TRANSWESTERN
REAL ESTATE SERVICES

Broadly Speaking

A quick take on how major U.S. commercial property sectors are faring in a slowing economy

December 2023

Rising interest rates and economic uncertainty have taken a toll on the real estate capital markets in 2023, yet commercial property owners and users have responded in remarkable ways. As we turn the calendar to a new year, we highlight underlying strengths and challenges across some of the most popular property sectors, while identifying potential risks and opportunities.

Office

STRENGTHS

Flight to Quality: Owners of newer product will see continued demand through 2024. However, a decelerating construction pipeline will limit options, likely prompting overflow demand in older product.

Creativity: Owners deploying hospitality approaches where the office outcompetes the home will win the tenant. Investments in fast/reliable internet connectivity, a mix of building experiences, and a building conference facility/lounge are popular upgrades.

Spec Suites: Spec suites lease up faster (typically at half the pace of a traditional suite), offer tenants a visual preview of the space, and accommodate a shorter term, which is attractive to tenants in an uncertain environment.

Suburban Investment: The suburbs have maintained a relative measure of healthy investment compared to the CBD, garnering nearly 2/3 of all office investment in Q3.

CHALLENGES

Rightsizing: Tenants are reducing space on average 20%. With leases still rolling, expect this to play out in the stats for years to come.

Obsolescence: All stakeholders (city/owners/tenants) must work together to find solutions. If not addressed, office values will continue to deteriorate and keep the vacancy rate elevated.

Concessions: Landlords fight to remain competitive, but stress in the debt stack will likely recalibrate concession expectations.

Insurance: Insurance premiums are accelerating, compounding already challenging cash flow problems.

Underwriting Standards: Falling asset prices and the current underwriting landscape make building valuations a moving target. This is stressing the investment environment, as investors fear moving at the wrong time and being underwater from inception.

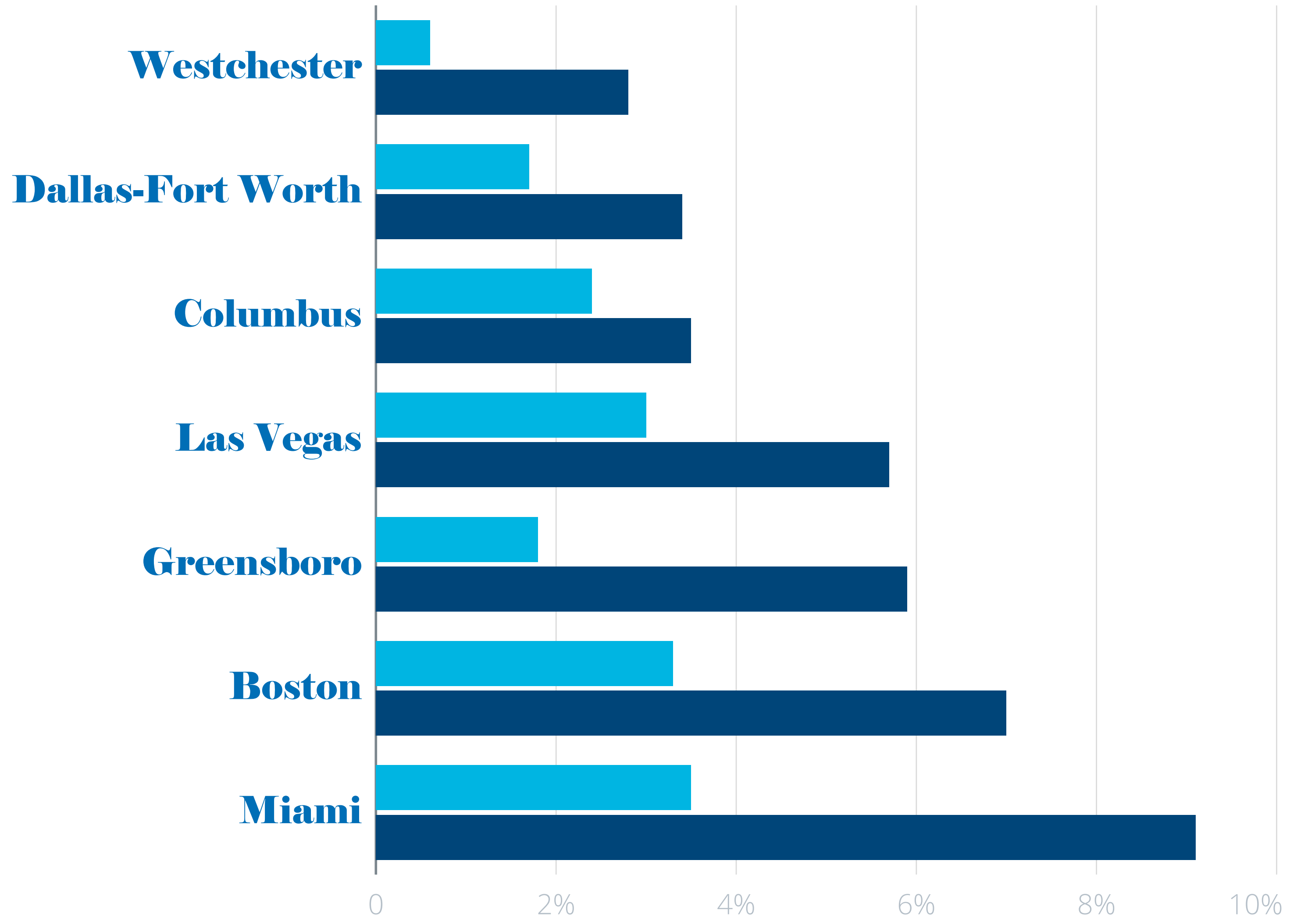
5.7%

The top three markets experiencing the most relative lift compared to pre-pandemic rental rate growth include Miami, Greensboro, N.C., and Boston. Miami's relative lift was the strongest at 5.7%, meaning that over the past 3.5 years, the annual rent growth was 9.1% compared to 3.5% for the 3.5 years pre-pandemic.

