How Technology May be a Key X-Factor in the Real Estate Industry's Road to Recovery

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As we cross the 45-day mark since the COVID-19 health crisis emerged in the U.S., the immediate impacts on the PropTech industry have crystallized. Real estate operations have changed in fundamental ways – office spaces have been vacated; warehouse and distribution centers have continued operations but supply chain issues and employee health concerns are prevalent; retailers, other than the limited spectrum qualifying as essential businesses, have closed brick-and-mortar locations; occupancy at hotels and resorts have hit record-lows; and health care facilities have undergone a wave of changes aimed at addressing the severe stress on the healthcare system. But in these changes, which are certainly painful for organizations in the near term, lie long-term opportunities for growth.

The PropTech movement has exploded in the last two-to-three year period with the rate of growth increasing year-over-year. Record amounts of private capital in real estate innovation have been invested, partnerships between real estate operators and creative technology developers have accelerated, and most importantly, the value derived from the implementation of technologies by real estate operators has been tested and validated by the operators themselves.

As 2020 began, the real estate side of the PropTech equation was making significant progress around self-adoption of technological change. Industry trends had generally shifted from disruptive approaches by tech leaders who had identified business opportunities in real estate operational inefficiencies, to negotiated and welcomed real-estate-tech partnerships driven by demands from real estate buyers, operators and tenants. This buy-in by real estate was what the industry needed to move to its next stage of growth.

The COVID-19 Tipping Point

Though the health crisis has and will continue to temporarily slow momentum, when the economic environment stabilizes and rebounds, PropTech will emerge with more explosive growth. While the real estate industry was beginning to embrace change, it was still relatively slow progress. When asked to summarize key aspects of the PropTech industry, experts will describe the industry as a nascent one. The COVID-19 crisis has further exposed vulnerabilities and friction points in real estate, in some cases to a degree that will necessitate complete rebuilding of core business models. This is a time to reflect on key aspects of the PropTech industry's success in recent years and to recognize where real estate companies can capitalize on those proof-of-concept technology-driven models to rebuild for the future.

The following is a real estate asset class-specific overview supporting the vision that PropTech industry growth will pick up pace with tailwinds when the crisis lifts.

Office

U.S. workers are predominantly working from home today and business is being conducted via digital means more often than ever before. Employees are adapting to working remotely with efficiency, and tenants will examine how much office space is needed for the future. Flexible office models, short-term leases and a variety of "space-as-a-service" offerings were already growing in popularity pre-crisis, which will be further accelerated. In the near term, employers may opt to reintegrate employees to the office on a staggered basis in order to limit employee-to-employee exposure, which will require less use of physical space.

In addition, the health and wellness capabilities of office properties will grow significantly. Air quality and ventilation, employee and other occupant safety and health measures and protocols – including biometric technologies, hands-free access and location tracking – will be expected when employees return to the office, and attention will be paid to balancing the privacy considerations associated with such measures.

Industrial

Warehousing and logistics are segments that have thrived alongside the progression of e-commerce. COVID-19 consumer demands however, have exposed significant supply-chain vulnerabilities of key e-commerce driven retailers. There is both room for improvement for these existing players and opportunity for retailer diversification in the e-commerce channel. As retailers rebuild and expand with more online presence, fulfillment and last-mile delivery capabilities will involve more space utilization and development of industrial properties. Robotic and other automated outfitting of warehouses, including the ability to coordinate with delivery drones, may also be technological features that are more frequently adopted for employee and customer safety, health considerations and fulfillment efficiencies.

Lodging

Hotels have suffered record declines in occupancy rates and bookings due to COVID-19's impact, highlighted by social distancing and the rise in unemployment, causing the travel industry to halt. In the near term, some vacant hotel space is being utilized to house healthcare workers in locations close to healthcare facilities, and hotels may do the same for COVID-19 patients. The lodging sector recovery should involve the implementation of software-driven booking platforms that attract consumers with interactive digital means to engage with the hotel and local experience of the destination. The branding and marketing success of Airbnb has captured this web-based accessibility to its rental locations, drawing on the experience that consumers seek when they book travel. Many traditional hotel operators have recently shifted to more technologically-enhanced platforms which should be more universally adopted for future success.

Hotels will also need to offer clean protocols in order to attract guests who will be concerned about health risks, as travel will be viewed as a luxury rather than a necessity for the immediate future. Predictive maintenance and clean-energy systems, health and wellness standards, smart technologies with occupant sensors, and effective marketing around the associated technologies will be key aspects to guest experience.

Retail

Many non-essential business brick-and-mortar retailers have closed as a result of the pandemic. In order to maintain operations in this environment, these retailers have shifted weight to online operations in efforts to maintain revenues. Retail e-commerce is a phenomenon that has caused significant declines in many retailer operations in the last decade, and though some retailers have survived until now, they have suffered from decreased market share. Now, customer traffic to physical stores is virtually zero. The consumer behaviors that are developing will have some permanent impact, and retailers should forecast with this assumption and resume operations with either a mix of physical and online presence or a shift to an e-commerce focused model.

