ANNUAL

# C&I COUNCIL MEETING

LancasterCommercialRE.com

C&I

COMMERCIAL & INDUSTRIAL REAL ESTATE COUNCIL

HIGH REAL ESTATE GROUP LLC

*Hosted by High Real Estate Group LLC*

# Welcome

# Agenda

8:30 – 8:35 AM Introduction

8:35 – 9:15 AM Presentation

9:15 – 9:30 AM Questions and Answers

**Mark Fitzgerald**
President &
Chief Operating Officer

**Bill Boben**
Sr. Vice President
Sales/Leasing

**Michael Lorelli**
Sr. Vice President
Commercial Asset Management

**Brad Mowbray**
Sr. Vice President, Managing Director
Residential Division

**Powell Arms**
Sr. Vice President
Retail


# A Welcome From

## Justin Geisenberger

2024 C&I President

HIGH REAL ESTATE GROUP LLC

# Mark Fitzgerald

President & Chief Operating Officer
High Real Estate Group LLC

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# Agenda: Three Areas of Focus

## Economic Overview

- Employment Trends
- GDP & CPI Projections
- Consumer Trends

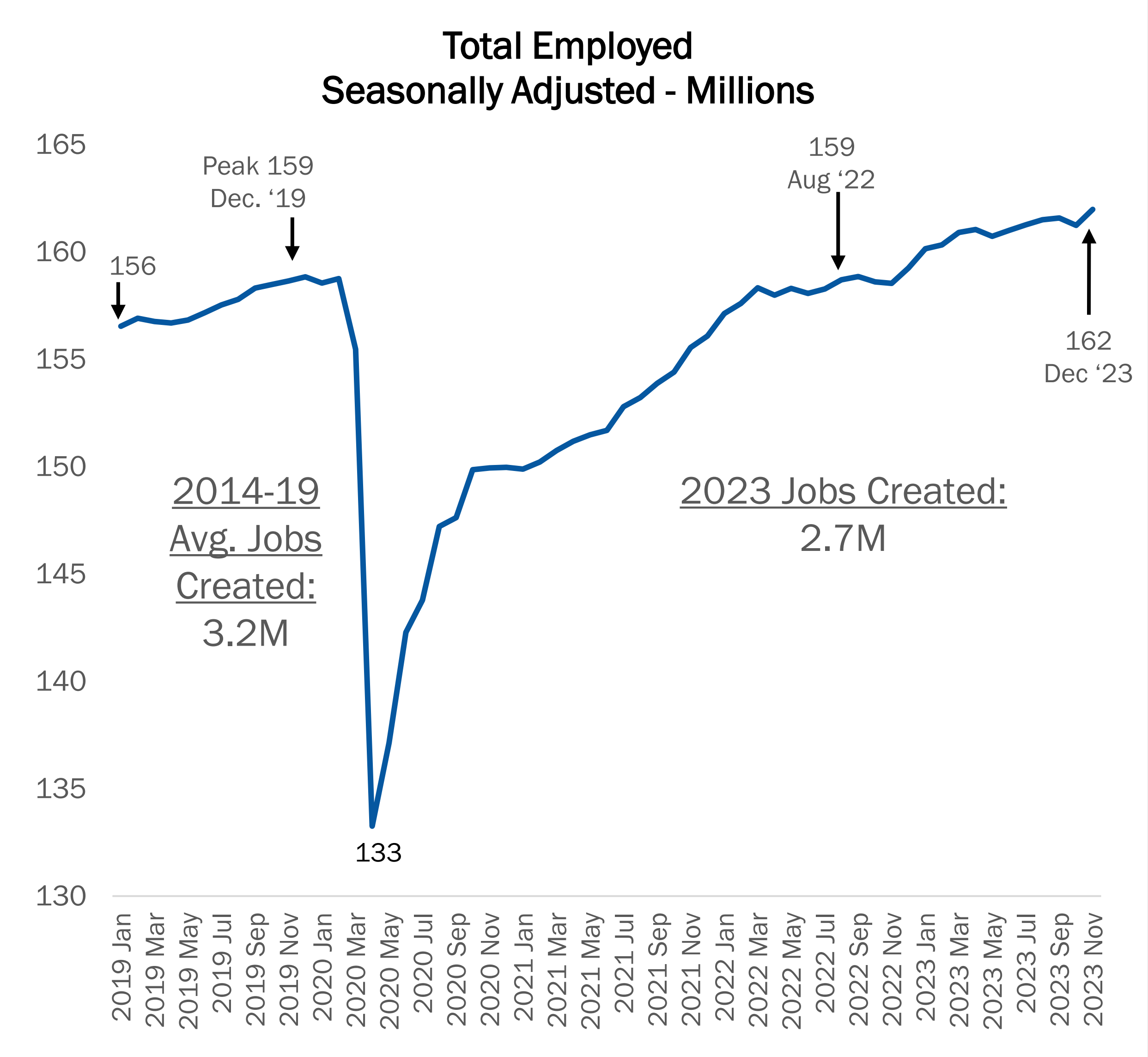
## Nationwide Real Estate

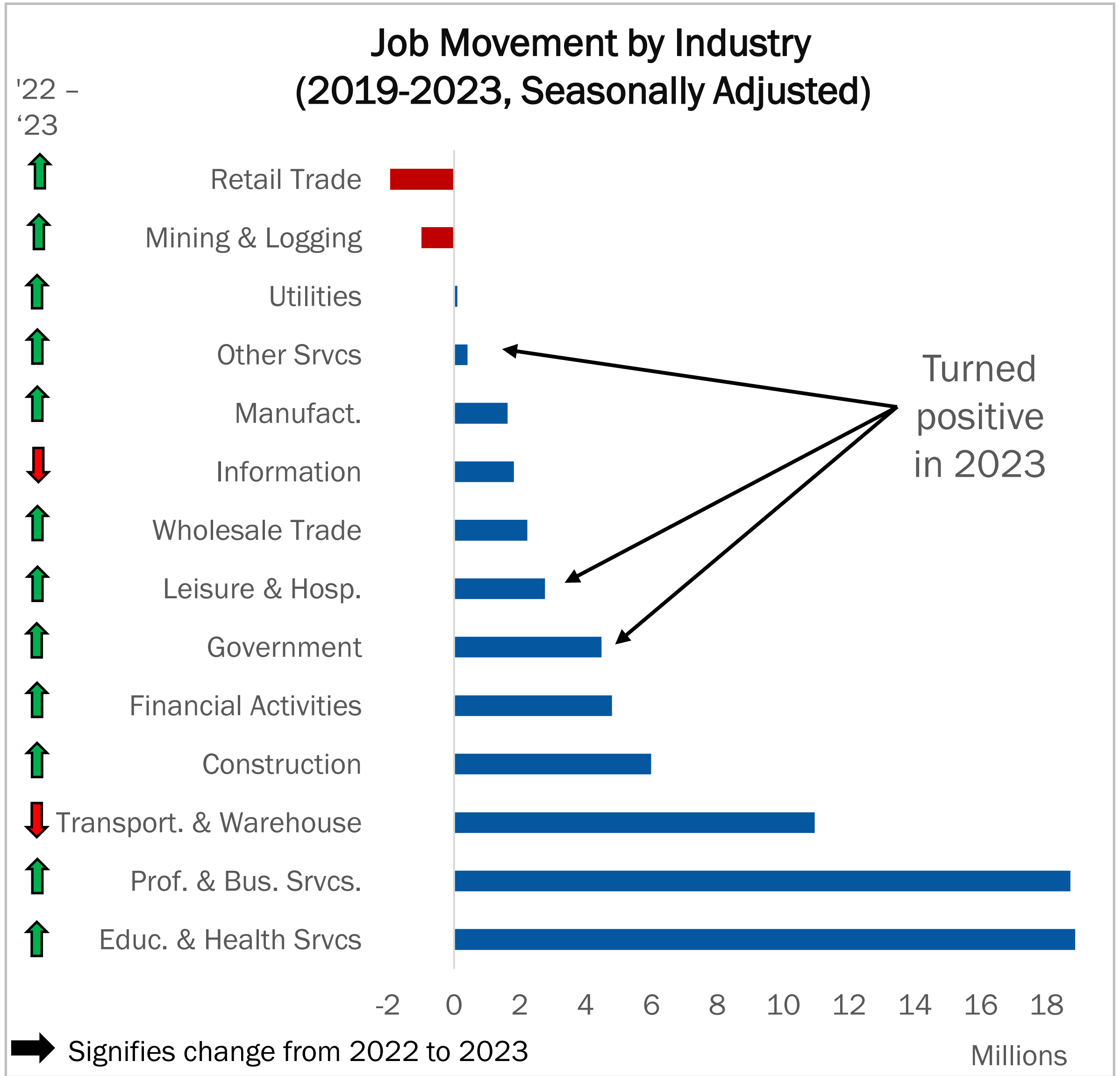
- Acquisition/ Development Sentiment
- Cap Rate Trends
- Underwriting Criteria
- Real Estate Cycle