Rental Rate Change

PRE-PANDEMIC 3.5 YEARS ANNUAL: 3Q 2016 - 1Q 2020

PRE-PANDEMIC TO CURRENT 3.5 YEARS ANNUAL: 1Q 2020 - 3Q 2023



Market to Watch

MIAMI

While Miami has long been a popular vacation and residential area, the region's favorable tax environment, excellent quality of life and reputation as a global city have helped it evolve into a desirable business destination. In recent years, it has been ranked among the top cities for foreign businesses, commercial real estate investment startups and business travel.

The metro is leading the U.S. in new business applications. A record 57 companies expanded or relocated in Miami-Dade County last year, as the area's growing reputation attracts corporate headquarters in a variety of sectors. We are cautious that Miami's high concentration of tech jobs, along with the city's well-known traffic issues, could lead to a lower percentage of in-office workers going forward. Still, sizeable commitments and renewals earlier in the year indicate ongoing confidence in the market.

Investment Prospect

BOSTON

A strong academic and life sciences presence drives a healthy and diverse white-collar workforce in Boston, which remains an attractive cutting-edge market as the economy emerges from this pause. While Boston has had fluctuations in office fundamentals the same as other like-sized markets, it is poised to recover swiftly, especially when factoring in PSF sale prices that are hovering in the mid-2010s.

Industrial

STRENGTHS

Relentless Demand: 55 consecutive quarters of positive net absorption, amassing 5.4 billion SF of occupancy growth has pushed asking rents up 80%.

Shift to E-commerce: Though returning to pre-pandemic levels following a rapid acceleration of growth, e-commerce sales continue to increase at a faster rate than store-based purchases, boding well for future warehouse growth.

Onshoring: An increasing number of American companies have shifted operations back to the U.S., or plan to, driving manufacturing development, as access to suppliers and speed-to-market are becoming increasingly critical.

Stability: Year-to-date return to healthy deal volumes, similar to those seen prior to the pandemic, is a strong signal that the wild fluctuations in demand have given way to stability, a much-needed sign of equilibrium.

CHALLENGES

Oversupply: While new starts have decelerated, a rising number of construction projects are being delivered empty. Additionally, tenants are returning an increasing amount of space to the market as subleases represent their highest share of overall availability since 2010.

Consumer: Heading into 2024, warehouses maintain strong inventory levels while consumer confidence has fallen, and spending has decelerated as excess savings have been depleted. The resumption of student loan payments, as well as historically high credit card and auto loan balances, pose a threat to the market.

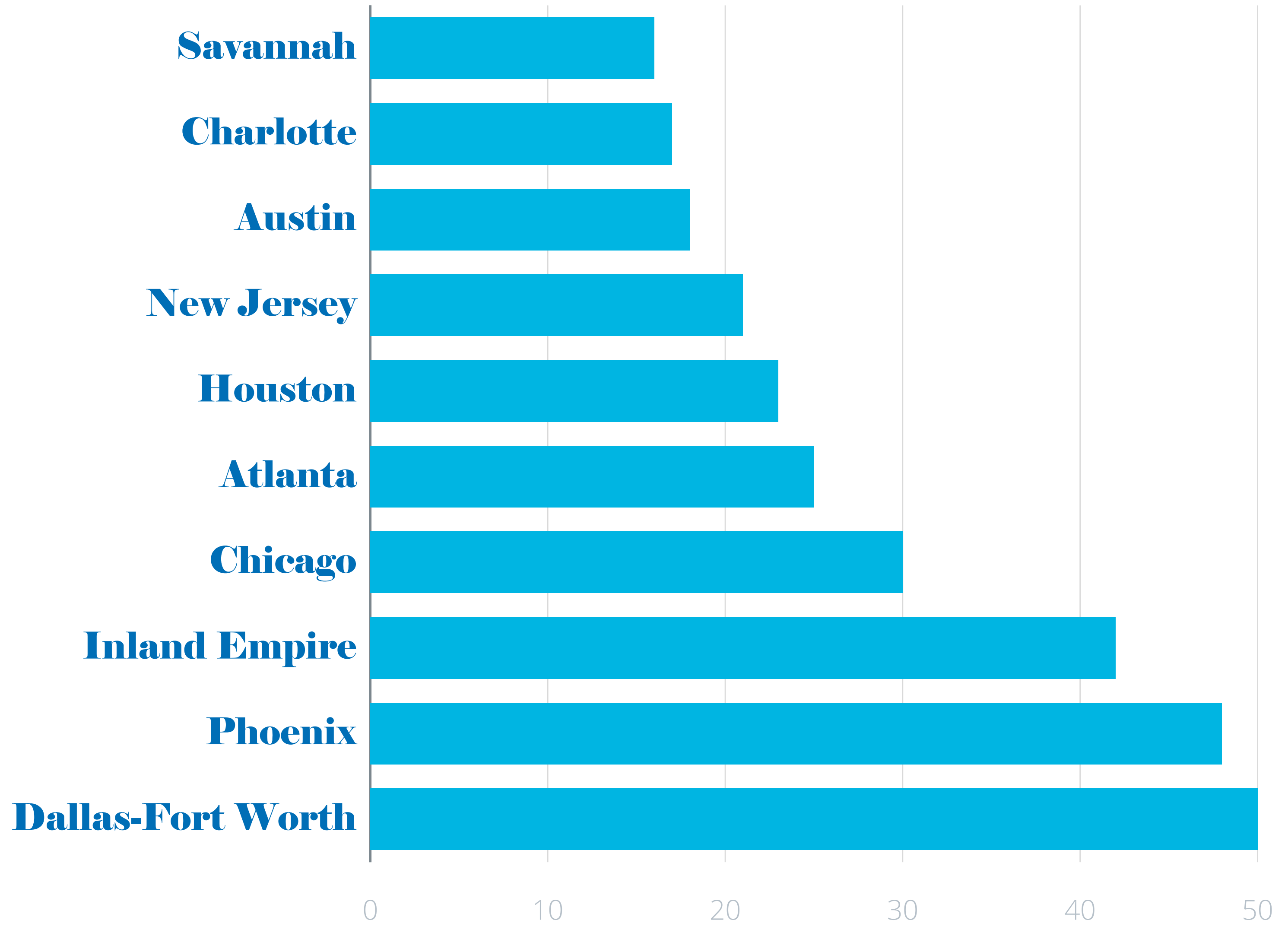
Labor: A shortage of truck transportation jobs persists, and there remains a dearth of accessible public transportation for workers at last-mile distribution facilities.

