EQUIFAX

No such thing as "business as usual"

Commercial real estate experts share strategies to adopt a more proactive mindset

Introduction

Commercial real estate (CRE) has a reputation for being old-school and tech-averse. As a recent article on proptech trends claims, “Commercial real estate has a unique set of characteristics which create a rather slow-moving change framework for problem-solving.”[1]

Not anymore. If you’re unable to drink from the firehose of change, prepare to get soaked. Digital acceleration is the name of the game, as brokers livestream walk-throughs and tech-enabled service providers proliferate.

In the four-year period ending in 2019, venture capital investments in the proptech sector increased 1,072% according to Nareit. Expect greater momentum: “Experts say the applications and opportunities for PropTech are as broad as the real estate industry itself, and things are only just getting started.”[2]

Looking around the corner

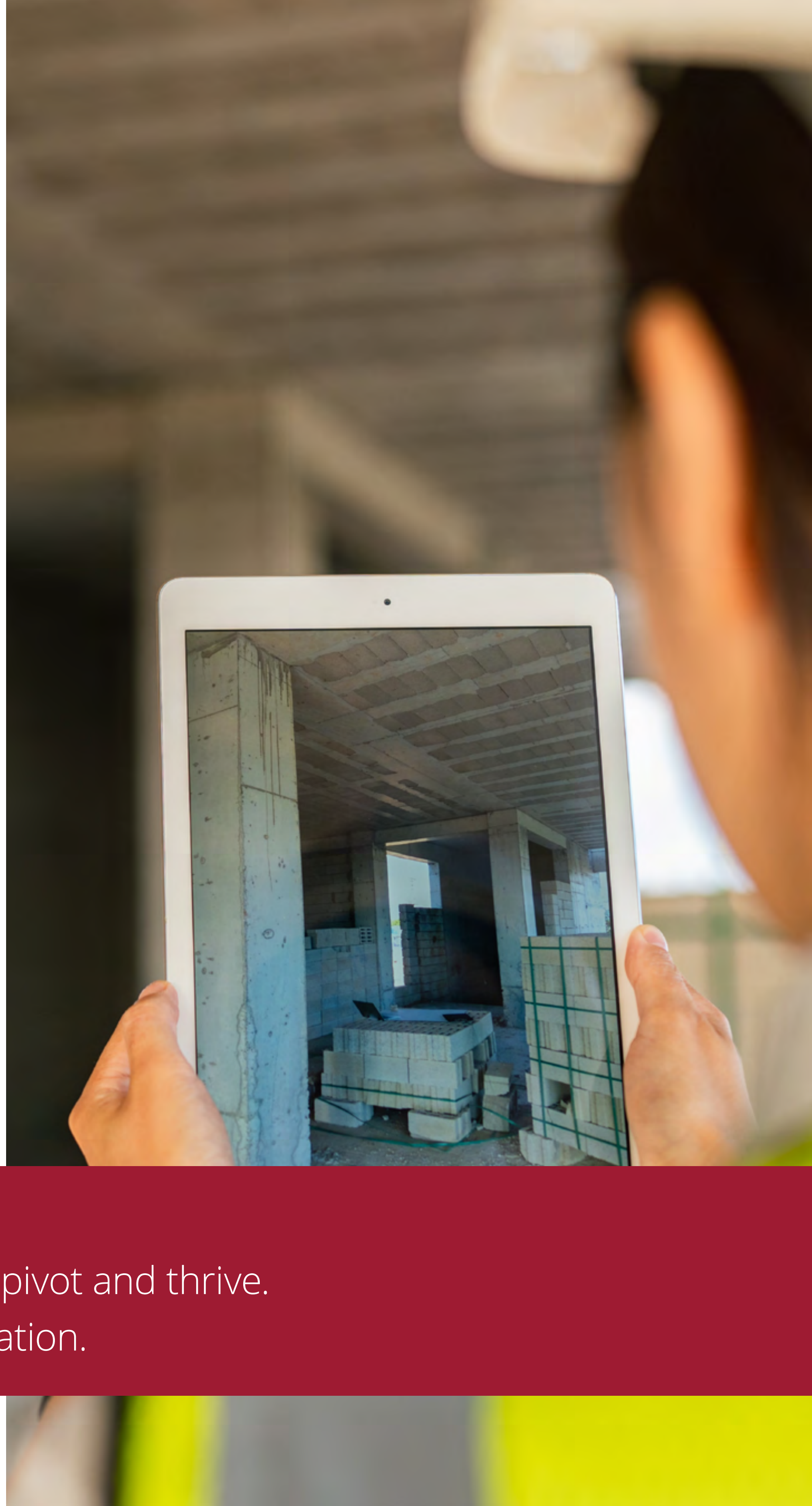
The accelerating pace of disruption — from the pandemic, from technology, from CRE visionaries — keeps players from settling into a steady state for too long. As a result, uncertainty has forced a redefinition of risk management. Owners, managers, lenders, and brokerages must shift their mindset from ‘what happened in the past’ to ‘how do we predict the future.’

