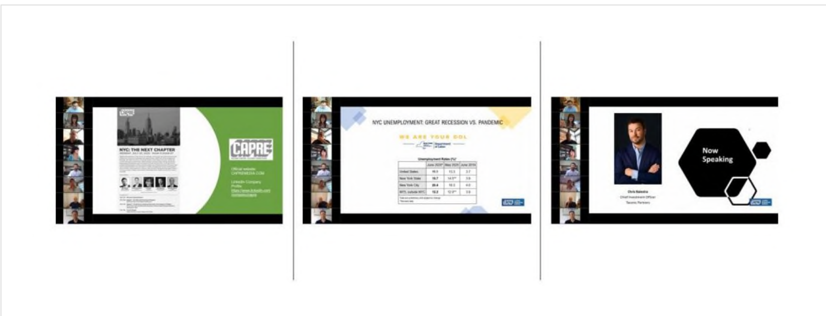
The Next Chapter of CRE in the Big Apple: What Will the New NYC Normal Look Like?



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NEW YORK, NY — Against the backdrop of COVID-19, commercial real estate executives are tasked with enormous challenges and opportunities. This week, CAPRE brought many aspects of borough real estate into focus on a webinar titled “NYC: The Next Chapter.” The session included analysis of the federal stimulus, the outlook for current and future construction, capital raising in unusual times, and the potential for development/investment over the duration of 2020 and into 2021.

Key questions included: How are decision makers managing the current environment? How do these unique dynamics influence their forward-looking business plans? What is the opportunity in today’s environment? And finally, what might the new NYC normal look like? The first half of the webinar was themed *The Public and Private Sector Response: Big Picture State of the Market and Recovery* and the tone was set by a pair of panelists offering a snapshot of the state of the market.

“A lot of my mom & pop workforce retail portfolio have taken a hit, but have been able to make it work,” remarked **David Shorenstein,** Principal, Hildreth Real Estate Advisors. “The price point is sustainable for a lot of people [for example, out in New Jersey]. But in Manhattan, when you’re paying $20,000 a month, that is never going to be sustainable. That rent is probably more like $7,000 a month now.”

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Next, **Neil Shapiro,** Partner – Real Estate at Herrick & Feinstein chimed in about some particular sectors with regards to rent and leases. "Well, in the hospitality space, people are still trying to figure out what metrics to use. Business plans are finding it difficult to plan," he shared "Lenders have been pretty accommodating. But as you get into the office space, there is a wider perspective as to which offices will be able to do okay over the next couple of years, and which ones will have problems. That's where we're seeing work-outs. In the multifamily space, collections have been higher than expected. So long as we keep the economic subsidy in place, that is. We're still in the forebearance phase, and after Labor Day some lenders will throw in the towel and you'll see more aggressive legal action."

The conversation then took a turn with the perspective of **Chris Balestra**, Chief Investment Officer of Taconic Partners, who has recently found some good deals on distressed assets. "How will you be able to add value to these assets that have had some real trouble?" asked **Lois Weiss,** Columnist for the New York Post and moderator of the panel.

"We're not hotel owners, but we expect there to be a lot of hotel issues. They may converge with those of multi family and retail. It'll take awhile to sort that out. But we're opportunistic….we do everything from workforce housing to luxury condos to life sciences, where there is actually a bit of a bright spot," Balestra shared. "We're evaluating right now….we're not diving not the first thing that we see, we think that they will take time to work through."

Weiss then asked panelist **Thomas Donovan,** Partner & Vice-Chairman at B6 Real Estate Advisors what he is seeing with buyers and owners. Are people aggressively buying, selling, or something else? "It's a tale of two cities," replied Donavan. "We have the old school families saying they're going to stick with it and want to wait it out in New York, and we have opportunistic buyers coming in and saying, if you know someone in trouble, I can come in and close in a week. People are asking us, what's a 30 day exit versus a 90 day exit? We haven't seen the pain yet – collections have been better than expected. When interest rates kick back in and when the stimulus ends, it'll be interesting to see what New York City looks like."

Soon, Weiss looked to a panelist from across the pond – **Susan Freeman**, Partner at Mishcon de Reya, in London, about how things are progressing in her neck of the woods. Specifically, are workers starting to trickle back into the office yet? "Well, it's interesting, because the government is shifting their messaging. It was that you should work from home if you can. Corporates were saying, why is it okay for people to go on a plane for holiday but no be in the office?" she shared. "In Central London, people are reporting about 10% occupancy in the commercial districts, and they don't expect things to really pick up again until at least September."