5.4 BSF

U.S. industrial real estate occupancy has expanded by 5.4 billion SF since 2010, or 24.5%, including 2.0 billion SF of occupancy growth during the 2020s, coinciding with the rise of e-commerce as a percentage of retail sales and its acceleration during the pandemic.

Construction Leaders

MILLION SF



Market to Watch

PHOENIX

The Phoenix metro has experienced a 20% increase in population since 2010, vaulting its ranking from No. 14 to No. 10 as of the 2020 Census. More than 5 million people now reside in the region, and growth is projected to continue for decades to come, with some estimates as high as 7.5 million residents by 2055.

Developers have responded by delivering more than 77 million SF of industrial real estate since 2020, with an additional 48 million SF under construction. Overbuilding is a concern as Phoenix ranks second in the U.S. in both total product under construction and percentage of construction as it relates to current stock. However, as one of the leading manufacturers of electric vehicles and semiconductors, Phoenix is well-positioned to benefit from onshoring as these growing sectors will expand the need for additional warehouse space.

Investment Prospect

NASHVILLE

Despite an overall slowing of industrial investment activity, Nashville remains robust with low vacancy, stable demand and falling construction of industrial space. Demand will fuel scarcity, which will drive up asking prices in this market as we emerge from the current pause. For industrial investors with cash in hand, the window has opened for investment in Nashville.

Healthcare

STRENGTHS

Strong Tailwinds: The U.S. population will continue to grow and age as the last of the Baby Boomer generation turns 65 in 2030. In addition, outpatient volumes will increase 10% over the next five years as services shift from inpatient settings. These two megatrends have created — and will continue to create — strong space demand for healthcare real estate.

Recession Resistant: Healthcare spending is largely non-discretionary, and healthcare job growth consistently outpaces the U.S. economy, even during recessions.

Attractive Fundamentals: Strong demand and disciplined development have allowed healthcare real estate to experience rising occupancy and strong rent growth.

Stable Returns: The unique strengths of the healthcare sector create an attractive return profile for investors with stable cash flows and asset values.

CHALLENGES

Lagging Reimbursements: Provider margins have come under pressure as cost inflation outpaces reimbursements. Tight vacancies and rising construction costs have driven rents to new highs in healthcare real estate. Space demand may be tempered as healthcare systems reevaluate future growth plans, e.g., acquiring existing practices versus organically growing with new locations.

Provider Consolidation: Practitioners continue consolidating into larger systems with more price-making power. Demand for healthcare real estate will certainly grow, but consolidation of patient pools may lead systems to optimize footprints to reduce redundancy and overhead.

Availability of Debt: Although equity investor interest has increased for healthcare real estate, tighter lending standards favor smaller deals over large portfolio transactions that dominate healthcare investment. That said, strong fundamentals for the sector will allow this challenge to dissipate as liquidity improves.