A community of CRE experts

To learn more about current CRE market trends, Equifax spoke to a diverse set of industry leaders who shared their time and insights. They explained how their organizations are rethinking resources, technology, and operations to deal with demand shifts and future-proof their businesses.

From the challenges these leaders are tackling to the trends they’re tracking, this narrative is designed to shape strategy and inform investments for 2022 and beyond. Let’s get started.

CRE has entered a new digital world that is redefining risk management. This creates new challenges — and opportunities — to improve visibility, accuracy, and real-time communication. To capture competitive advantage, lenders, leasers, brokers, owners, and technology providers must keep up or catch up.



Here’s a hint:
Data’s at the core of the ability to pivot and thrive.
Not just data, actually, but information.

The CRE contributors

Equifax would like to thank the following CRE executives who contributed to this initiative. Their collective thought leadership is moving our industry forward.

Matthew C. Mulvihill
Vice Chairman,
CBRE

A 20-year industry veteran, Matt works with his clients’ operations, logistics, labor and finance divisions to drive operational efficiencies by defining the best course of action for their real estate portfolio or individual locations. Specializing in commercial and industrial markets, Matt leads an award-winning team and serves on CBRE’s National Industrial Advisory Council.

“Our industry has been forced to become technology-centric, whereas before executives didn’t want to mess with it. Now we’re working harder to integrate directional information from different aspects of our business, from labor analytics to supply chain metrics to construction procurement.”

William Phelan
SVP and General Manager,
Equifax Commercial

Bill Phelan co-founded PayNet in 2000 with the belief that when commercial lenders are assured of risks, they’re more likely to make credit available, unlocking opportunity for small businesses. As General Manager & SVP at Equifax, which acquired PayNet in 2019, Bill oversees sales, marketing, analytics and information technology across the U.S. and Canada.

“We’re all searching for answers as to how we can optimize growth as we emerge from the pandemic. Fortunately, powerful, differentiated data is available to guide us. There are so many insights needed in CRE — about cash flow, business model stickiness, if tenants will be around for years and are likely to be growing. We can tell you that with a high degree of confidence.”

Stephen K. Rachman
First Vice President Investments,
Marcus & Millichap

Over his 15+ year career with Marcus & Millichap, Steve has built a reputation for being a cycle-tested, client-focused straight shooter. In addition to advising clients on a daily basis, he is also responsible for growing his team’s presence in the sale of Chicagoland multi-family and mixed use properties. Steve has personally closed and overseen the closing of over 500 transactions valued well in excess of $4.5 billion dollars.

“All the shortcomings in the supply chain and labor markets were laid bare by COVID. If you manage apartment buildings, it takes three weeks to get a service tech out. You can’t fix that overnight. The regulatory environment will shape the future of the CRE industry.”

Heidi Smithson
EVP/Director of Commercial Real
Estate Group at First Midwest Bank

A strategic Commercial Banking Lending Executive, Heidi specializes in real estate loans secured by income-producing properties and all facets of construction lending. Forward-thinking and results-oriented, Heidi is a financial services executive with an exceptional record of building success through relationship management and customer support.