## Lancaster Real Estate

- Office
- Industrial
- Apartments
- Retail

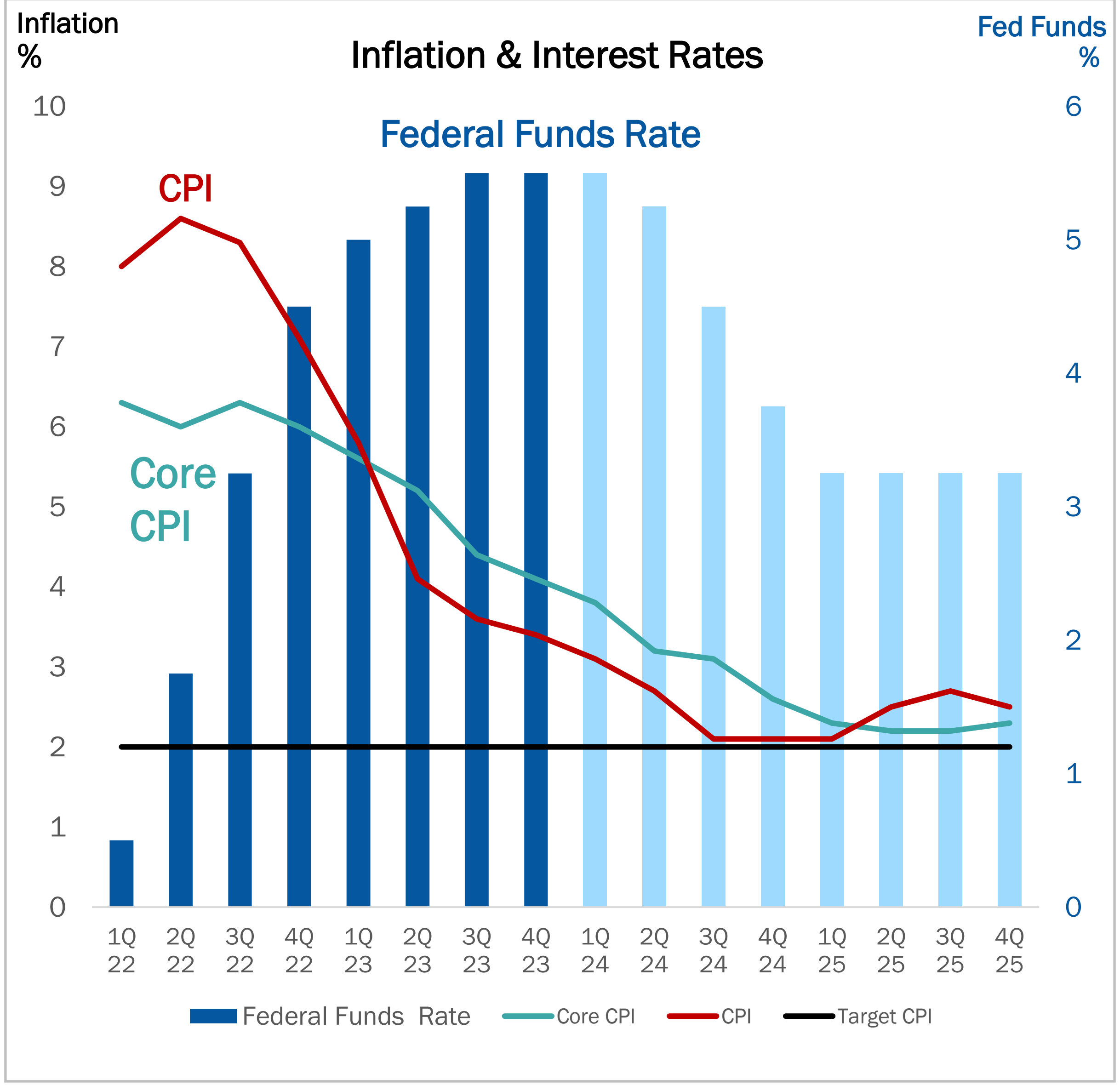
# Jobs Recovery is Complete



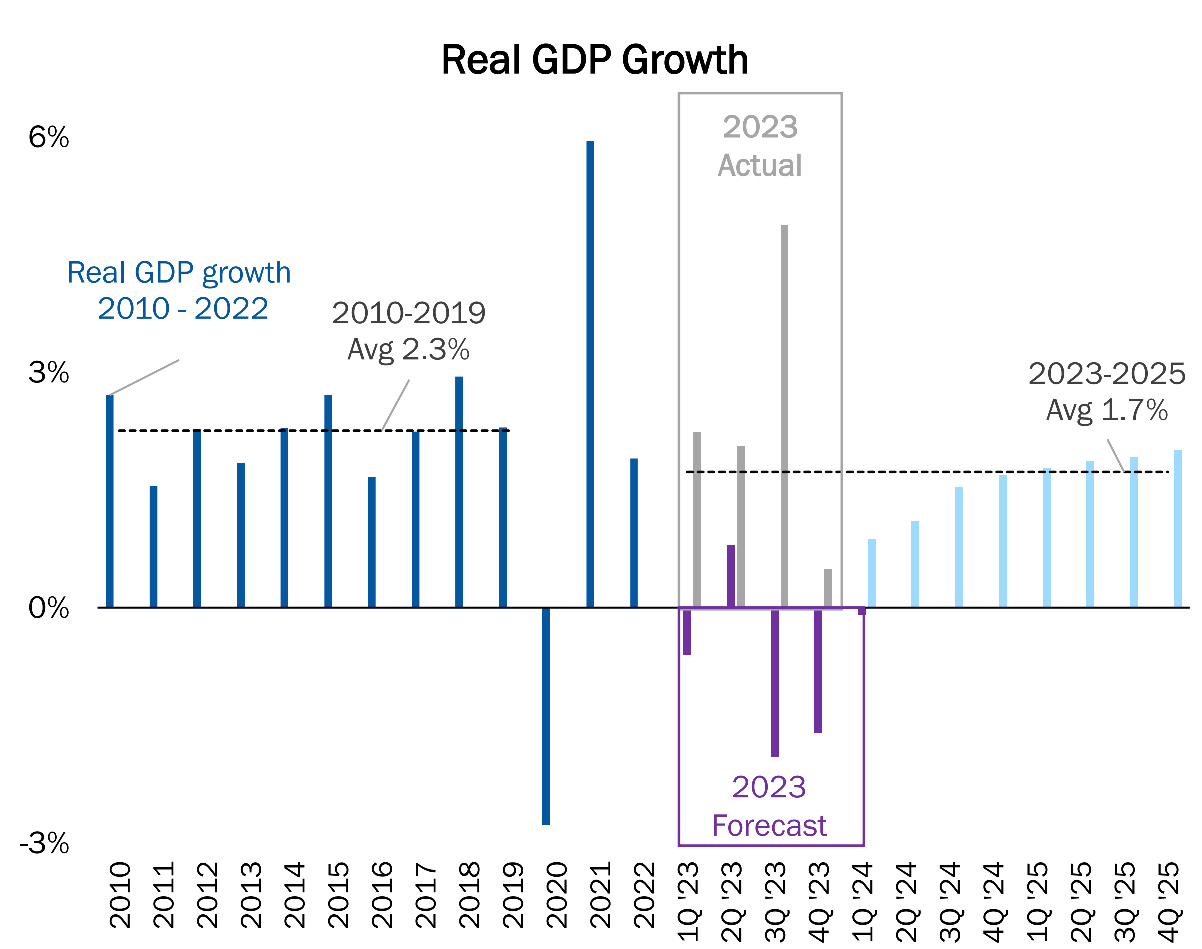




Source: US Bureau of Labor Statistics

## Impact of Federal Stimulus




## GDP Growth Outperforms Forecast




This time last year, 61% of economists surveyed by WSJ projected a recession in next 12 months, today only 39% project a recession in 12 months