4.3 MSF

ABSORBED EACH QUARTER

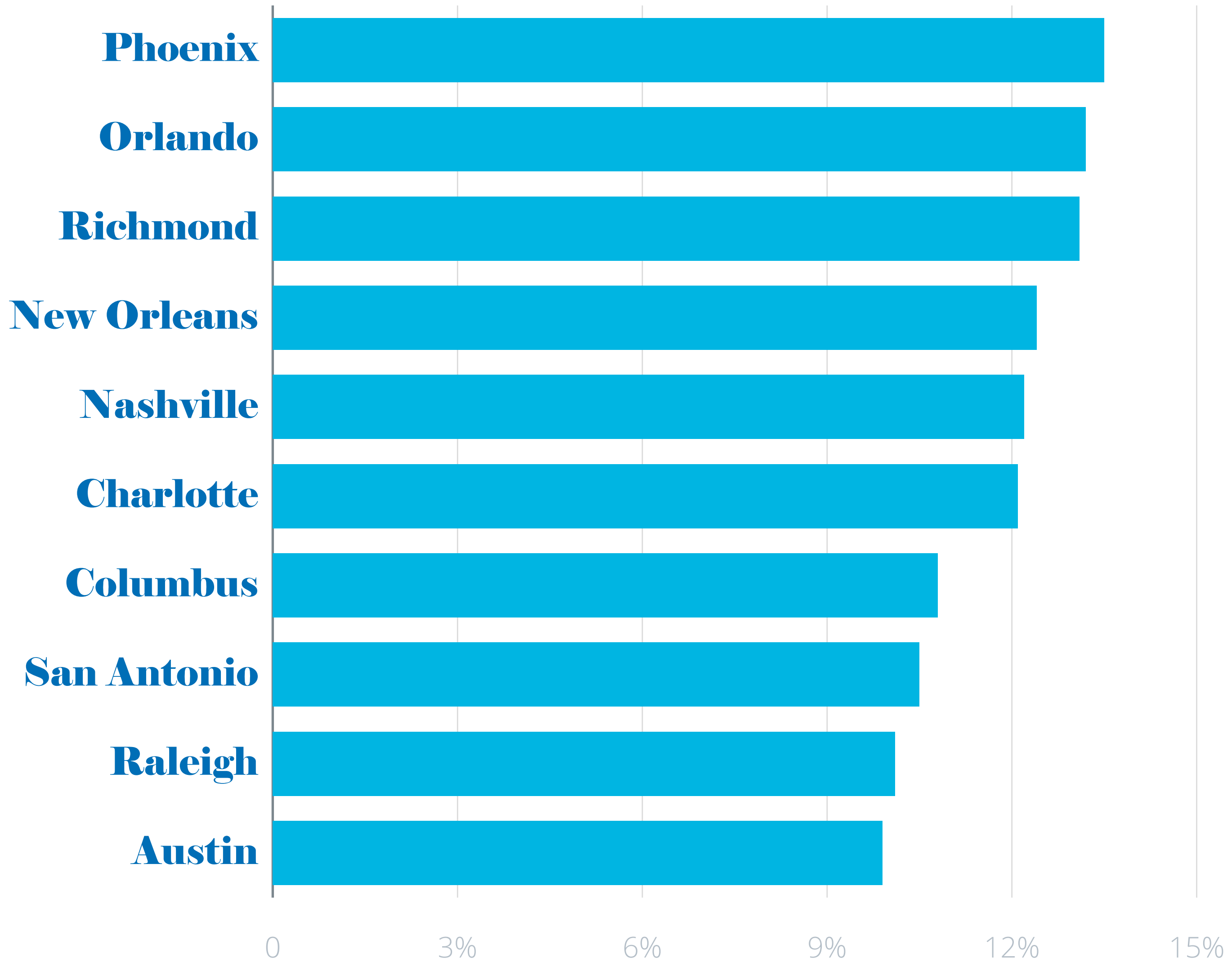
3.2 MSF

DELIVERED EACH QUARTER

Demand for medical office space consistently outpaces new construction in the Top 100 U.S. markets, providing a stable outlook for occupancy, rents and returns in healthcare real estate.

Hottest Markets for MOB Demand

CHANGE IN OCCUPIED SF OVER LAST 3 YEARS



Market to Watch

THE TEXAS TRIANGLE

An estimated 21.8 million people live in the Texas Triangle, an emerging mega-region connecting the Dallas, Houston, Austin and San Antonio metropolitan areas. Over the next five years, its population will grow by 6.4%—four times the national average. More impressively, population growth in every age cohort will fortify healthcare providers: Infant and senior cohorts that dominate healthcare demand will rise well above national averages as growth in the working age (18 - 64) population increases the number of privately insured households.

Texas' pro-business climate extends to healthcare real estate with a relatively streamlined regulatory system for providers and an entitlement process that is friendly to medical uses. As a result, a full spectrum of investment opportunities exists, ranging from small freestanding facilities for diversified funds, to large MOBs for REITs and institutional investors, to vacant office buildings ripe for conversion by opportunistic investors.

Investment Prospect

ANY MARKET WITH POPULATION GROWTH

The outlook for healthcare real estate is strong in many markets due to aging populations and strong sector fundamentals. But markets with above-average population growth will be most ready for investment, particularly where housing starts establish new trade areas and patient pools that spur healthcare providers to open new hospitals, surgery centers, and physician offices.

Multifamily

STRENGTHS

Consumer Confidence: Apartment demand is normalizing, with absorption in Q3 positive for the third quarter in a row following a volatile 2022. One demand driver is stronger consumer confidence as inflation, excluding lagged shelter data, has cooled.

High Mortgage Rates: The cost of buying a home versus renting one is at its most extreme in decades, with the average monthly mortgage payment significantly higher than the average apartment rent, providing a demand boost to multifamily.

Long-term Demand: The housing market is chronically undersupplied, and even taking into account the current wave of deliveries from pandemic-era projects, long-term demand for housing of all types will support apartment rent growth.