“As the economy and our business returns to its pre-pandemic pace, we are returning to the practices that led to our historical successes. We are piloting new process improvements to boost responsiveness and operating efficiencies, as well as reviewing an upgrade to our CRM platform with an eye toward capturing a more robust understanding of our clients’ business needs.”

Carl Streck
MountainSeed
CEO & Co-Founder

Carl oversees all aspects of new and existing client relationships while directing strategy and ideation at MountainSeed, the largest commercial appraisal management company in the nation. Carl is passionate about enabling predictable growth in companies with amazing products and services. Serving 600+ banks totaling over $750B in assets, the company is on a journey to be the world leader in commercial real estate.

“In the world we live in today, the expectation is making decisions with really good information. Consumers and businesses expect and demand more. That’s the big shift. Until today, the data hasn’t been there to back it up in commercial real estate. We’re working to bring more transparency to an industry where it didn’t exist before.”

First, some context

It goes without saying that the last few years have witnessed massive upheaval in CRE markets. A Congressional Research Service report notes, “The impacts of the pandemic may result in a substantially changed world for CRE, as lenders structure deals and offer credit to commercial borrowers in new ways to address risks associated with changing social preferences.”[3]

The scale of that impact is remarkable, both on the industry itself and by extension to the economy as a whole. Although some segments within CRE’s $17 trillion annual transaction flow weathered the storm — industrial comes to mind — hospitality, retail, and office segments experienced rising delinquency rates.[4] With the average cost of losing a tenant running more than $66/sf according to Equifax research, losses add up quickly.

Compounding effects of upheaval

“There’s not one segment of the industry that hasn’t been transformed in one way, form, or function,” says Steve Rachman of Marcus & Millichap. “No one has the answer to when the retail or office space is coming back.”

CRE’s Huge Economic Impact[7,8]

- The vast majority of U.S. banks hold CRE loans, worth more than $2 trillion
- Global CRE deal volume declined 36% YOY at the height of the crisis
- CRE companies planned to reduce operating costs by 20% this year

Notable trends

Equifax’s Bill Phelan spells out further implications of enduring market shifts such as remote work. “Let’s say business moves to a hybrid workplace model. For each day at home, you’re taking 20% of capacity offline. With 58 million commercial parcels in America, that’s a huge number.”

Industry leaders are keeping a close eye on other economic trends, particularly supply chain interruptions and the rise of construction costs. NAIOP, the commercial real estate development association, found that 86.6% of developers now report delays or shortages in construction supplies, an all-time high.[5]

Additionally, our contributors are paying attention to other CRE developments, including the conversion of mall space into sports zones or third mile distribution centers. They’re also tracking skyrocketing residential rent and housing prices, which in turn are driving employees to new regions and boosting “vibrant” commercial recoveries in places like Des Moines, Iowa, and Boise, Idaho.[6]

$66/sf

is the average cost of losing a tenant

Hybrid is here to stay

CRE lenders are closely tracking remote work trends, including employee preferences and corporate policies on vaccine mandates. In its annual Work Trend Index, Microsoft notes “Business leaders are on the brink of major changes to accommodate what employees want: the best of both worlds.”[9]

66%
of leaders say their company is considering redesigning office space for hybrid work

73%
of employees want flexible remote work options to stay

67%
of employees want more in-person work or collaboration post-pandemic

A massive resource shift

For many CRE firms, pandemic-driven transformations upended not only future plans but also daily workflows. First Midwest Bank (FMB) reallocated resources to help its small business clients navigate the crisis. Bankers jumped in to work shifts on client hotlines and help clients apply for the Paycheck Protection Program (PPP).

“We needed to learn how to read the manual while flying the plane,” says FMB’s Heidi Smithson. “The pandemic and the way that FMB reacted to it really highlighted the flexibility and experience level of our banking team — and our ability to quickly shift to lean in and assist our clients.”

Rapid digital acceleration

Like many CRE firms, FMB also spent more time taking deep dives into its CRE portfolio by asset class and tracking impacts on rent collection, occupancy, and leasing trends. The situation exposed the need for better tools to predict and react both to unforeseen events and everyday realities.