"I don't think anyone really has a clue," interjected Herrick & Feinstein's **Shapiro**. "I think the earliest people are saying is Labor Day, but I think as usual people are just picking a date far enough out that it makes sense but close enough that people are on notice. I'm hearing a huge amount [of chatter] in New York City, because of the public transportation system, how will you get employees in? what about liability? What if someone gets sick on the way into the office and they say they didn't want to be there in the first place? I don't think people are targeting Labor Day. I personally don't think that's going to happen. I think we might get to 20% or 25% occupancy, but people will find that the commute and conditions are much worse than before. I think we'll end up getting to much later in the year."

Soon, the conversation honed in another adjustment the commercial real estate industry has had to grapple with under COVID-19 – how are tours taking place (or are they)? Weiss looked to B6's **Donavan** for color. "We generally can't tour, we decided that a long time ago," he revealed. "We take really, really good pictures and videos, and we talk about the metrics with buyers. Under very special certain conditions, we might make certain exceptions, but it's going to be with masks and social distancing. IT's definitely a case by case basis. The opportunistic attitude of, let's walk everyone through, is not happening during the pandemic."

"Interestingly, apps are now being used more and more to connect tenants to owners," contributed Mishcon de Reya's **Freeman.** "They're being used to notify tenants about health issues like air quality. It's absolutely vital and people are realizing how important these tools are. So what's happened is that a lot of firms have been trying to get their people to embrace such technology, and now those people are having to embrace it. So this is probably one of the few positive things to come out of all of this."

The panelists then coalesced around the idea that the ability to protect tenants from COVID-19 has become a key differentiator among property owners. "Everyone is looking for security, safety. Who is taking responsibility for taking temperatures and spacing in elevators?" added **Balestra**. "It's now all about touch screens, ultraviolet lights, etc. You've got to get your tenants to be comfortable to get them back. But what people want to know is, where are people getting the capital to make those upgrades? Especially if you're losing tenants. But everyone wants to know what it looks like and how we're all addressing it."

Shorenstein then chimed in to share his firm's experience, which spans across multiple sectors. "Well, self-storage runs itself. Everyone is required to wear a mask, and most everyone is wearing gloves too. With retail, it's at the retailer's discretion, but I see all of the retailers abiding by guidelines," he divulged. "I haven't seen any issues."

"Do you think we'll see a bifurcation?" asked **Weiss** to the panel, referring to major firms with HQ in New York City who might choose to move a significant portion of their operations to somewhere less high risk than the Big Apple, in terms of both COVID and political unrest. "Or are you starting to hear clients talking about [permanently] leaving their workforce at home or renting in a suburb for office space?"

"Well, I know a lot of operators are looking at that, things like suburban hubs. But I think these things will, take time. People are locked into leases. It might take some time even if you do want to change locations immediately," contributed **Freeman**.

"A lot of people are talking about that, because we have a lot of time to talk," chuckled **Shapiro**, before making a couple of more serious predictions. "I think in New York in particular, I think it will become part of many bigger companies plans – that hub and spoke model. But New York will rebound, and people will come back. We'll see some movement there, but people were already going there anyway. It's just been proven that this can work. But I don't think you'll see big corporations fully pull out of New York City anytime soon."

And what about in terms of sales? Moderator Weiss then asked the group if sellers are having a trouble convincing tenants it's the right time to rent. "Look, consumer confidence drives everything," asserted **Donovan**. "If consumer confidence returns, businesses will thrive. If it doesn't, people will stay home....on the residential side, I have friends looking for a home in Long Island, and in March, April, May...a lot of people were making an exodus, but it hasn't been as bad as we all thought, and some people are thinking maybe they should hold off on closing."

"At this point, there is very, very little leasing activity that wasn't a pre-pandemic [deal] that was already happening," shared **Shorenstein**. "Rents will probably drop, and maybe that's something that will make some tenants say, hey, I can really get a bargain now...lenders might have to be more cooperative. We're not seeing that yet, because lenders allowed forbearance, but over the next six months, we'll see when it stops."

At that point, **Weiss** asked her panel to pause, and asked a blunt question to really delve into that string of thought. "Where are we seeing, well, no one being able to pay anything across the board?" she queried.