Cost Burden of Homeownership: Accessibility will continue to push many would-be buyers to the rental market due to affordability, which will keep the multifamily investment market stable in the long term, even if investment patterns are inconsistent in the short term.

CHALLENGES

Oversupply: New supply is surging and will peak in 2024 before moderating, putting downward pressure on rent growth and causing rents to flatten out.

Cost of Debt: Most banks tightened construction lending and developers cite the lack of construction financing as a reason for indefinite delays to apartment starts, slowing much-needed future supply growth.

Operational Expenses: Utilities, payroll, operations, taxes, administrative and marketing are all more expensive, especially turnover costs and insurance.

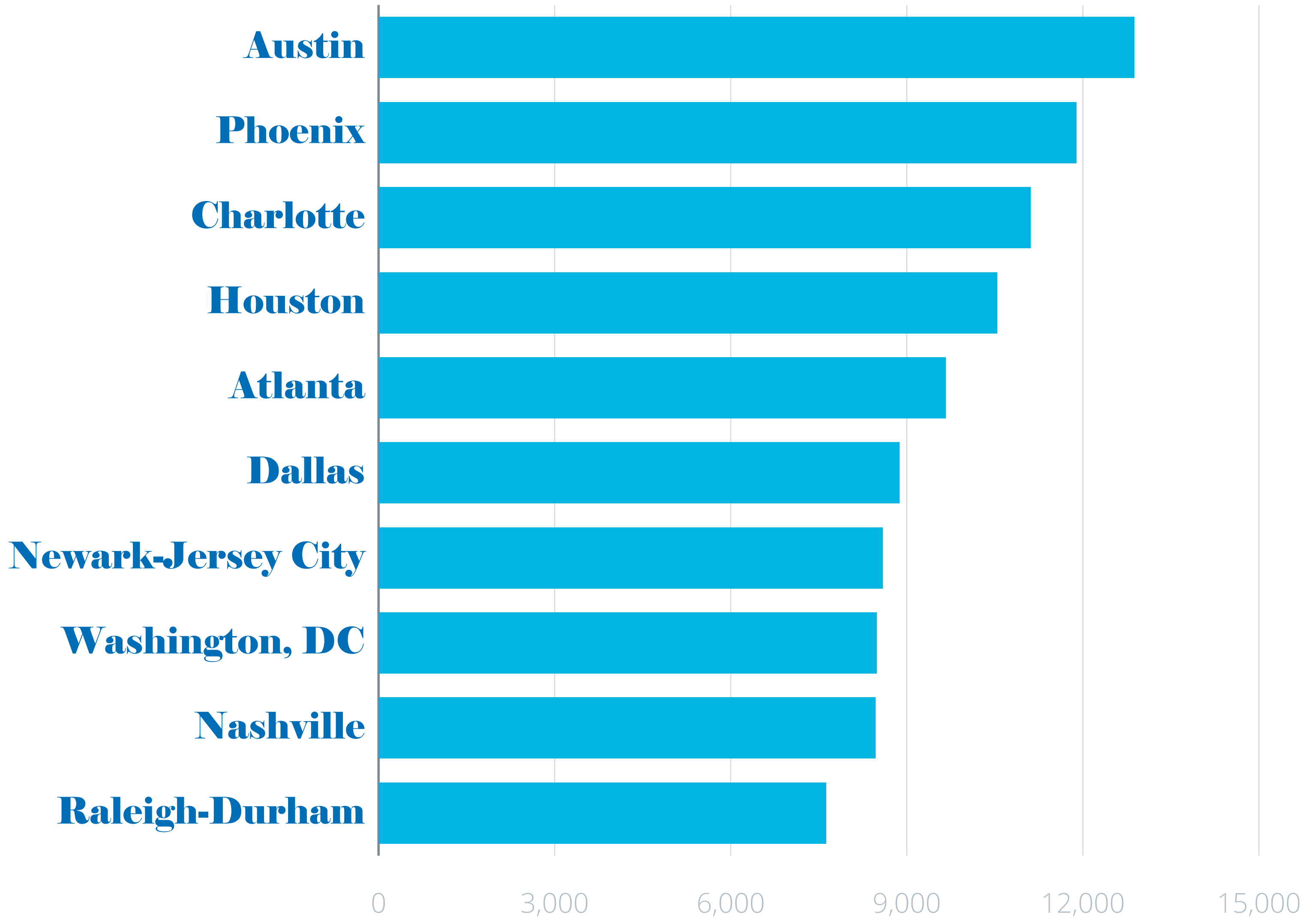
Negative Leverage: This is occurring most frequently in areas where rental income is declining and vacancies are increasing, causing stress for property owners encountering difficulties covering loan obligations. Repercussions include a challenged lending environment as well as a potentially greater pullback of leverage in the short term.

3.5%

U.S. multifamily real estate inventory will expand by 3.5%, or 681,800 units, over the next four quarters as a flurry of pandemic-era projects come online.

Annual Demand Leaders

OF UNITS ABSORBED | Q3 2023, FOUR-QUARTER TOTAL



Market to Watch

CHARLOTTE, N.C.

Charlotte's expanding job market, driven by a mix of finance, technology and healthcare industries, attracts a steady influx of young professionals and families, creating strong demand for rental properties. Charlotte experienced the fifth-largest population increase between 2021 and 2022, and developers responded by delivering over 13,500 units during the last four quarters, placing Charlotte in the top 10 markets for new supply nationwide. Absorption typically follows supply, and as such, Charlotte placed third in the nation for the number of new units absorbed over the last year, reflecting the region's attractiveness from a cost of living and quality of life perspective.