Source: Federal Open Market Committee; Wells Fargo Annual Economic Outlook – 11/23; OECD; Bureau of Economic Analysis



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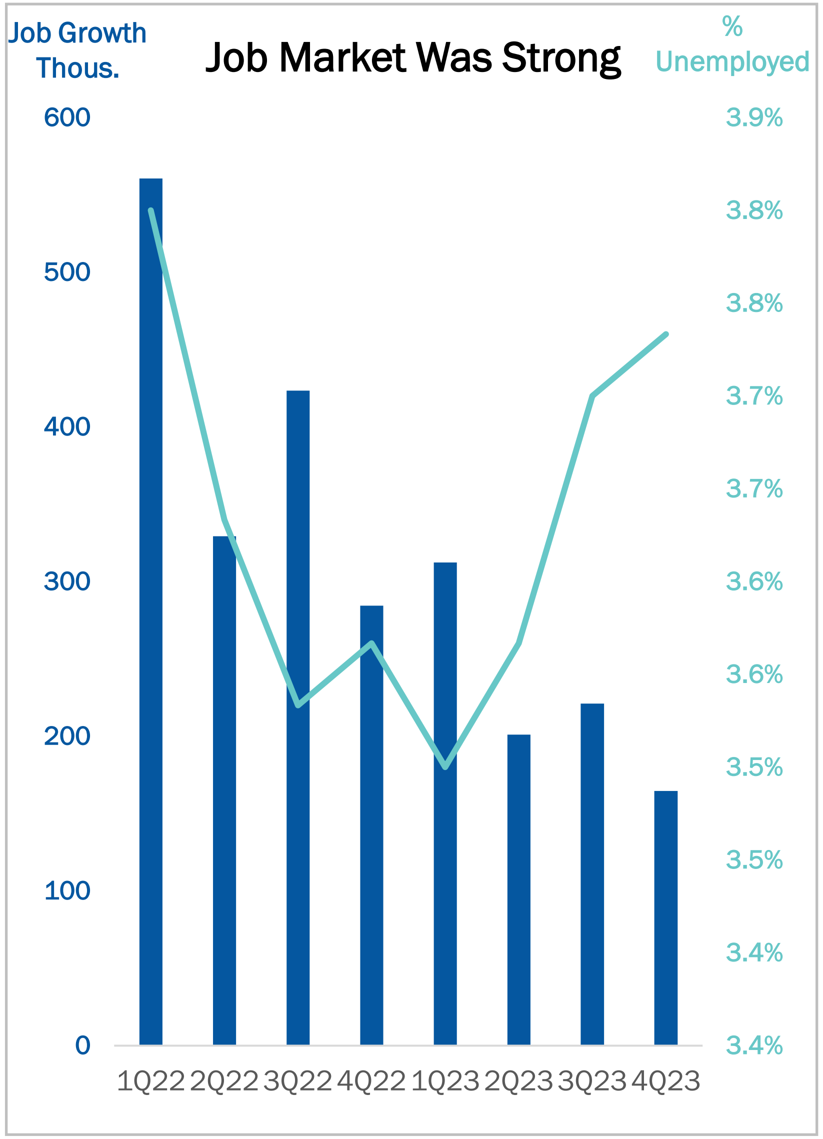
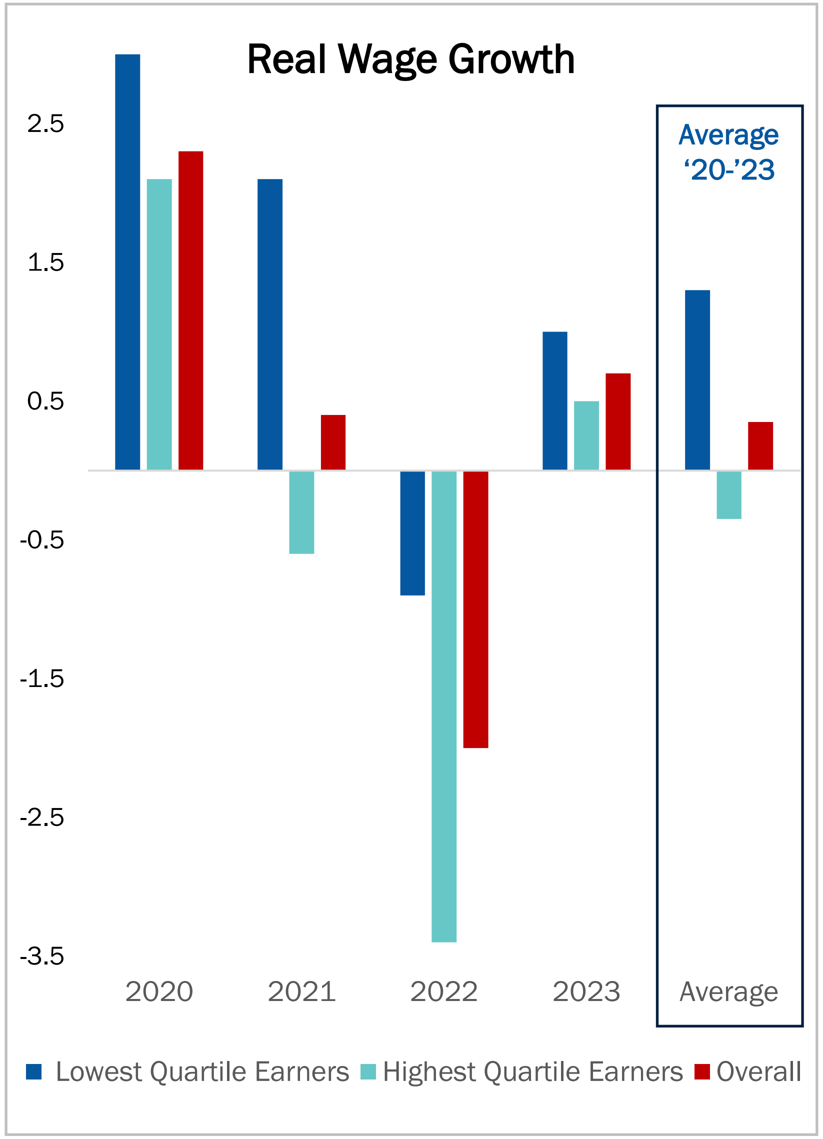
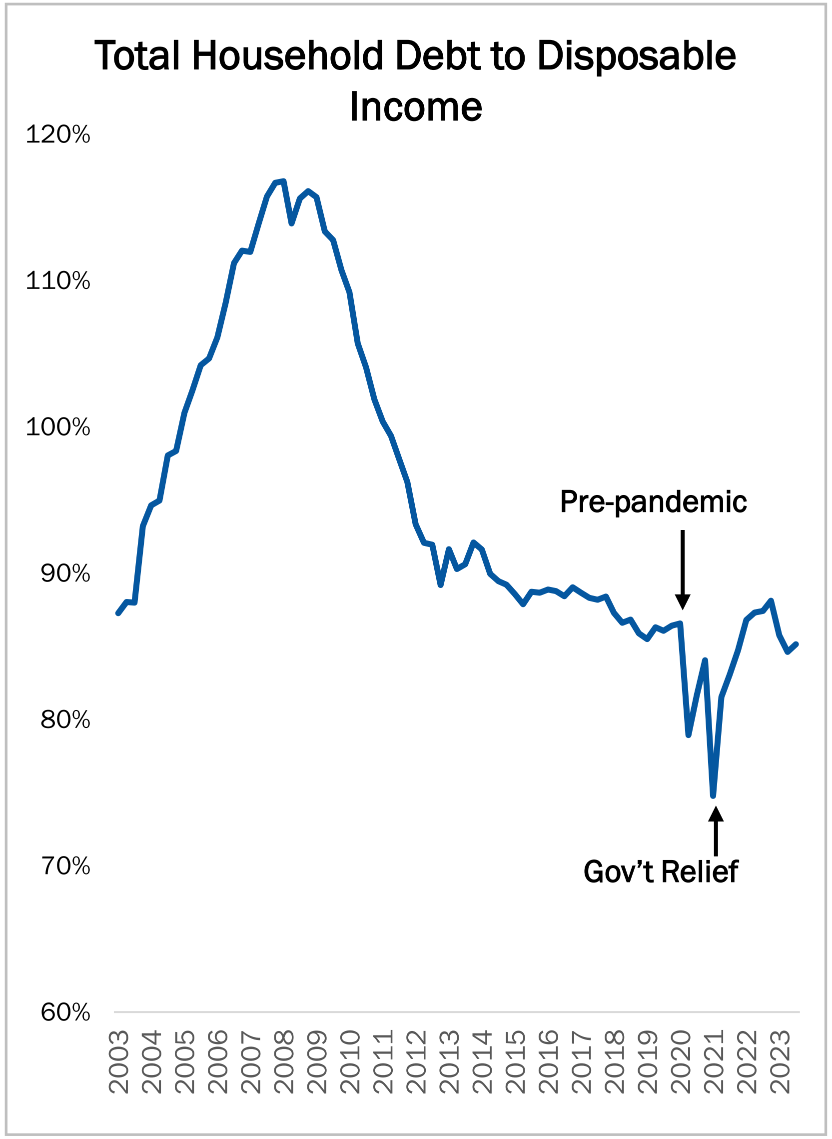
# Consumers Remained Resilient in 2023