"I think you're seeing that in hospitality, no question," replied **Shapiro**. "You're seeing that across the board. But, for right now, we're in forbearance land, and everyone is playing nice. That will change, both in terms of lender personality, lender needs, the ability of the sponsor to step up with fresh equity, and the viability of the asset. If the borrower is doing the best they can under the circumstance at X per square foot...and in the new normal, its X-10, I think most lenders will be accommodating to get something fresh....but there's always going to be assets that aren't going to be viable or sponsors that can't step up with new equity."

"How important is the owner of the building to the lender, in terms of being able to work things out?" followed up **Weiss**.

"It's 1, 2, and 3 in terms of priority. Why change up horses when they're doing the best they can?" he replied. "I tell people, call up your lender, tell them the problem...most lenders right now have the capital. They're not forced to sell their assets. They'll stay in the game as long as the borrower is being reasonable."

As the webinar approached the conclusion, the topic turned to the perennial topic of property taxes. “Major developers were already not paying taxes for the last year or so on some retail properties and newly constructed buildings that hadn’t rented yet,” posed **Weiss**. “Are your clients admitting that they didn’t pay and how are they coping with this?”

“Well, the first thing I tell my clients is that the first things you’re going to pay are your insurance and real estate taxes – they’re going to accrue at a pretty high rate,” **Donovan** proffered. “You lender would prefer you pay your real estate taxes as well. I’m not seeing that as being a major issue. Those taxes will reset based on valuation, but that will take some time.”

From there, **Weiss** pivoted to a topic that was at the top of everyone in NYC’s mind — the renter protections passed in 2019. “When you’re dealing with sponsors and trying to get them funds, how important is it that there be a future upside? Is there a future upside now?”

“Well, you have to understand the asset class. If your tenants are paying simply because they’re getting unemployment checks, that’s a very different situation than if you have credit tenants or white collar tenants working from home” outlined **Eyzenberg**. “It’s not a broad-brush answer. Is there upside in [new] buildings? That’s a tough question…the rents you’re seeing today will be here awhile…but the first priority is sponsorship. Taconic being a tenant is very different from your average Joe down the street, because they have credit and equity behind them. That is very relevant to what’s happening today – a lot of it will come down to the ability of a sponsor to handle and manage a property.”

“How will WeWork’s collapse affect these buildings? They have, what, 8 million square feet of space across various properties? And in some cases that’s entire buildings.” asked **Weiss**. “How will they pull it back together and pile on leases?”

“The demand for short-term tenancy still exists. It’s not going away,” **Eyzenberg** replied. “We have a tendency to think about things only happening in the next 6 months – as though things won’t continue after that. But COVID will go away, in one way or another. There will be a need for shared office space. When you’re growing into a new market or new space, you don’t take 10,000 square feet immediately. You grow into it. Those requirements will continue, especially if we do transition to the hub and spoke model.”

Before wrapping up, the panel took some questions from the audience, one of which was about insurance. Specifically, will building owners see their insurance costs go up due to COVID?

“Well, insurance claims take a long time…but what they say is that a situation like this could lead to very bad law. You might find a judge that is very sympathetic to Mom & Pop type shops,” mused Herrick & Feinstein’s **Shapiro**. “A lot of people thought that business insurance coverage covered them for this exact situation. But after SARS, many companies wrote it in as an exclusion, and lots of us just stuck out heads in the ground and thought, there will never be a Pandemic in the United States. So it probably won’t be covered, and I haven’t heard from anyone about rising premiums.”

“And my rates have been going up forever,” joked **Balestra** from Taconic Partners, chiming in one final time. “I’m not sure I’m seeing any increases due to COVID. But you know, when there’s a hurricane in Texas, our rates go up here. So I’m sure it’s coming. Rising insurance rate has been a big issue in recent years, with prices going up, and a product we owned in the Bronx was very susceptible to it…due to things across the board.”

The final request of the panelists to offer a forward-thinking outlook. Weiss asked each of her panelists to muse a bit, and Hildreth’s **Shorenstein** had a quick prediction. “I think prices will continue to deteriorate as we move forward,” he forecast, with a positive bent. “I think prices will hit around the 2010-2012 levels. There will be some generational opportunities out there. If you have the money and put it together, there could be some really good deals. But it’s going to take more time – the stimulus packages have to wear off, the taxes have to come due, the tenants have to leave. IT’s going to take 3, 6, 9 months to settle into all that.”

Donavan largely concurred to close out the panel, foreseeing that the next six months will be painful for many across the commercial real estate industry. “We’re an entrepreneurial market and society, and New York City will figure it out In the long term, we’ll be okay,” he assured the group.

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