Investment Prospect

BUILD TO RENT, SUNBELT MARKETS

The average U.S. home sale price increased 37% from mid-2020 to today, pricing many middle-income families out of the homeownership market in two short years. In the same period, BTR construction increased more than 50% and emerged as an affordable alternative for families who desire a more traditional single-family style home but find ownership out of reach.

Retail

STRENGTHS

Consumers Still Spending: Inflation-adjusted retail sales remain resilient, rising 0.1% YoY at September 2023 and 0.3% from the previous month.

Vacancy and Availability: Retail space is in demand, defying inflation pressures, high interest rates and closures. At 4.9%, nationwide available space is at its lowest level since 2007. Similarly, the vacancy rate is also at its lowest level since 2007, 4.1%.

Strength in Suburbs: Suburban retail continues to experience growth, even with high inflation and rising interest rates, as retailers open in the suburbs to meet the demand of workers who continue to work remotely or in hybrid situations. Suburban availability rates have declined to a 15-year low of 4.6%.

Retail-driven, Mixed-use Developments: Risk mitigation is a focus for investors, so projects that accommodate and attract people with a whole-life solution to simplify and increase efficiency are increasingly an investor favorite.

CHALLENGES

Lack of New Space: New construction has dwindled to its lowest point in decades as rising interest rates make development increasingly cost-prohibitive. There is currently 60.2 million SF under construction, the lowest level since Q1 2013.

Savings Dwindling: Any excess savings is most likely gone for the bottom 80% of households; bank deposits and other liquid assets were lower in June this year than in March 2020 after adjusting for inflation.

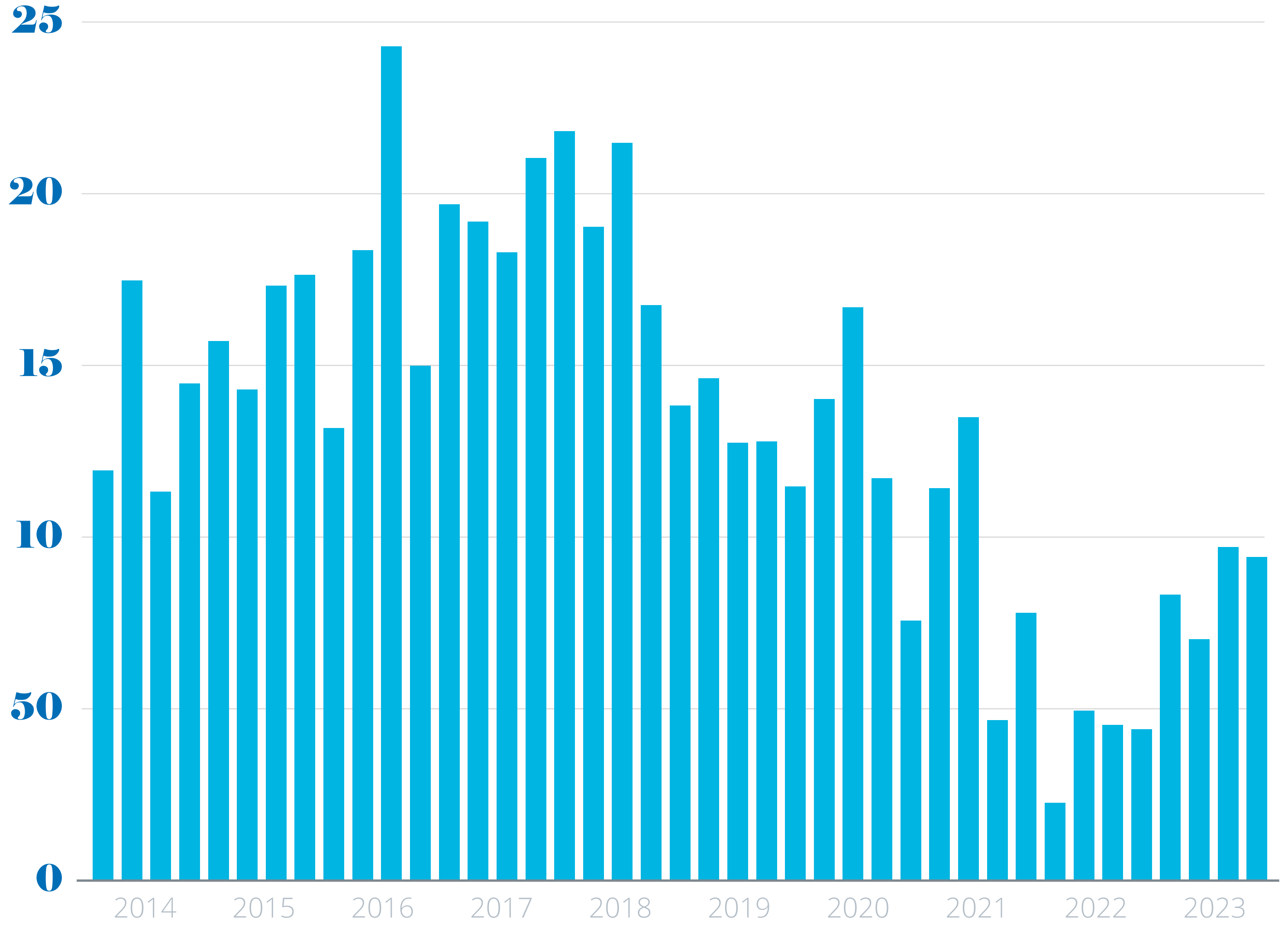
Increased Debt: Consumers continued to spend from savings and other sources. Credit card debt has greatly increased, hitting above $1 trillion in the second quarter according to the New York Federal Reserve Bank.