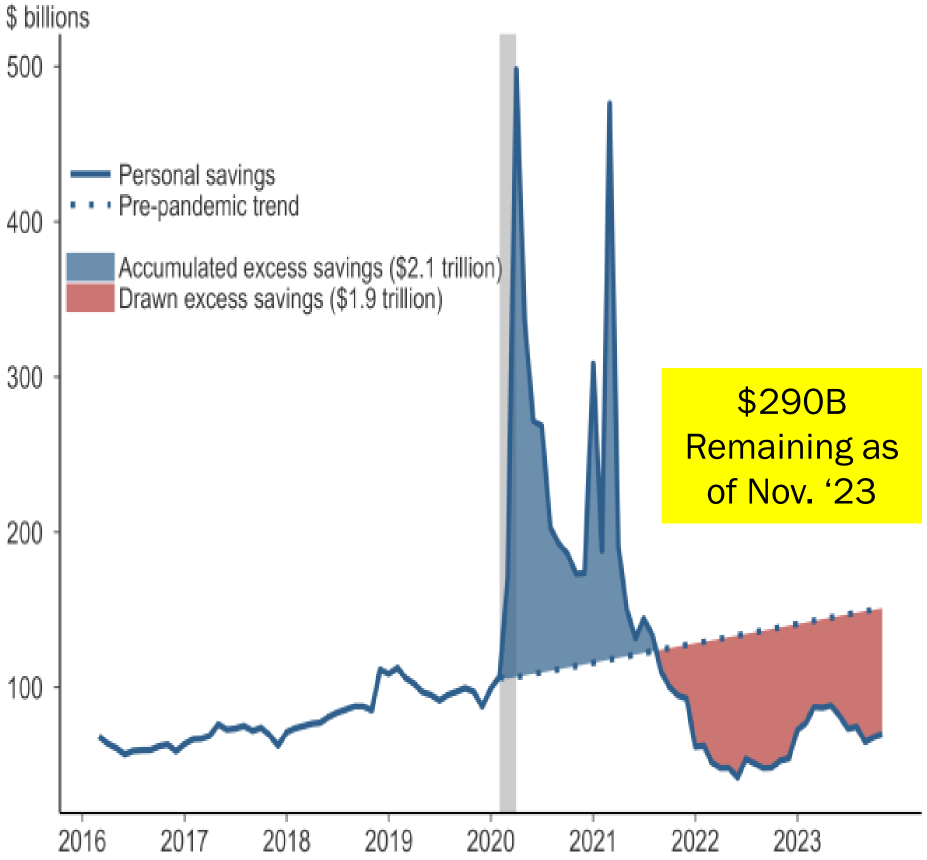



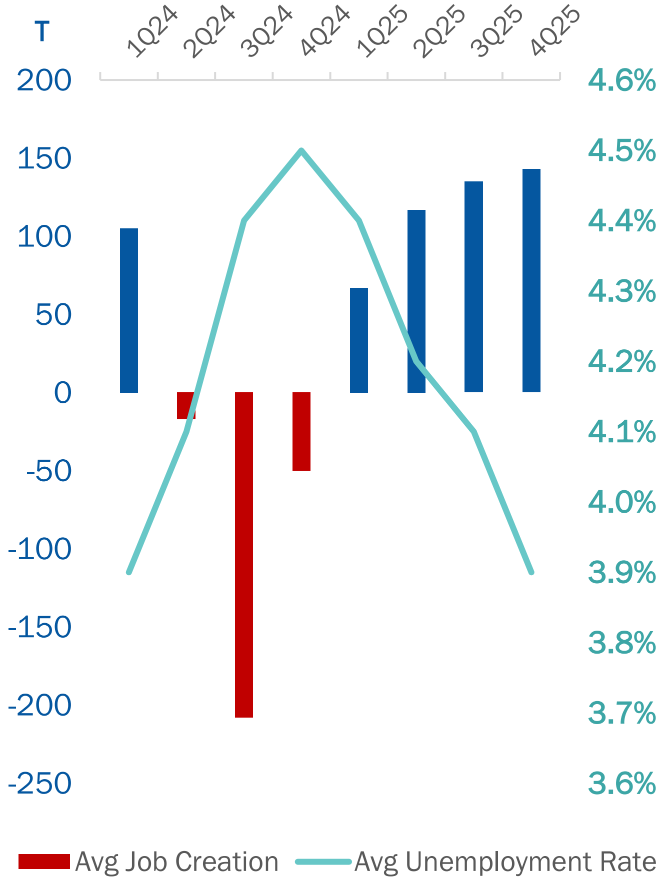

Source - U.S. Bureau of Economic Analysis, San Francisco Federal Reserve

# Clouds on the Horizon

## Excess Personal Savings Almost Depleted




## Job Market Expected to Cool




## Increased Uncertainty

- War in Ukraine & Middle East Escalating
- Inflation & Interest Rate Remain Higher for Longer
- Decreased Liquidity in Capital Markets
- Long Term Impact of Work from Home ("WFH") on Urban Centers
- Eurozone Recession
- Continued Slowdown in China