The story’s not all negative, though. “The pandemic opened everyone’s eyes as to what’s possible, how business can operate completely differently,” says Equifax’s Bill Phelan. “The CEOs I’ve talked to are experiencing five to seven years of digital acceleration.”

A data-driven environment

Carl Streck of MountainSeed echoes this sentiment. “The biggest shift I’ve seen in the past few years has been an increasing reliance on data. Not just any data... accurate, real-time, and relevant data.” An industry outlook report from Deloitte shines a spotlight on this necessity: “Digital transformation of the business and tenant experience could become a business imperative.”[10]

And yet, many CRE firms feel ill-equipped to ride the wave. Only one-third of respondents agree or strongly agree that they have the resources and skills required to operate a digitally transformed business.[11]

56% of CRE leaders believe the pandemic exposed shortcomings in their digital capabilities[12]

> “The CRE market is starving for accurate, real-time, and relevant data.”
>
> **Carl Streck**, MountainSeed

Reading the pulse of the market

Even in periods of great change, one thing remains constant: the need for CRE leaders to understand every aspect of their clients' businesses, as well as their own.

"In the brokerage business, you have to be an expert on many things," shares Matt Mulvihill of CBRE. "You have to be construction experts, labor experts, supply chain experts, lease experts, incentive experts. All these facets that go into a transaction, we have to understand how an occupier analyzes or justifies space."

Help wanted

Not only does this demand for expertise spark demand for better data, it also drives demand for new organizational skill sets. So supply chain professionals previously from FedEx or DHL may consult on a warehouse deal, or government lobbyists may weigh in on local regulations or tax incentives. But perhaps the most critical skill gaps come in the domain of data science.

In a recent Ernst & Young survey, 92% of respondents indicated that data analytics is the single most important vertical that CRE owners want technology to address. However, only 35% have adopted or developed a tool to date.[13]