4.9%

Percent of retail space available as of the end of Q3 2023, the lowest level on record. Retail availabilities have decreased by 20 basis points over the past year and are 200 basis points below the historical average of 6.8%.

Retail Space Construction

MILLION SF DELIVERED



Market to Watch

ATLANTA

With space to grow, strong development activity is occurring in the city proper and suburbs due to population and economic growth. Atlanta's population has grown to 5.16 million, with an additional 66,730 residents over the last year. Metro Atlanta saw the fifth-largest percentage increase in new jobs in the U.S. since early 2020, trailing Austin, Dallas, Las Vegas and Orlando.

Atlanta's retail market is one of the top markets in the country in terms of trailing 12-month net absorption, along with other major Sun Belt markets such as Dallas-Fort Worth, Phoenix and Houston. Over 1.6 million SF of retail space is under construction, with more than 85% of that space pre-leased. Additionally, more than 90% of retail properties delivered since 2020 have been leased. With record-low availability and a growing population, Atlanta is one of a few markets where retail rent growth, 6.1% YoY, is outpacing inflation.

Investment Prospect

CHICAGO

Chicago's retail market remains robust despite some notable closures. The current low retail availability rate of 4.8% indicates a tight market. This scarcity, coupled with limited new construction, effectively maintains a balance between supply and demand. Current projections suggest that the high occupancy rates in the retail sector are likely to persist, underscoring the stability of retail as a strong contender for real estate investment.

Life Sciences

STRENGTHS

Governmental Investment: Ongoing government investment continues to spur innovation and support ongoing discoveries within the life sciences sector. Legislative-led initiatives help protect infant technologies and breakthroughs made by U.S.-based companies.

Educational Epicenter: The U.S. is home to renowned academic institutions that excel in science, technology, engineering and mathematics (STEM). These STEM-specialized institutions continue to experience elevated graduation levels, feeding a robust qualified talent pool for years to come.

Ongoing Demand: The aging global population fuels ongoing demand for drug and healthcare advancement, as safe and effective treatments are seen to ease the strain on the healthcare system. Currently, one in six Americans are over 65 years of age.

Deglobalization: Post-pandemic trends aim to onshore critical infrastructure, reversing a 30-year trend on globalization and outsourced manufacturing practices. Shifting toward securing supply chains and limiting foreign reliance within the system will create an opportunity for U.S.-based ancillary services.

CHALLENGES

Excess Inventory: Increased sector demand prompted record real estate development, much of which is set to deliver within the next 24 months. Major life sciences markets are forecasted to have excess inventory if pre-leasing continues to slow.

Supply Chain Delays: Laboratory equipment and specialized construction materials face ongoing delays. The supply chain headwinds affect new development and second-generation space equally. Components related to transformers, cleanroom equipment and bioreactors lead the largest delay.

Variance: Life sciences buildings are highly specialized assets that demand non-traditional premiums, varying greatly based on use, condition and age. Space improvements can easily be more than $1,000 PSF.