Source - U.S. Bureau of Economic Analysis, San Francisco Federal Reserve



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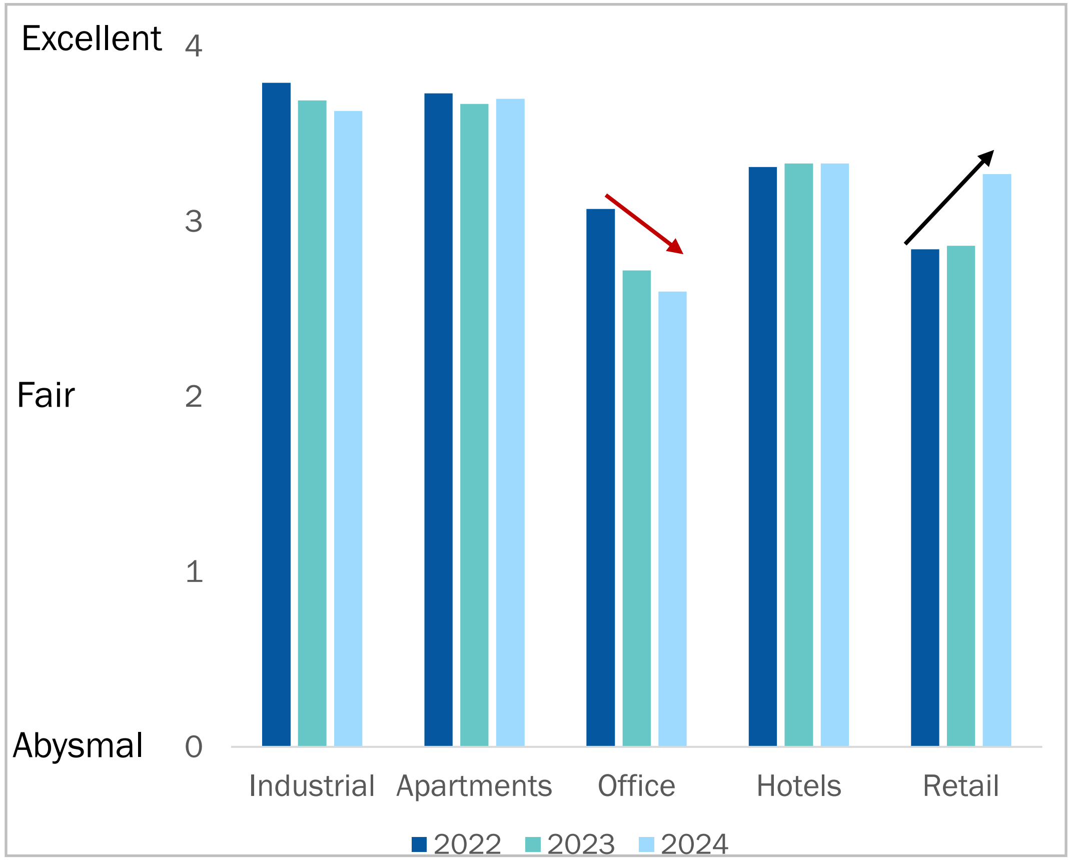
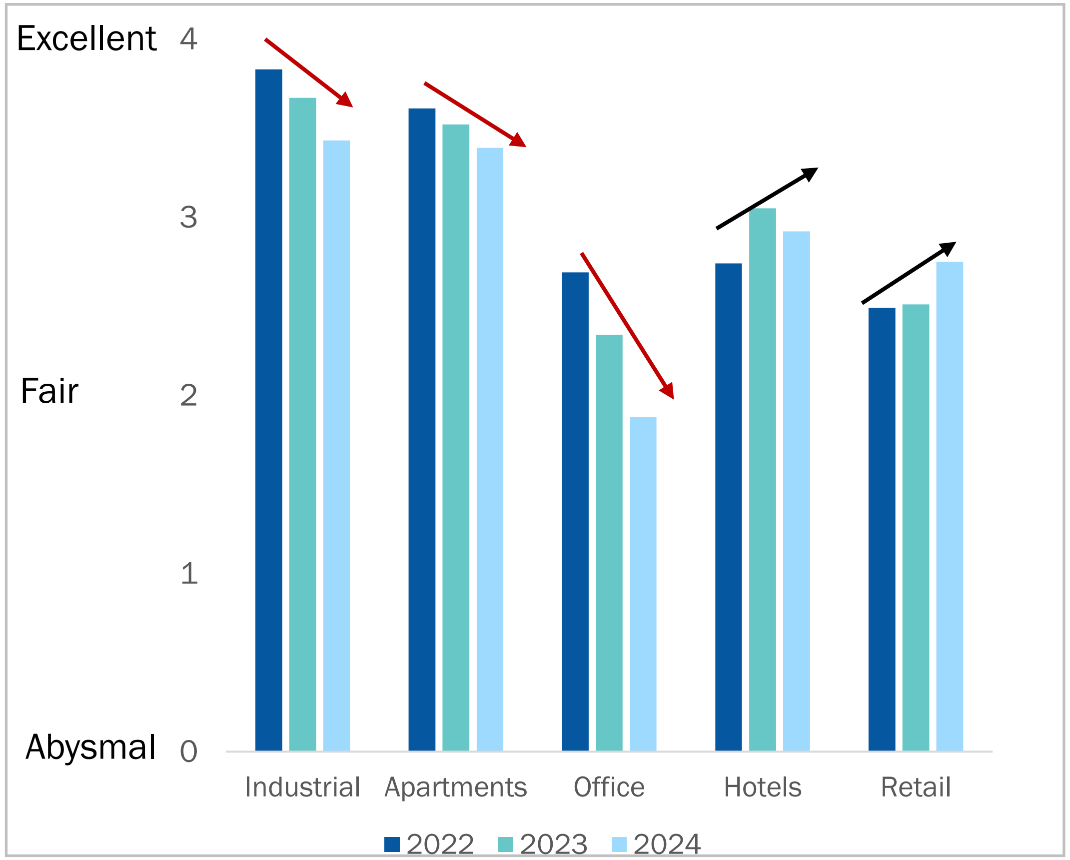
# National Sentiment for Acquisition / Development

**Acquisitions**




- Industrial & multi-family remain relatively strong
- Office has significant reduction
- Retail surprise improvement

**Developments**




- High interest rates and construction costs make it difficult to justify new construction

Source: PWC, ULI; Emerging Trends in Real Estate 2024

# US: Cap Rates Are Rising

| | Range | 2023 Average | Change from 2022 | BPS |
|---|---|---|---|---|
| Apartments | 3.8 – 8.0% | 5.3% | ↑ | 38 bps |
| Warehouse | 3.0 – 6.5% | 5.0% | ↑ | 57 bps |
| Suburban Office | 5.0 – 8.0% | 6.5% | ↑ | 54 bps |
| CBD Office | 4.3 – 8.5% | 6.2% | ↑ | 37 bps |
| Neighborhood/ Strip Centers | 5.0 – 10.0% | 7.2% | ↔ | (14) bps |
| Limited-Service Hotels | 9.0 – 11.5% | 10.2% | ↑ | 37 bps |

- Cap rates increased on all property types except retail
- Increases average 40-50 bps
- Debt & Equity underwriting is becoming much more restrictive

Source : PWC Real Estate Investor Survey 3Q 2023

# 2024 Underwriting Criteria

| | Max LTV | Vacancy | Cap Rate | Spread | All in Interest Rate | Transaction Volume[1] |
|---|---|---|---|---|---|---|
| Apartments | 65-75% ⇔ | 5-7% ⇔ | 4.5-6.0% ↑ | 1.6-2.0% ↑ | 5.6-6.0% ↑ | (65%) |
| Industrial | 65-70% ↓ | 5-10% ⇔ | 5.5-6.5% ↑ | 1.6-2.0% ↑ | 5.6-6.0% ↑ | (49%) |
| Office Suburban | 45-55% ↓ | 15-20% ↑ or actual market | 8.0-10.0% ↑ | 2.5-3.0% ↑ | 6.5-7.0% ↑ | (63%)[2] |
| Retail ("Anchored") | 55-65% ⇔ | 10-15% ⇔ | 6.5-7.5% ⇔ | 1.8-2.4% ⇔ | 5.8-6.4% ↑ | (45%) |
| Hotel | 50-60% ↓ | Actual Vacancy ⇔ | 9.0-12.0% ⇔ | 2.5-3.5% ⇔ | 6.5-7.5% ↑ | (36%) |

Range for 10-year treasury projections = 4.00%

[1] Trailing 4 quarters ending Q3 2023, [2] All office

Source: M&T Realty Capital Corporation; Data as of January 2024; CBRE Capital Market Q3 2023



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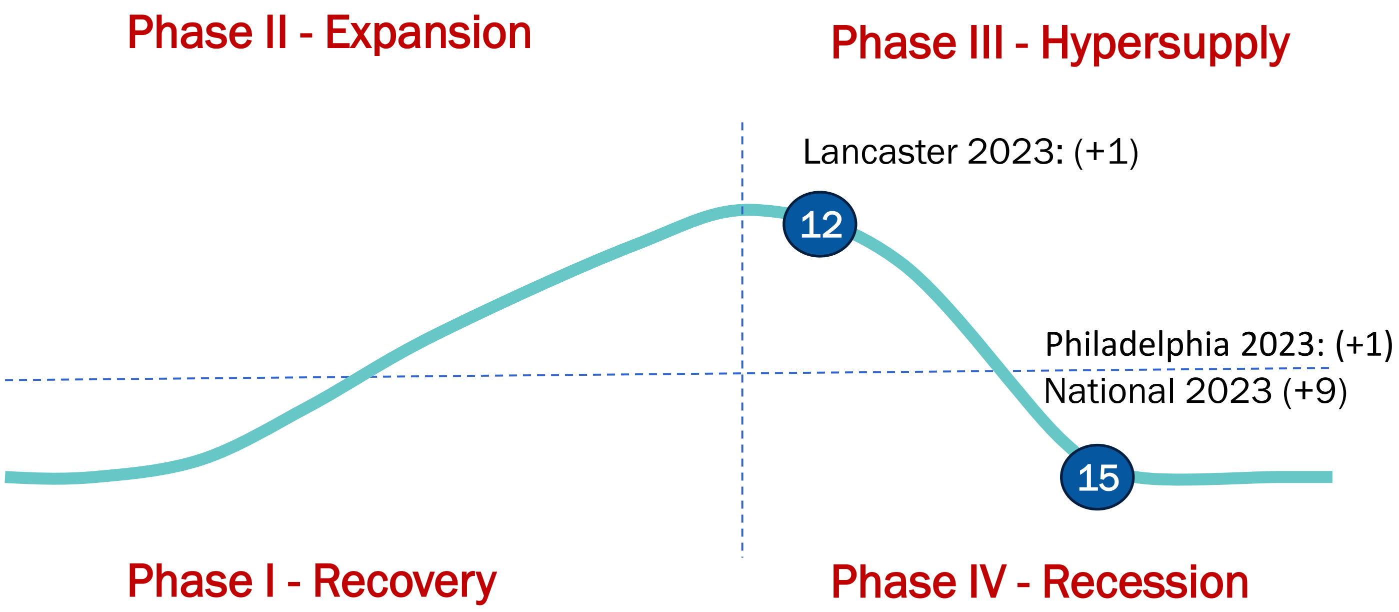
# Office

