices are more stable than physicians' practices, with lower exit rates.

Amir Abdu, Principal, Investments at BentallGreenOak, tells GlobeSt.com that medical office buildings are viewed as recession-resistant, which can be attributed to its sticky, long-term tenancy and constrained supply pipeline.

"Medical users tend to invest meaningful capital into their space build-outs and are likely to renew their leases as a result," Abdu said.

"These assets are mission-critical to the success of their businesses – and this dynamic applies to tenants ranging from small physicians' offices to large, institutional health systems.

"The sector has demonstrated high renewal rates, limited credit loss, and resilient occupancy levels throughout past cycles, with limited new supply risk. Even during the height of the pandemic, occupancy lost during this period was limited despite a substantial drop off in doctor visits and elective procedures. Increased interest rates coupled with construction cost inflation has created a scarcity of competing medical office product, which should bode well for leasing fundamentals."

William S. Kramer, partner, Brinkley Morgan Partner, tells GlobeSt.com that healthcare's strong fundamentals offer reliable and consistent occupancy, making it a prime sector in the office real estate market.

"Medical offices are outpacing other industries with substantial rent growth and significant new construction and/or re-purposing of existing office space, thanks in part to the increase in population and demand for medical office buildings," Kramer said.

"In my practice, my clients investing in medical office space are seeing strong returns on their investments. It's clear that medical offices are performing well in today's real estate landscape, even where margins are tighter due to significantly increased costs of borrowing."

Warehouses, Especially IOS, Excel

Warehouses can perform better in a downturn relative to other industrial properties, according to Keyway.

For example, during the Great Recession, warehousing businesses experienced a 42.4% five-year survival rate, which is higher than its industrial peers.

Adrian Ponsen, national director of U.S. industrial analytics at CoStar Group, tells GlobeSt.com that one factor that helps insulate distribution properties from economic downturns is their shorter construction/development timelines.

“The average construction time from start to finish for a large distribution center is 13 months, which is about half the time it takes to complete high-rise office or multifamily projects,” Ponsen said.

“This means that when interest rates rise, the economy slows, and developers begin pulling back on new projects, the number of new developments completing construction each quarter begins to decline more quickly in the distribution sector than it does in most other property types, which helps the overall market vacancy rate stabilize and begin to tighten again more quickly.”

Vince Tibone, Managing Director, Green Street, tells GlobeSt.com that industrial outdoor storage (IOS) is a niche commercial property type that has grown in popularity among institutions in recent years amid the broader industrial boom.

“Investor demand for IOS has been buoyed by strong recent operating results, favorable long-term supply-demand dynamics, and a de minimis cap-ex burden,” according to Tibone.

Research and data on the sector remain scarce, which can create opportunities, he said.

Green Street believes that IOS sites in infill submarkets are priced to deliver risk-adjusted expected returns that are superior to those available on most other commercial real estate property investments, including the more traditional industrial.

“Lower-barrier IOS does not sport the same favorable supply-and-demand attributes and expected returns are more likely middle-of-the-pack relative to all commercial real estate,” according to Green Street.

The research firm said the simplest definition of IOS is a land site zoned for industrial use where the tenant can store something outside, most commonly vehicles, construction equipment, building materials, or containers.

Most IOS sites have a small building that is generally used as an office and to store tools/parts required for the tenants’ operations. Typical IOS sites range from two to 10 acres of land with a small building (~10k sf) in the front center of the parcel. The building-to-land ratio, or FAR, is generally less than 20%.

IOS also includes truck terminals, which are specialized, low-coverage industrial facilities designed for the maximum throughput of goods. Truck terminals are cross-docked facilities where a long-skinny building resides near the center of the site. Goods are not stored in truck terminals but rather moved from one truck to another in the most efficient manner possible.

Less-than-truckload (LTL) third-party logistics operators, which combine multiple customers' freight on a single truck for at least the long-haul portion of the journey, are large users of truck terminals."

SFR Can Bail Out Homebuilders

Jordan Kavana, Founder & CEO of ARK Homes for Rent, tells GlobeSt.com, "The continued migration to the Sunbelt region supports high rental housing demand outside metro urban cores, providing ample opportunities for SFR operators to grow and perform well during this economic downturn.

"During uncertain economic times, homebuilders have experienced high cancellation rates for products and have needed help offloading inventory. As a result, SFR operators specifically focused on build-to-rent are well positioned as an alternative type of buyer for homebuilders with oversupplied pipelines."

Data Demand Won't Recede

Matt Landek, Managing Director, Enterprise Division, JLL who specializes in Data Centers and Telecom, tells GlobeSt.com that the demand for data and its supporting digital IT infrastructure and capacity is driven by non-economic factors from AI and cloud-computing to the Internet of Things keeps data centers front and center.

"The need for more robust connectivity and innovative data storage solutions continues to drive high investor demand, where the global colocation data center market size is forecasted to grow 11.3% from 2021-2026," Landek said.

"This strong demand also impacts supply, which continues to closely track absorption, keeping vacancy at record lows and allowing operators to keep strong pricing. Data is king, and it is here to stay."

Self Storage in Good Times and Bad

Paul Letourneau, Senior Manager, Commercial Lending, Alliant Credit Union, tells GlobeSt.com that he remains bullish on self storage during tougher economic times because of its strong history and proven track record performing well during both economic bull and bear cycles.

"One reason lenders like us love self-storage is that these properties display one of the lowest credit risk expected loss ratios of most real estate asset types," he said.

"The properties tend to draw upon a diverse mix of customers given the relatively low price point per rental unit and convenience of use within their neighborhood. Furthermore, demand for self-storage can be driven by a slow economy (think: downsizing), a booming market (boats, RVs, and other luxuries), and other points in the economic cycle in-between."

Letourneau said its uses are so varied that a customer may utilize a self-storage unit for everything from storing family heirlooms and children's keepsakes to clearing out some much-needed space for a home office. Alternatively, self-storage units can host whole rooms of furniture due to downsizing residences in times of economic turmoil due to a loss of primary income or relocating for employment.

https://www.globest.com/2023/05/02/%E2%80%8Bthese-cre-assets-have-a-track-record-of-resiliency-in-economic-downturns/