

In 2009, The Music Stopped. In 2020, Real Estate Kept Dancing

In the first weeks and months of the coronavirus pandemic, [real estate professionals were asking one question again and again: Will it be as bad as the 2008 recession?](#)

As panic gripped financial markets amid unprecedented global lockdowns, real estate was trying to understand the extent of the downturn it might be facing. And the prospects didn't look great.

A human toll unimaginable in peacetime was leading to a dire situation for the economy and businesses: GDP fell by 3.5%, the largest drop since the demobilisation of the second world war, huge swathes of the population faced unemployment, and crucially for real estate, whole sectors of the built environment were closed by government decree.

And yet, when the big-picture data is examined, the pain for the real estate sector barely scratches the surface when compared with the Great Financial Crisis of 2008 and 2009.

On average, U.S. commercial real estate lost 23% of its value in 2009, after falling 12% in 2008, according to data from [MSCI](#). In 2020, values fell on average by just 2.3%. Rents in New York fell by 27% in '08 and '09, MSCI said, compared to just 0.4% in 2020, although there may still be pain to come there of course.

After Lehman's collapse, [CMBS](#) lending markets shut down for 21 months, [Trepp data](#) showed. Even as U.S. [coronavirus](#) deaths were at elevated levels, CMBS markets shut down for just 60 days in 2020. The \$419B of property traded compares to just \$72B in 2009. Even as the health crisis worsened, before [vaccines](#) offered a path through the [pandemic](#), real estate kept on buying, a situation that could not have been more different to the aftermath of Lehman.

That data is of course a broad average, and within that lies a lot of nuance: Retail real estate has fared worse recently than it did in 2008 and 2009, and for hospitality 2020 was a disaster, just as it was in the GFC. The pandemic has also exacerbated the inequality in the workforce already present along gender and racial lines.

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But a human tragedy has not translated into a real estate disaster as some feared. Different sectors have become decoupled, with some, like logistics, actually benefiting from the pandemic, whereas 2008 hit almost every sector equally hard.

So, why has real estate has been insulated this time?

[Central banks](#) have underpinned the sector more quickly and thoroughly than in 2008: the stimulus they have provided has saved jobs, and in a huge boon for real estate, created mountains of capital still willing to invest in the sector, putting a floor under prices; and the stimulus has given banks a cushion that allows them to be part of the solution rather than part of the problem. In the short term, this is leading to the likelihood of a much faster recovery for the sector than post-2008/9. But longer-term, many questions still remain.

"The primary difference for real estate between the 2008 [recession](#) and now is that the impact then was felt across all asset classes," real estate law practice [Saul Ewing](#) Arnstein & Lehr's Miami office Managing Partner Luis Flores said.

"During [the Great Recession](#), we saw a virtual standstill in development, with the only transactions closing being the purchase of distressed real estate by [vulture funds](#), as well as [distressed debt](#) by savvy investors," Flores said.

By contrast, the pandemic-inspired recession of 2020 has negatively impacted only a few asset classes, such as hospitality and retail properties, Flores said, with multifamily, industrial and developable land still desirable to active developers, especially in places that are still growing, such as Texas and Florida.

"The biggest difference between the pandemic-fueled disruption and the 2008 recession is that this disruption has focused on health, consumer behavior and logistics for retailers," developer Urban-X Group co-principal [Andrew Hellinger](#) said.

An all-sector recession (2008) compared with a recession that only impacts a few sectors (2020) mirrors the wider impact of the two recessions on the U.S. economy.

The recovery from the 2008 recession was a long slog for most sectors of the U.S. economy — and most sectors of the real estate market. In 2020, the pain is more focused and, if early indications in 2021 are a guide, might be more short-lived as the health crisis eases.

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One major metric of economic pain, the headline [unemployment rate](#) as measured by the [Bureau of Labor Statistics](#), illustrates the slow recovery from the 2008 recession, and its possible contrast with 2020.

Before the 2008 recession, U.S. [unemployment](#) had hovered around 5%, with a sharp spike upward by early 2009 to about 10%. It wasn't until late 2015 that the unemployment rate had returned to 5%, and it kept going down until early 2020.

The unemployment spike in 2020 was much steeper as the pandemic caused sudden contractions in parts of the U.S. economy. From 3.5% in February 2020, unemployment ballooned to 14.7% in April. Since then, however, while the jobs recovery has been uneven, it has been much faster than after 2008. As of January 2021, the U.S. unemployment rate stood at 6.3% after dropping almost every month since April.

Keep Laying The Bricks

In the [construction industry](#), unemployment topped out at over 25% in 2010, and it didn't reach its pre-recession levels of between 5% and 10% until after 2015.

The pandemic inspired a short spike in construction unemployment to over 15% in early 2020 as construction sites shut down, especially in places like New York, which imposed hard lockdowns on the industry for a short time. Before long, however, those were lifted and construction companies adapted partly to social distancing and other health-related measures, so by the fall the rate was below 7%, especially as the demand for labor on housing developments grew.



The current disruption hasn't impacted every sector of the construction industry as the 2008 recession did, Central Consulting & Contracting President and CEO Richard Simone said.