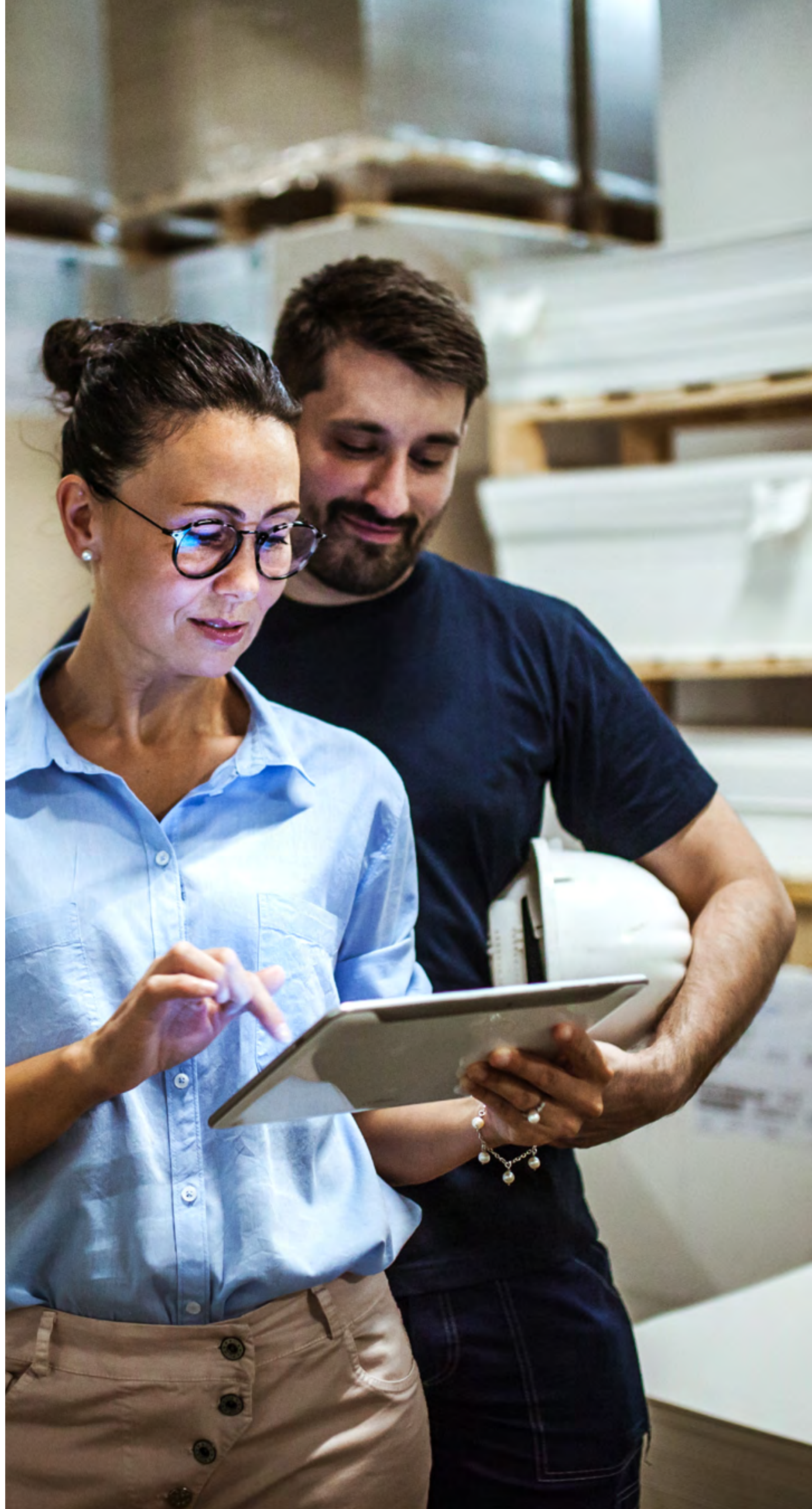
Making sense of data

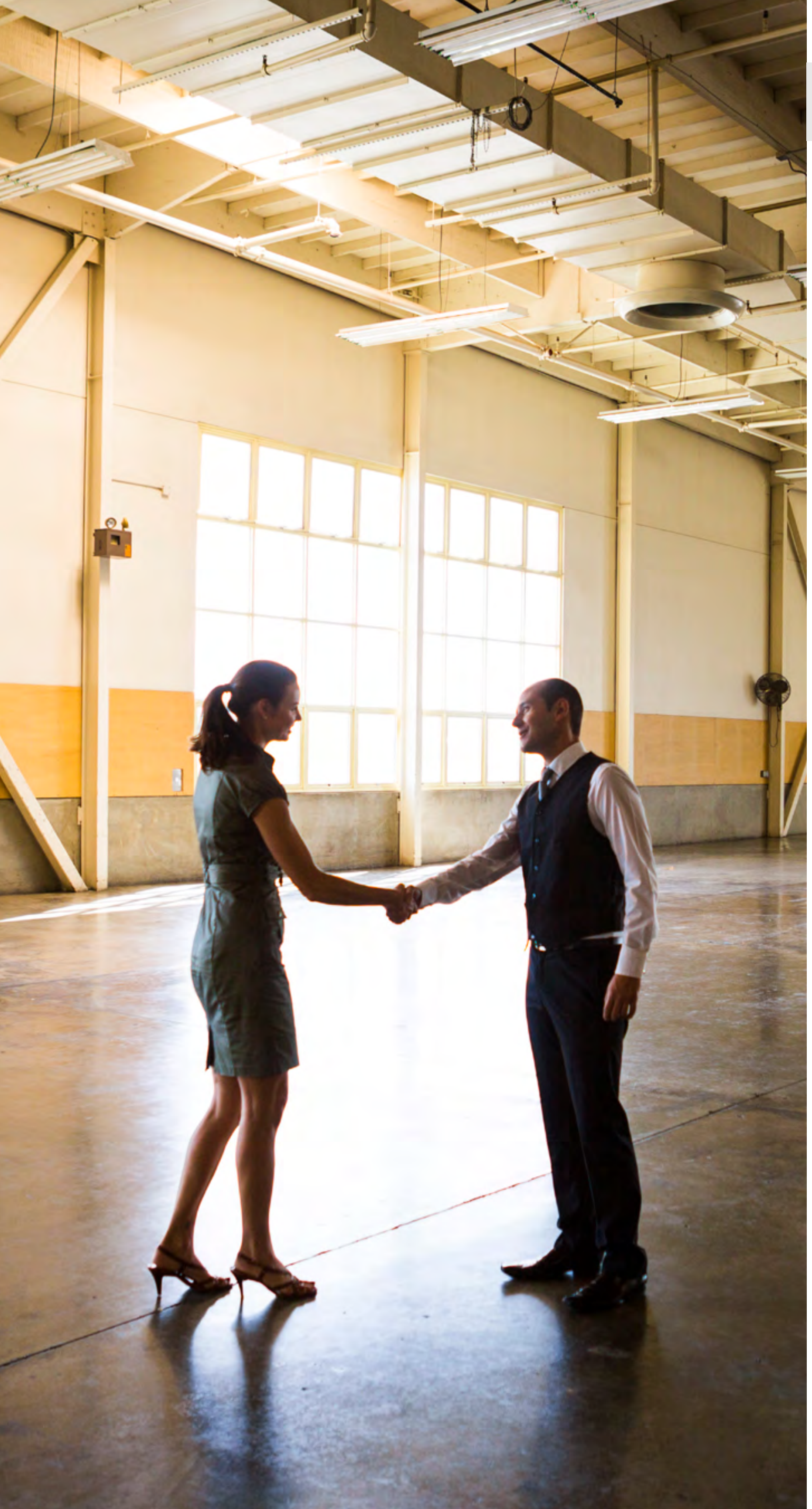
This "disconnect between interest and adoption" highlights the difference between data and information. Too much information can be overwhelming. "The market embraces more transparent data, but it doesn't always know what to do with it," explains Carl Streck of MountainSeed. Making sense of CRE information — by curating and organizing and scrubbing and analyzing it — takes a next-level effort.