If retailers are perceptive to these trends, there is significant opportunity for the sector to emerge with more competitive balance opposite Amazon, which has showed supply-chain vulnerabilities. As a result of conditioning its customers to expect virtually immediate delivery of goods, and sometimes failing to deliver on its core promise in a crucial period, some customers have turned elsewhere. Many customers will form loyalties with other staple retailers like Walmart, Target and wholesalers, BJs and Costco, which have all wisely and rapidly ramped-up tech-driven logistics capabilities in order to regain market share.

Consumers are also developing online buying habits for groceries during this period due to social distancing and other health considerations. While these buyers will eventually return to physical stores, many have now placed grocery orders online for the first time. The expansion of consumer knowledge of online access capabilities will result in an increase in grocery e-commerce post-pandemic, which will impact grocery retailers that fail to innovate.

Restaurants have also suffered tremendous losses. Most restaurants have closed (or have been ordered to close) and patrons are opting to prepare their own food versus takeout for health concerns. When dine-in operations resume, ensuring that food is prepared, served and consumed under clean protocols will be the subject of high scrutiny. Ghost kitchens and delivery-only models will likely be in high demand.

Residential

The residential market remains relatively stable. Homeowners and renters are staying in place during the current period of uncertainty, which may change based on the economic climate going forward. For residential transactions that are occurring, real estate brokerage firms are utilizing virtual touring technology rather than open house or other physical tours of properties for social distancing concerns, and these are technologies that will likely stick when the pandemic subsides.

Smart home technologies are also in high demand as workers setup home office spaces. To the extent that remote working remains prevalent following the pandemic, workers will likely continue to demand (and states may mandate) working conditions that mirror their office experience. Working from home also means that e-commerce sales will comprise the primary channel of retail activity. These transactions may be facilitated through IoT hub devices in the home such as Amazon's Echo and Alexa. In addition, as most in-home services on appliances by third-party providers have been suspended, predictive maintenance technologies are becoming attractive to consumers. Sales of home security technologies, which communicate with IoT devices, have also increased significantly since the onset of COVID-19.

Data Centers, Cell Towers & The 5G Network

Data centers and cell towers are low risk sectors during the pandemic because they have limited negative impact from social distancing. Real estate companies in this category have had high financial returns in recent years and therefore generally enter this challenging economic period with high liquidity and borrowing capacity. Providing the infrastructure to the eventual implementation of 5G has been an event on the horizon correlated to positive impact on operations. Prior to 2020, the rise of the 5G network has been gradual as telecom providers have implemented 5G service on an as-demanded basis, and some consumers have hesitated to adopt due to increases in cost. The pandemic has forced much of the U.S. workforce to work from home and the remote-work business model has created heightened demand for network capacity, including the demand for entertainment content. 5G is more capable of serving higher bandwidths needed to accommodate the increase in network technologies being utilized. Data centers and towers will serve as the infrastructure to deploy these network services.

Life Science

Life sciences companies have not been immune to the adverse consequences of the pandemic. Fortunately, however, many U.S. states that issued stay-at-home orders carved out exceptions that have allowed many life sciences companies to continue their operations during this pandemic. While there have been significant business interruptions resulting from the COVID-19 outbreak as life sciences companies have considered the safety and well-being of their employees and accordingly restricted access to their facilities mostly to personnel and third parties who must perform critical activities on-site and limited the number of such personnel that can be present at the facilities at any one time, operations have largely continued. The research and development, preclinical and clinical activities of life sciences companies require facilities and onsite access remains paramount. The real estate needs of biotech, medical device, digital health and pharmaceutical companies consist of laboratories, storage facilities for specimens, reagents and patient samples, and manufacturing facilities. As global pharmaceutical research and development spending is increasing, so is the demand for high-end biotech space to accommodate growing lab and office needs. The global health crisis has further highlighted the necessity for continued innovation in the life sciences industry to address evolving healthcare needs. There will be an abundance of opportunities for commercial real estate to design, develop and operate the specialized facilities required by these companies’ unique space needs.

Conclusions

COVID-19 has put unprecedented stress on real estate operations. But the industry will recover, and being forced into a rebuilding phase provides the opportunity for real estate leaders to reflect on how to re-position real estate business with strength for the future. The well-reported narrative has been that real estate is both the planet’s largest industry and the last industry to embrace technology. Some of this delay has been attributable to the fact that the view of many real estate operations is that their business does not need fixing. The health crisis has brought the slow adopters in the industry along with the rest of the economy to a point where fixing will be required for survival. The paths to technological change for real estate were paved in the last several years of the PropTech industry’s accelerated growth and now is the time for full immersion. Much of this will be mandated by the technological demands surfaced by the health crisis, but forward-looking real estate leaders will understand that tech adoption will position the business for sustainable long-term growth well beyond recovery from the pandemic.