"The effect on the supply chain, the availability of [PPE](#), and the sudden overnight shutdown of all nonessential construction were worse, but for a shorter period of time," he noted. "Essential projects continued, including healthcare projects, and construction reopened relatively quickly."

With interest rates staying low, money is still available to build projects this time, with projects being released and bidding active, Simone said. It wasn't like that after 2008 when recovery seemed glacial.

"I'm optimistic that when we look back, the effects of the pandemic on the construction industry will not be as bad nor as long-lasting," Simone said. "I'd like to think the first half of third-quarter 2021 will be a bumpy ride, with a speedy recovery towards the end of the year."

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The slow recovery in construction post-GFC has actually helped real estate this time around: There was no building boom during a 10-year recovery that saw values in most major metros climb higher than their 2007 peak. So when [the coronavirus](#) came, few sectors had the excess of space that had been so catastrophic for the sector in the recessions of the 1990s and 2000s.

Capital Markets: The Music Didn't Stop

The 2008 recession had a near-fatal impact on debt and [CMBS issuance](#) that hasn't been replicated in 2020, though there has been a serious impact this time around. According to the [Mortgage Bankers Association](#), total U.S. outstanding [mortgage debt](#) spent the years from 2008 to 2012 stagnating at about \$2.5 trillion.

Only after that did the total start growing again, up to well over \$3.5 trillion by 2020 — and the total didn't drop at all last year, but continued to rise slightly. [Mortgage originations](#) might have been down in some sectors (hotels, retail) but the robustness of industrial and apartments seems to have made up the difference.

[CMBS loans](#) put into [special servicing](#) likewise surged after 2008, with none impacted more than hospitality — and it would be again in 2020. Hospitality loans in special servicing reached a recessionary peak of about 25.5% in September 2010, according to Trepp. The pandemic peak exactly 10 years later in September 2020 was slightly higher at just over 26%, and by the end of 2020, the rate was down a little to about 24%.

"The implosion of credit markets in 2008, the most conventional cause of real estate market crashes, wreaked havoc across markets as liquidity was sucked out of the markets almost overnight," [UK investor Prestbury](#) Chairman [Nick Leslau](#) said.

The most fundamental difference in 2020 compared to 2008 is the extraordinary amount of capital sitting on the sidelines waiting to lap up distressed situations, Leslau said, which other than in the completely unloved retail sector, will be frustrated as large transactions are few and far between. There is also significant capital still willing to buy good quality assets.

"For that reason, values will recover where they have gone down sooner than most expect, and while rents across offices will soften for a while, the medium-term prognosis is good," Leslau said.

"Logistics is excellent, leisure and hospitality will bounce back with a vengeance starting with the low-cost providers, and industrial will be pretty stable," Leslau said. "Retail, for the most part, is in total transition and it isn't dead, but it needs to entirely reinvent itself, and it will, though physical retailing will be a fraction of its size of five years ago."

Inequality Exacerbated

Recessions generally hit people whose finances are already precarious harder than more comfortable households, especially minority households. In 2008, all U.S. ethnic groups suffered declines in income, with Hispanics hit particularly hard. For non-Hispanic White households, the drop was 2.6% from 2007 to 2008, while African-American households were hit with a decline of 2.8% during that period.

The median Hispanic household income, by contrast, fell 5.6% during that year, a sharp drop due probably to that group's concentration in the construction industry, which suffered a major contraction after the bursting of the [housing bubble](#), according to the [Economic Policy Institute](#).

Early indications regarding the loss of U.S. household income between 2019 and 2020 are equally grim and seem to have impacted minority households the most. The 2020 recession also appears to be particularly hard on women, which is in contrast to the 2008 recession. Back then, between Q4 2007 and Q1 2009, men suffered 78% of the job losses, with the unemployment rate for men up from 4.9% to 8.9%, while the rate for women rose from 4.7% to 7.2%.

As the pandemic devastated service-oriented sectors that employ more women, such as restaurants and hospitality, more women lost their jobs, University of Arkansas Professor in the Department of Education Reform Gema Zamarro said. As schools and [daycare](#) closed, and as lockdowns made it difficult for family members to help out, childcare needs soared.

"While men are more likely to die from infection by Covid-19, overall the pandemic has had a disproportionately detrimental impact on the [mental health](#) of women, particularly those with kids," Zamarro said. "Considering women already shouldered a greater burden for childcare prior to the pandemic, it's unsurprising the demands are now even greater."

A One-Way Ticket To Bazookaville

Two factors that were absent or slow to develop after 2008 that have protected the sector and might aid the pace of recovery after 2020 are the speed and scale of [Federal Reserve](#) intervention, and the willingness of commercial lenders to forebear at least some loan repayments. If the central bank monetary stimulus was described as a bazooka after the GFC, then this time around [the Fed](#) has brought a ballistic missile to the battle.

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In 2020, the Federal Reserve took an array of actions to limit the pandemic's economic damage, and it did so in a matter of months, including as much as \$2.3 trillion in lending to support financial markets, but also state and local governments, households and employers. Congress passed the \$2.2 trillion [CARES Act](#) in late March 2020, followed by other stimulus packages in December and March 2021, which included direct payments to individuals and companies.