- Hybrid is "new normal"
  - 30% of total days are worked as WFH
  - Utilization ~45-50% pre-COVID
- Values are down 30-70%
  - Suburban is outperforming urban
  - Newer buildings outperform older buildings
- Leases are being renewed, but tenants are taking 10-20% less space
  - 1980's: 20.7%
  - 2010's 11.4%
- Strongest growth sectors are medical, and data centers

## *Third Quarter 2023*



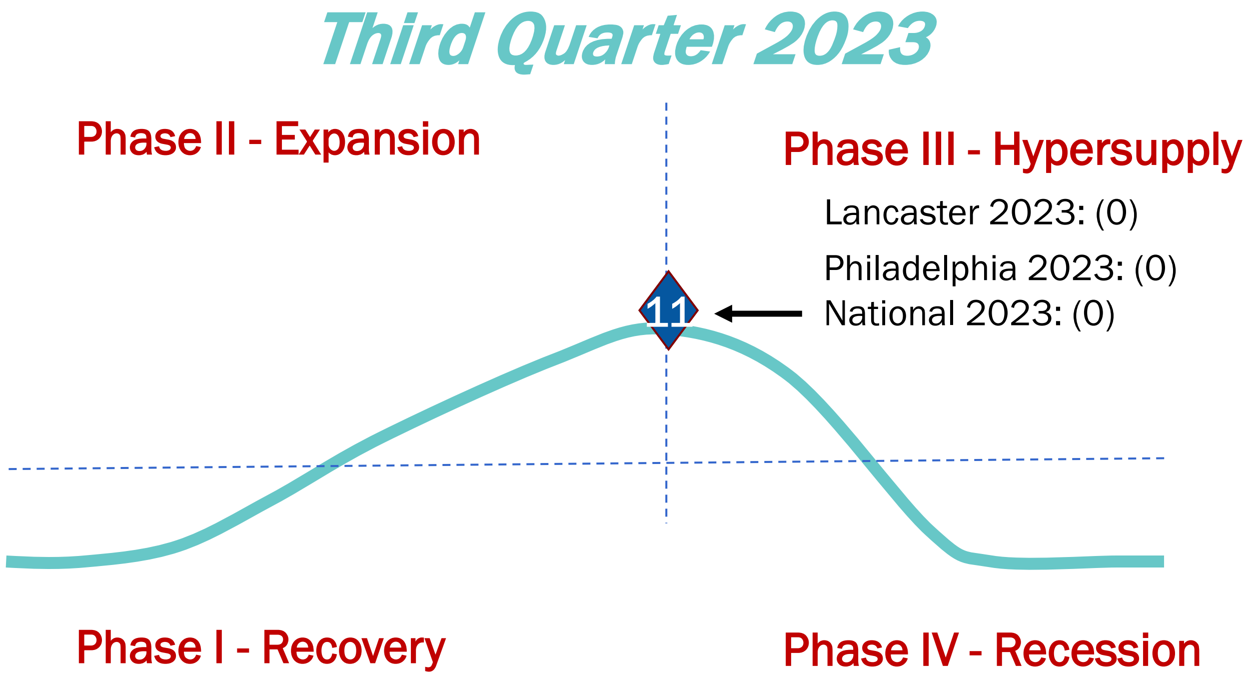

### YOY National Change

| | Actual 2023 | Projected 2024 |
|---|---|---|
| Occupancy | (0.7%) | (1.6%) |
| Rents | 0.6% | 0-3% |

Source: University of Denver – Real Estate Market Cycles; Lancaster: High Real Estate Group LLC; PWC; Urban Land Institute 2023; JLL; CBRE Research, Real Estate Market Outlook 2023, Marcus and Millichap

# Industrial

- Construction starts declined ~50%
  - Increased construction cost and interest rates
- Net absorption is down ~50%, vacancy rates are starting to increase
- Major drivers for location decisions:
  - Distance to major highway (trucking expense)
  - Availability of workforce
  - Workforce housing
- Trends to watch
  - Solar rooftops installation
  - Electric charging stations
  - Air conditioned warehouse
  - Fully robotic warehouse




**YOY National Change**

| | Actual 2022 | Projected 2023 |
|---|---|---|
| Occupancy | (0.6%) | (0.5%) |
| Rents | 4.6% | 8.0% |

Source: University of Denver – Real Estate Market Cycles; Lancaster: High Real Estate Group LLC; PWC; Urban Land Institute 2023; CBRE Research, Real Estate Market Outlook 3Q 2023, Marcus and Millichap

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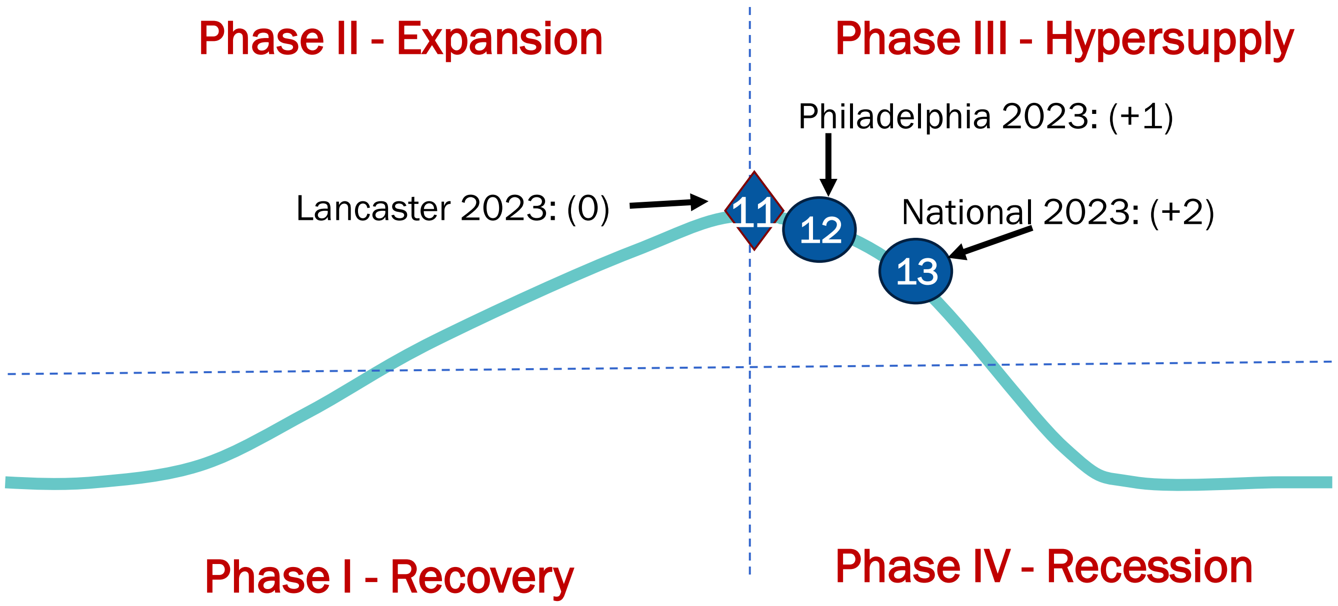
# Apartments

