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Self-inflicted wounds - by Kevin Tubbesing, SIOR, CCIM, ALC
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Trendlines are emerging from the pandemic reshaping the way we work and live. Development, being a reflection of our society's demand, has rarely had to pivot so abruptly. Rare is the proforma being put forward today to build hotel, office, sit-down restaurant, or almost any strangers-near-me public space.

Although we in the commercial real estate (CRE) space tend to turn a blind eye to the single-family residential market, it should be noted that Kansas City is in its most drastic housing crises in its history and the speed at which this occurred did not provide the supply market time to adjust to demand. For a myriad of reasons, there has been a major shift in market demand toward low-rise, high-quality, multi-family housing. Developers and investors are responding to this demand making Kansas City one of the hottest housing investment markets in the country.

Here's where things get interesting: individuals choosing not to get vaccinated are creating a major negative impact on business value and performance. Fear of infection among the unvaccinated, coupled with fear of breakthrough infections in vaccinated populations, is lowering demand for business services which makes up the majority of our nation's GDP. At the time this article was written, only 50% of the U.S. population was fully vaccinated. Worldwide this figure is less than 15%. As the Delta variant has demonstrated, the unvaccinated are incubators for additional (and likely more dangerous) variants which will prolong the pandemic and thereby its impact on business for years to come. This impacts existing CRE values and the future direction of CRE development.

Remember that demand for residential product above? This demand is translating to a previously unseen transference of asset value from office, restaurant, and retail to residential sectors. A renter is more likely now to seek a 2-bedroom apartment making one of their rooms a permanent office so they can stop spreading their work across the kitchen table. This translates to the multi-family asset holder gaining rents and profits that take away from the office asset holder.

The same thing is happening in homes as people upsize and upgrade wanting more space inside and to add beatification to their backyards. To avoid human contact they are transferring value from brick-and-mortar retail to the industrial sector with home delivery. Empty-nesters are reflecting on highest home value they have ever seen for their property and choosing to cash out for lock-and-leave apartments. People learned to cook during COVID taking value from restaurants and moving it to grocers, but not in a way that is benefiting grocery center in-line spaces and pad sites (…except the liquor stores).

Buying a new home (and probably paying too much these days), along with most of the other trends initiated by COVID, are not short-term blimps but will continue to impact development for years to come. Over the next 3-5 years one of the greatest shifts in CRE will be office and retail leases coming to term and not renewing - at least at their currently occupied size. Offices will close or shrink as key employees demand to remain at home or go hybrid. Restaurants and retailers that can't get enough help to sustain pre-pandemic operations will reduce their footprints.

Every civil engineering firm in town is running at full tilt, but more than half of their work is residential. Alternatively, many commercial-oriented architectural firms are struggling. Big-boxes will convert to last-mile distribution, extended stay hotels will turn into apartments, and office will continue to flip to lofts. What's not listed here is that which we have yet to identify: the creative genius of the (re)developer of tomorrow that is going to make bank on a new idea.

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