The Fed's reaction in 2008 and 2009, after cutting interest rates to effectively zero, involved targeted assistance to financial institutions and special lending programs, along with large-scale asset purchases, better known as [quantitative easing](#). Congress enacted the [Troubled Asset Relief Program](#), or TARP, essentially a [bailout](#) of the financial system.

"When the pandemic hit, the Fed really did take a lot of the global financial playbook into consideration and used almost all the same tools, but much faster this time around," [Reonomy](#) Market Analyst [Omar Eltorai](#) said. "The Fed essentially did in one month in 2020 what took eight months during the [global financial crisis](#)."

This central bank stimulus has kept [bond yields](#) low, which has increased the attractiveness of real estate investment and created that wall of money Leslau described still looking to invest in the sector.

Combined with tighter regulation, it has also meant that banks are better capitalized than in 2008 and 2009, meaning they are better able to support borrowers with loan [forbearance](#) and restructuring.

Another critical difference between 2020 and 2008 is the rental moratoriums and mortgage forbearance mandated by all levels of government during the pandemic, albeit that has left behind unresolved problems in 2021, including as much as \$70B in unpaid back rent, the impact of which still remains unclear.

Two Roads To Recovery: One Was Long, The Other Will Be Short?

The differing impact of the two recessions on real estate will probably mean a different kind of recovery. After the worst of the 2008 recession, the recovery for virtually all sectors of real estate was steady but slow, because all of the sectors had been affected adversely by the recession.

This time, different sectors will recover at different speeds. Data from MSCI showed that while U.S. logistics capital values rose 6% in 2020, multifamily dipped 2%, office 3%, retail values crashed by 13%.

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“At this stage, we're expecting that the recovery will be much more uneven across the different sectors than after 2008,” [Nuveen Real Estate](#) and Real Assets [CEO Michael Sales](#) said. “Some areas, such as logistics and residential, haven't suffered materially this time, so there's no need for any recovery.”

Other sectors, such as office assets, should recover relatively quickly in cities with a low propensity to [work from home](#) or low construction levels, as should the hospitality sector as soon as restrictions can be fully lifted, Sales said.

On the other end of the spectrum are weaker retail assets and those hotels that cater only to business travelers, Sales said. Some of these assets will likely never fully recover, and it is likely that at least part of those markets may need to be converted for alternative uses.

“That said, in general, we would anticipate that real estate markets should recover faster than after the global financial crisis, due to the market being overleveraged at that time and debt crises historically taking longer to work through the system,” Sales said.

The exception to a quick recovery scenario in 2021 is likely to be physical retail. After the Great Recession, brick-and-mortar never really regained its pre-recession development and leasing vigor, but the shock to the sector coming into and exacerbated by the pandemic is another order of magnitude. Data from RetailSphere showed that 1,338 retail stores closed in 2008. In 2020, that figure was 15 times higher, 20,296, which is more than double the 2019 total.

The optimistic theory says that retail should have a post-pandemic bounce, as stores open up and pent-up demand is unleashed. But longer-term, the pandemic has precipitated certain changes, which were happening in any event, Leslau said. The shift in retail has shortened a slow death of much physical retail into almost instant euthanasia, but what was retail's loss has become logistics gain, he said.

Physical retail might not ever really recover, but the pandemic will nevertheless probably have a lasting impact on surviving retailers that the 2008 crisis didn't have, said Mario Natarelli, managing partner at MBLM, a consumer brand consultancy. Mainly, the pandemic has spurred other modes of retail sales.

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"Many brands have had to enhance or upgrade their digital commerce and rely on new delivery methods, such as curbside pickup," Natarelli said. "Some consumers undoubtedly have pent-up demand for physical retail experiences, and those brands poised to leverage this may benefit faster than others."

Other consumers may wait longer to feel safe in entering brick-and-mortar stores, Natarelli said. To the degree that many are anxious to get on with life, there is an anticipation to return to what can be recovered of pre-pandemic normality.

The recovery will also be a function of state and local circumstances. Just as not every state has handled the pandemic like every other, the recovery will be varied as well.

"The real difference in this recovery compared with last time is that some states have their oars in the water and some don't," said Paper City Investments Managing Member Gardner Rivera, who specializes in multifamily development. "If the state government is both proactive and pro-business, they'll backstop their property owners and retailers."

Though 2021 is still very much an open question, the current recession would have to get much worse in the near future to set the economy, and commercial real estate, on a path similar to that after 2008. Thus, there is an undercurrent of cautious optimism for most sectors of commercial real estate looking ahead, especially as vaccination ramps up and the number of Covid-19 cases and deaths declines.

A new wave of vaccine-resistant virus mutations could alter that picture of course. And there is no certainty about the medium- or longer-term impact of the flood of central bank stimulus that has washed through markets, less than a generation after that pumped into economies after the GFC. But for now, real estate looks to have escaped the worst scenarios that seemed plausible a year ago.

"Barring war or Covid 2.0, we'll be in a more recognizable place by later this year," Rivera said. "In the end, I always bet on the American people."