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Pandemic sends commercial real-estate market into a tailspin

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Anyone who has strolled through Israel's commercial streets over the past few months couldn't miss the abundance of storefronts with for-rent signs in the window, many of them already standing vacant. The feeling until now was that things are as bad as they're going to get, but a review by TheMarker shows that the current lockdown, with its unclear goals and exit strategy, has pushed down commercial-asset values and rents even further, changing the nature of commercial rental contracts.

These changes are likely to depress commercial real estate prices over the next few years.

The value of the commercial and office real estate market has been cut sharply since the beginning of 2020 in general, and since the coronavirus pandemic began in particular. Since March, the market's valuation has dropped by 25% on average from the beginning of the year. During the first wave of the coronavirus outbreak, commercial real estate valuations dropped on average 20%, and then stayed at that rate in the following months, and then the September lockdown brought another 5% drop," says Shmulik Cohen, owner of SK Real Estate Appraisers, which specializes in financing for real estate ventures.

The most notable price drops were for real estate housing and the businesses most vulnerable to the effects of the crisis, such as restaurants, coffee shops, clothing stores and others that pull in customers, says Cohen. The value of these assets dropped by 25% during the first wave and then by another 10%, for a total 35% loss. In comparison, offices used by lawyers, accountants and other professionals lost 15% of their value in the first wave and another 5% in September. Health clinics lost 10% of their value in the first wave and have since stabilized.

Looking ahead, "asset value is not expected to start increasing again until the second quarter of 2021 at least," says Cohen.

Another effect of the second lockdown is a decrease in rental prices being offered by landlords.However, almost no deals are being signed, as there are almost no potential renters willing to sign right now.

"After the first lockdown, there was renewed interest from renters who hoped to open new stores and take advantage of lower rental prices," says Haim Malka, owner of Jerusalem-based Haim Real Estate, which deals in commercial property. "They responded to rental ads that I published, they called, and some even advanced with negotiations – but when the second wave arrived, everything halted. Things are totally frozen now."

Malka says the low prices and pressure from landlords aren't helping. "I have a store on King George Street in [downtown] Jerusalem that was being rented for 18,000 shekels [$5,300] a month before the coronavirus arrived and is now being offered for 9,000 shekels a month. It's been standing empty for more than half a year. On [downtown] Ben Yehuda Street I'm offering storefronts that used to rent for 14,000 to 15,000 shekels a month for 8,000 shekels, and no one is interested.

"Landlords are being flexible with all aspects of the timeframe for which they're willing to accept lower rental prices: If during the first wave the lower prices were only for six months, now they're willing to revert to full price in three years, with gradual increases every year. They're also giving renters the option to exit the contract after three years, instead of five to 10 years. And still, there are no renters. The last time I made a deal was in May," says Cohen.

Despite the understanding that the crisis is likely to be a long-term one, most of the commercial assets are being offered for rent, not sale. Haim Kaufman, former chairman of Madlan, a representative body for Israeli real estate agents, and an agent with his own storefront on Tel Aviv's Ibn Gvirol Street, says, "It's hard to rent out businesses today on the city's commercial streets, particularly Ibn Gvirol, even though rental prices have dropped by tens of percentage points. My last deal was three months ago. I currently have seven stores for rent on Ibn Gvirol being offered for 4,000-4,500 shekels a month, compared to 7,500 shekels before the crisis."

He adds, "You'd expect at this point that the landlords would start offering their assets on this street for sale, but it's not happening. There are storefronts standing empty for six months and the landowners are continuing to pay municipal tax and other bills, and they're still not ready to sell them, even though there are enough 'sharks' out there who are looking to buy right now."

Kaufman says that the landlords are probably reluctant to sell right now due to the high betterment tax rate.

"I have customers who are interested in buying, but people aren't interested in both selling cheap and also paying the taxes on it – they feel like they're losing twice," says Malka. If the state would reduce betterment tax rates, they'd sell, and the government would ultimately receive more money, he argues. "However, I believe that if the current state of things continues another six months, we'll start seeing storefronts for sale."

Cohen says the percentage of assets being offered for immediate sale is actually down. "In terms of quick sales, the market is slowing and even assets being offered for sale aren't selling that fast at less than market price.

Before the pandemic, some 10% of all assets were offered cheap to ensure a quick sale. In April-June that figure jumped to 50%, "apparently due to panic and uncertainty. As time passed and people got used to the crisis, the percentage decreased, and now it's only 15% of all assets," he says. "Landlords are presuming that asset values won't continue decreasing, and I think they're right."

Renters are also struggling to keep afloat. "If I close the business, I'll be left with 350,000 shekels in bank debt," says the owner of a fast-food restaurant in Tel Aviv. "They shut us down every other day, and when we're working, sales are down. I'm stuck here in order to pay off debt," he said. "Otherwise I would have shut down already."

Guy Yakar, the owner of the Falafel Ba'ribua chain and a board member of Israel's Association for Commerce, Fashion and Restaurants, says that half of all restaurateurs and store owners would have closed up shop already if it weren't for their debts.

"Business owners can't really close shop because it will cost them more than to keep going," he says. "They have debts to suppliers, workers and landlords, and that's not counting any loans they may have," he says. Since a recovery isn't expected any time soon, "Some will collapse within a few months, while the more financially stable ones will somehow survive."