It's an effort that clients expect. "Controlling and having good data is important to CRE decision making," says Steve Rachman of Marcus & Millichap. "We are the collectors and keepers of data for our clients. We do our own data harvesting by being deep in the market every day, and then we translate that into actionable strategies and solutions."

"CRE leaders don't want data, they want answers."

Bill Phelan, Equifax





In the cloud vs. on the ground

If data is the big differentiator for CRE firms, building a positive customer experience can't be far behind. Striking a balance between people and process represents a perennial topic in CRE workforce planning.

The personal touch still counts

We hear it again and again in conversations. CRE is a relationship-driven business:

"Quality of information comes from the ground up. While we're very proactive in the use of technology, I still rely on my own shoe leather and talking to people every day."

Steve Rachman, Marcus & Millichap

"These are big, real life decisions. You want an expert talking to you directly. It's not always a database exercise, it's more of the personal touch."

Matt Mulvihill, CBRE

"I must tell you that the tenants are people. And I'd much rather rely on people to make the decisions as to what is attractive and what isn't versus some artificial algorithm."[14]

Sam Zell, Founder & Chairman, Equity Group Investments

Too much or too little data

While CRE firms with in-house data scientists may have the capacity to ingest and analyze disparate sources of data, the average owner or property manager may not. These sources continue to explode, from distributed lease appraisal reports to GIS-enabled retail parking lot traffic maps.

A key area to watch cited by WealthManagement.com is the development of enhanced property data and analytics tools that provide "user-friendly access" to reliable lease and lending data for underwriting and business development.[15]

Just as too much information poses a challenge, so can too little. Missing, inconsistent, and irrelevant data plagues the CRE market, particularly for non-credit tenants. For example, community banks and credit unions are often left out of delinquency and default indices, even though they represent 30% of the banking industry's CRE loans.[16]

A big picture mindset.

What's needed is CRE data packaged in digestible ways and easily integrated into proprietary predictive models. There's simply not enough time and people to gather in-person intelligence on 99 million commercial properties. Effective data analytics unlocks the ability to scale.