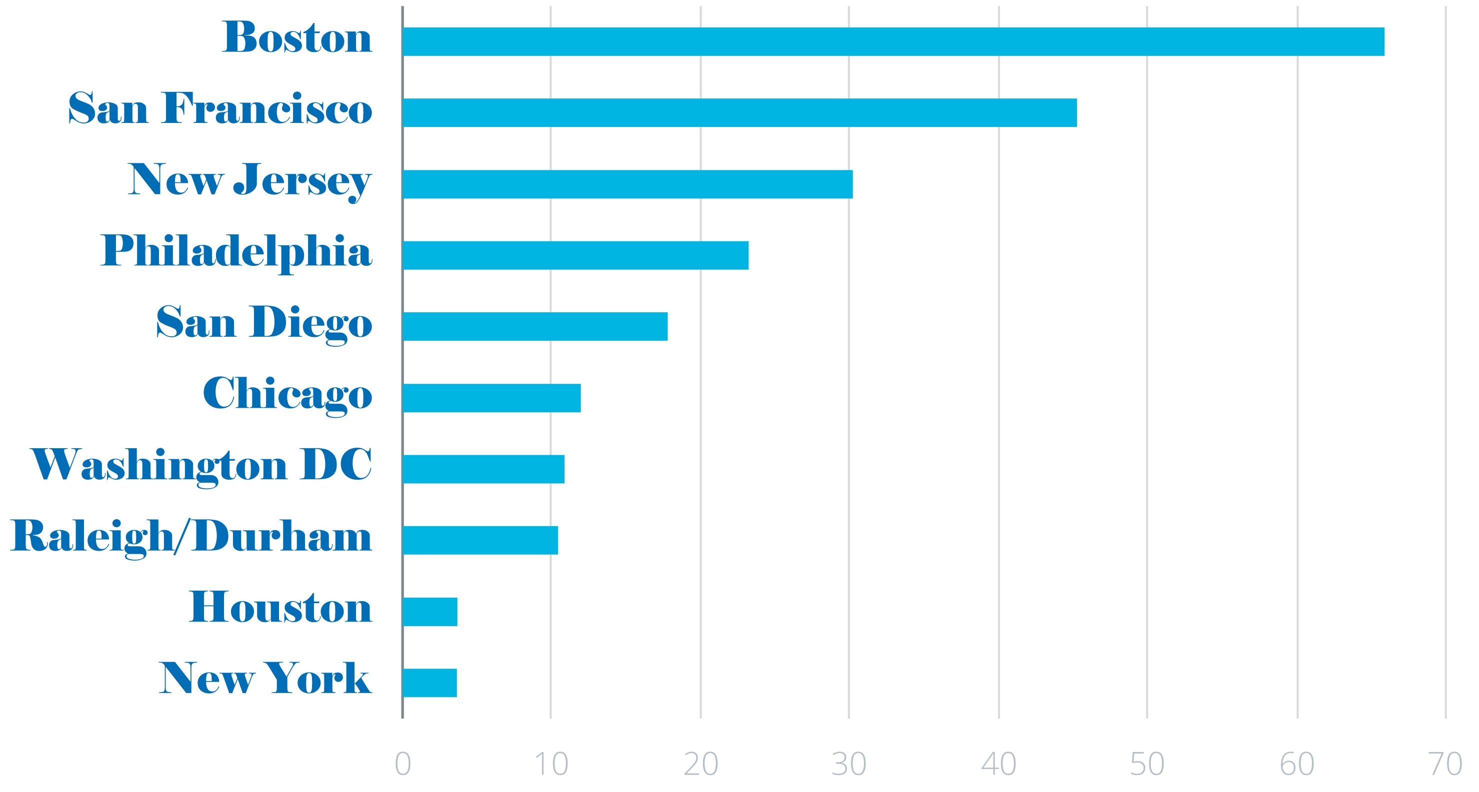
Public Markets: A suppressed IPO market has created an environment of cash conservation for many life sciences companies working to ensure operational funds get through until the IPO market resumes fully. Stifling operational efficiency as a cost-saving measure could make these companies less agile when the IPO market does resume.

$46.8B

Funds the NIH awarded in 2023, a 7% increase over 2022.

National Market Inventory

MILLION SF



Market to Watch

SAN DIEGO

Factors such as industry employment growth, ongoing institutional investment and increased NIH awards all help to boost San Diego's life sciences market. Industry employment has grown 21% since 2018 and is slated to remain on trend until at least 2030. The area is home to 23 higher education institutions that help supply a well-qualified talent pool with 10,000 graduates per year, of which 3,100 are STEM-related. Additionally, the region's life sciences employment statistics show the median workforce age is 31, notably less than the other major markets.

Ongoing institutional investment is evident, as several top-tier developments have aimed to capture the demand for quality. Despite the building boom, excess inventory concerns seem to be muted, with local pre-leasing data leading the nation. Ranked No. 6 in awarded NIH grants and No. 5 in venture funding, the region is well supported with access to capital and is expected to sustain a stable growth trajectory. Lastly, the temperate climate and economic affordability relative to Boston and San Francisco make San Diego a desirable option for budding life sciences companies.

Investment Prospect

SANTA CLARA COUNTY, CA

Geographic proximity to South San Francisco, a top two life sciences cluster, makes Santa Clara County an interesting prospect for increasingly aggressive expansion of life sciences activity. With the tech industry shrinking footprints across the County, fundamentals and PSF sale prices have been negatively impacted, creating an opportunity for cash-heavy investors to capitalize on the next wave of life sciences demand in an area where office to life sciences conversions are common.

TRANSWESTERN

Authors

Jennifer Barili
National Investment Research Leader
Senior Research Analyst | Phoenix

Alex Browne
National Life Sciences Research Director

Matthew Dolly
National Industrial Research Leader
Research Director | Strategic Accounts

George Entis
National Multifamily Research Leader
Senior Research Manager | San Francisco

Maurice Harris
National Retail Research Leader
Manager - Research | Minneapolis

Andrew Matheny
National Healthcare Research Leader
Research Manager | Dallas-Fort Worth

Elizabeth Norton
Sr. Managing Director
Research Services

Doug Prickett
Sr. Managing Director
Research & Investment Analytics

Corrie Slewett
National Tenant Advisory Research Leader
Research Manager | New York

About Transwestern

Five dynamic, integrated companies make up the Transwestern enterprise, giving us the perspective to think broadly, deeply and creatively about commercial real estate. Clients and investors rely on us for expertise that spans institutional and opportunistic investment, development, hospitality, and brokerage and asset services. Our award-winning, collaborative culture empowers team members with resources and independence to work across boundaries in pursuit of innovative solutions, reinforcing a reputation for service excellence that translates to measurable results. Through offices nationwide and alliance partners around the globe, we positively impact the built environment and our communities while fostering a work climate that champions career vitality for all. Learn more at transwestern.com and @Transwestern.

Sources: CoStar, Real Page, Real Capital Analytics, Bureau of Labor Statistics, Financial Times Nikkei Investing in America, DLA Piper, CommercialCafe, Newsweek, Beacon Council, FRED, Coresight Research, NIH, Pitchbook, U.S. Census Bureau.