- Short term headwinds, long term demographics look strong
- Increasing % of renters that are housing cost burdened
- Rising interest/cap rates decrease values 15%-20% from 2022 peak
  - Rents flat/declining in over supplied markets
  - Insurance cost up 20%-30% but starting to level off
- Long terms trends are favorable
  - Population growth
  - Increased household formations
- Increased suburbanization

## Third Quarter 2023




### YOY National Change

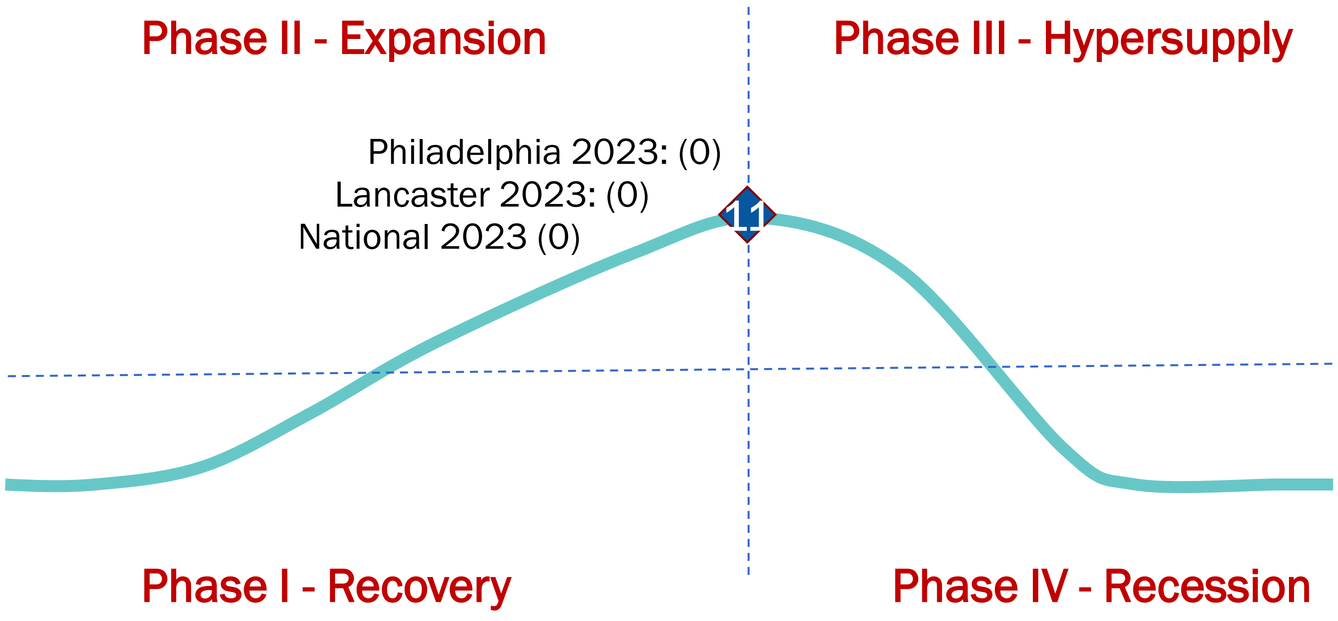
| | Actual 2023 | Projected 2024 |
|---|---|---|
| Occupancy | (1.1%) | (0.2%) |
| Rents | 0.9% | 2.4% |

Source: University of Denver – Real Estate Market Cycles; Lancaster: High Real Estate Group LLC; Urban Land Institute 2023; CoStar

# Retail

- Community/neighborhood centers have lowest vacancy rates in 20 years
  - Driven by strong consumer preference for convenience shopping
- Between 2021-23, 25M SF was added per year, down over 50% the previous decade average keeping supply down
- Suburban retail outperforms urban, as WFH impacts downtown demand
- 5,200 new stores opened, 3,200 closed in 2023
- Largest increase in investor appetite over all asset classes

## Third Quarter 2023




**YOY National Change**

| | Actual 2023 | Projected 2024 |
|---|---|---|
| Occupancy | 0.5%* | No change |
| Rents | 3.6% | 1.5% |

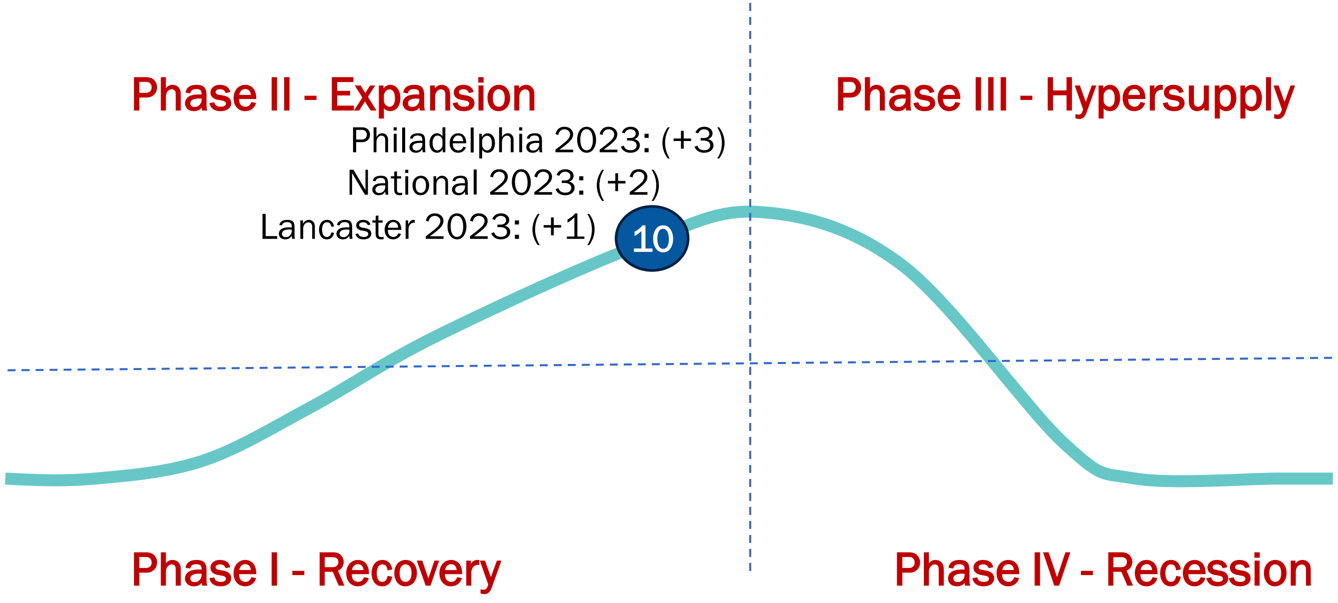
*New record high (per Denver Mueller)

Source: University of Denver – Real Estate Market Cycles Q32023; Lancaster: High Real Estate Group LLC; Land Institute 2023

# Select Service Hotel

- Leisure demand has plateaued, midweek group & business segments continue to recover
- Since March 2022, RevPAR has exceeded 2019 averages
- Destination and suburban hotel continue to outperform urban hotels
- Compensation pressures remain a leading challenge to a sustained recovery
- Select/limited-service hotels accounted for 80% of the sales in 2Q 2023

## *Third Quarter 2023*




**YOY National Change**

| | Actual 2023 | Projected 2024 |
|---|---|---|
| Occupancy | +0.5% | +1% |
| Rate | +4% | +3% |
| RevPAR | +5% | +4% |

Source: High Real Estate Group LLC, PWC Hospitality Directions November 2022, LARC Jan 2023 Forecast, AHLA Hotel Booking Index Survey- January 2023, CBRE State of the Union Dec 2022, Co-Star Question for Hotel Industry Jan 2023, Skift Blended Travel Comes of Age Jan 2023

# Michael Lorelli

Sr. Vice President
Commercial Asset Management
High Associates Ltd.