"The acceleration and adoption of technology during the pandemic has impacted everything, and real estate is no exception. The question remains: what will stick?"[17]

CRE, The Counselors of Real Estate

Getting more proactive

Although the future of certain CRE segments remains unclear, firms are picking up the pieces and striding forward. As Heidi Smithson of FMB puts it, “We’re continuing down the path to getting back to ‘business as usual’ and eager to get ‘back to offense’ to grow the business.”

On the bright side, long lease structures provided some protection against delinquencies. The Mortgage Bankers Association reports, “For multifamily, this was driven by the strong federal support for households; for offices, by the long lease structures and relatively few bankruptcies by office-using tenants.”[18] The full impact of COVID-19 and associated business shifts won’t be evident until leases expire.

People vs. profits

By necessity, in the last few years many CRE lenders and lessors shifted to shorter-term deal structures or granted payment concessions, buying time and prioritizing business protection over profits. Matt Mulvihill of CBRE explains, “We serve as an extension of the companies we work with. It’s our obligation to make sure they’re making smart decisions, even if they’re not the most lucrative for us.”

The ability to leverage predictive, contextual, and forward-looking data remains key to the industry’s ability to come out of the downturn stronger. Marcus & Millichap’s Steve Rachman explains, “Investors quantify risk to be competitive in their bidding. They want to be rewarded for risks they’re taking, and they don’t want to lose out because someone is less risk averse.”

Pinpointing risk profiles

L.D. Salmanson, CEO and Cofounder of Cherre, notes that practitioners are leaning more on external data, in turn “… creating a shift from a property-centric data environment to a more contextual one.”[19] With greater context — about local markets, tenant risk profiles, and more — investors and operators can make better data-driven decisions.

> “There is constant dialogue about how we approach existing loans and future opportunities within disrupted asset classes. What’s top of mind now is how the pandemic impact will create new opportunities for our clients and prospects.”
>
> **Heidi Smithson,** FMB

Takeaways

The resilience of the CRE sector is nothing short of amazing. Operationally and emotionally, CRE leaders are invested in the recovery of the sectors hit hardest, although they’re aware that the only constant is change.

“The U.S. economy is constantly evolving to adapt to constraints; it never stays still. CRE plays a big part in that evolution,” says Bill Phelan of Equifax. “Hundreds of new businesses and startups are rethinking real estate, sharing space, and finding new ways to collaborate.” CRE must leverage data to thrive in a transformed industry.

Eyes on the future

Here’s how this should play out. Traditionally, CRE risk assessment relied on historical data — the equivalent of looking in the rear view mirror. The closer we get to real-time data, the more accurate the risk assessment and more profitable the deals. Now we’re looking out the front windshield, with help from targeted ‘engine light on’ warnings.

A level playing field

Better data benefits everyone in the CRE ecosystem. “Anything we can do to level the playing field in risk assessment is a win,” says Steve Rachman of Marcus & Millichap. “I’m not sure how happy sellers will be, but buyers will flock to better data and it will serve the market well in the long run.”

Ultimately, better risk assessment puts more capital into the hands of smaller businesses, local depositors, and community investors. “There’s a lot of talk about ‘big bad developers’ making money on deals, but there’s also a lot of Main Street folks who suffer from bad information and bad decisions,” says Carl Streck of MountainSeed.

What’s your take?

With help from our contributors, clients, and partners, Equifax strives to stay on top of forces impacting companies across the CRE ecosystem. Now we’d love to hear from you.

How is your business changing to realize operational and financial value in a period of volatility? Please reach out to discuss your questions, feedback, and concerns.

Let’s connect: **go.equifax.com/cre**.

About Equifax

At Equifax (NYSE: EFX), we believe knowledge drives progress. As a global data, analytics, and technology company, we play an essential role in the global economy by helping financial institutions, companies, employers, and government agencies make critical decisions with greater confidence. Our unique blend of differentiated data, analytics, and cloud technology drives insights to power decisions to move people forward. Headquartered in Atlanta and supported by more than 12,000 employees worldwide, Equifax operates or has investments in 24 countries in North America, Central and South America, Europe, and the Asia Pacific region. For more information, visit Equifax.com.

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End notes

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2 https://www.reit.com/news/reit-magazine/march-april-2020/how-proptech-impacting-commercial-real-estate
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