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# Methodology For Lancaster Market Research

- Research
  - Primary and Secondary sources (CoStar, MLS)
  - Owner occupied properties are excluded (e.g. Nordstrom and Americold)
- Office – Institutional-grade, for lease (259 buildings, over 5,000 SF, total 6.4M SF)
  - Lancaster City, Manheim Township, East Hempfield, and East Lampeter Townships
- Industrial – Institutional-grade, for lease (394 buildings, 26.1M SF)
  - Over 10,000 SF in size
  - Lancaster County



Source: High Real Estate Group

# Office: Lancaster – Stable Despite Uncertainty

- No new office construction delivered in 2023
- Two buildings planned for 2024 delivery
  - 1860 Oregon Pike, Lancaster
  - 35 Erick Road, Lancaster
- Occupancy relatively stable at 92.2% for Class A
- Class A & B experienced 2% rate growth in 2023
  - Class A $23-$29/SF Base Yr
  - Class B & BC $11-$17/SF N/N/N
  - 0% to 1% rent increase expected in 2024

Source: High Real Estate Group LLC; CoStar



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# Lancaster Trend Comparison: Net Absorption

| *In Thousands* | | 2019 | 2020 | 2021 | 2022 | 2023 | 5 Yr. Avg. |
|---|---|---|---|---|---|---|---|
| Class "A" Office | Absorption | 116.3 | (25.5) | 4.2 | 35.2 | 35.8 | 33.2 |
| | Vacancy | 5.5% | 7.6% | 7.1% | 7.5% | 4.9% | 6.5% |
| | Amount Constructed | 126.7 | - | - | 46.5 | - | 34.6 |
| | Available Supply | 71.5 | 97.0 | 92.8 | 104.1 | 68.3 | 86.7 |
| "B/C" Office | Absorption | 70.7 | (44.7) | (36.9) | (37.0) | (49.1) | (19.4) |
| | Vacancy | 3.2% | 4.3% | 4.7% | 5.6% | 6.8% | 4.9% |
| | Amount Constructed | - | - | - | - | - | - |
| | Available Supply | 116.5 | 161.2 | 198.0 | 235.1 | 284.2 | 199.0 |
| Business Center | Absorption | 105.5 | (12.1) | 11.3 | (44.5) | 37.3 | 19.5 |
| | Vacancy | 8.1% | 13.4% | 14.4% | 20.2% | 15.3% | 14.3% |
| | Amount Constructed | 32.0 | 25.5 | 34.5 | - | - | 18.4 |
| | Available Supply | 48.7 | 86.2 | 109.4 | 154.0 | 116.7 | 103 |

Source: High Real Estate Group LLC; CoStar



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# Industrial: Lancaster – Healthy Market Leasing Activity Remains Strong for <200,000 SF

- Three projects completed totaling 649,600 SF
  - 1010 Cornerstone Drive: 232,400 SF
  - 425 S. Muddy Creek Rd: 117,000 SF
  - 60 Industrial Road: 300,200 SF
- Four projects under construction totaling 821,500 SF
- Existing market rate increased 8% for industrial:
  - Existing space $7.50/SF NNN
  - New space $8.25-$9.00/SF NNN
- Market rate increased 4%-6% for flex, average $10.50/SF NNN

Source: High Real Estate Group LLC; CoStar



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# Lancaster Trend Comparison: Industrial Enters Fifth Strong Year

| | *In Thousands* | 2019 | 2020 | 2021 | 2022 | 2023 | 5 Yr. Avg. |
|---|---|---|---|---|---|---|---|
| Industrial Space | Absorption | 989.7 | 13.2 | 1,311.9 | 371.7 | (133.3) | 510.6 |
| | Vacancy | 5.2% | 6.6% | 2.7% | 2.4% | 5.5% | 4.5% |
| | Amount Constructed | 1,487.6 | 342.8 | 125.9 | 559.5 | 649.6 | 632.9 |
| | Available Supply | 1,268.6 | 1,598.1 | 412.2 | 600.0 | 1,382.9 | 1,052.2 |
| Flex Space | Absorption | 58.7 | 11.1 | (186.9) | 138.6 | (115.6) | -18.8 |
| | Vacancy | 1.4% | 0.7% | 9.8% | 2.7% | 9.8% | 4.9% |
| | Amount Constructed | - | - | - | - | 7.9 | 1.6 |
| | Available Supply | 23.6 | 12.5 | 199.4 | 60.8 | 184.3 | 96.1 |

Source: High Real Estate Group LLC; CoStar

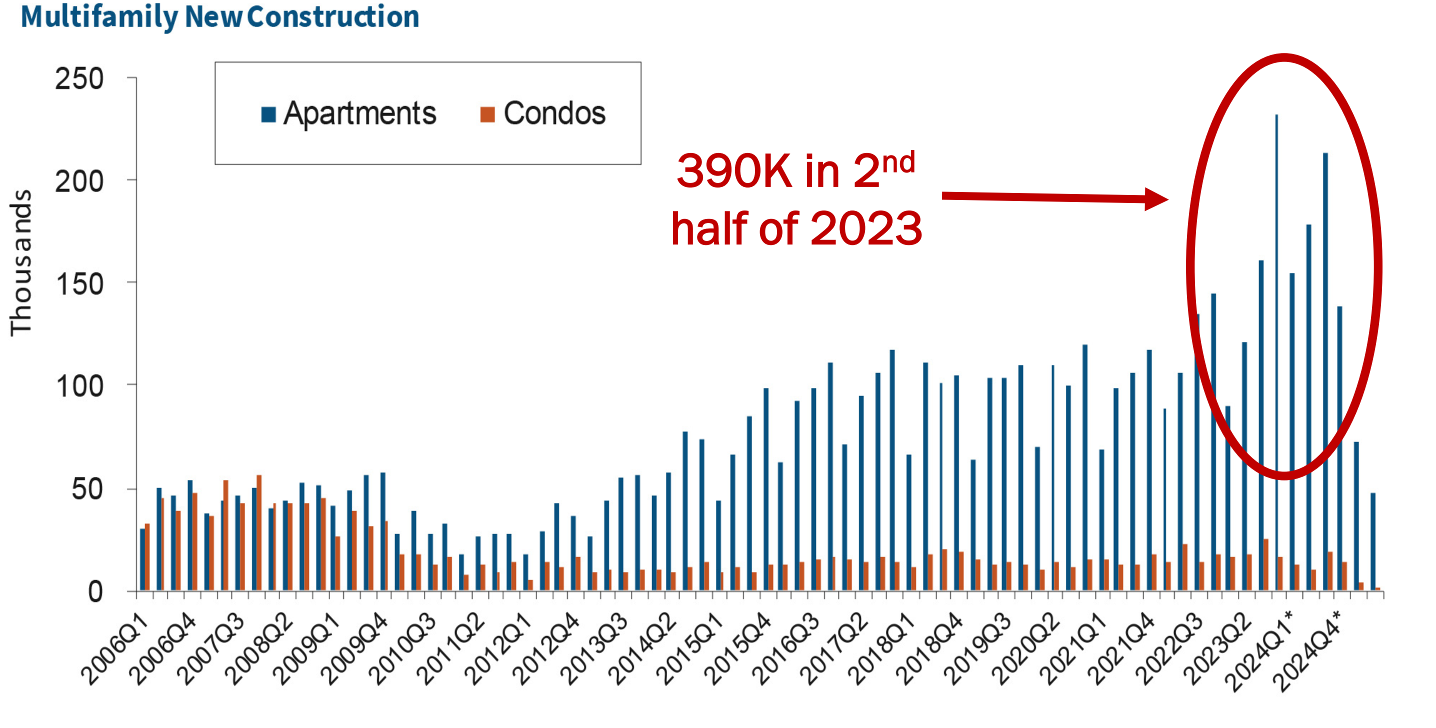
# Brad Mowbray

Sr. Vice President, Managing Director
Residential Division
High Associates Ltd.

# Near Term Headwinds for Multifamily

- US rent growth slowed more than projected in 2023, while Lancaster outperformed
- 736,000 new units expected to deliver in 2024, more than double historical average
- Owners focused on maintaining occupancy vs. rent growth until supply is absorbed
- Significant expense increases:
  - Labor cost – especially maintenance
  - Repair costs
  - Insurance

| YOY Rent Growth | | | |
|---|---|---|---|
| | ‘23 Proj. | ‘23 Act. | ‘24 Proj. |
| National | 1.7% | 0.9% | 2.4% |
| Lancaster, PA | 2.6% | 3.5% | 3.8% |

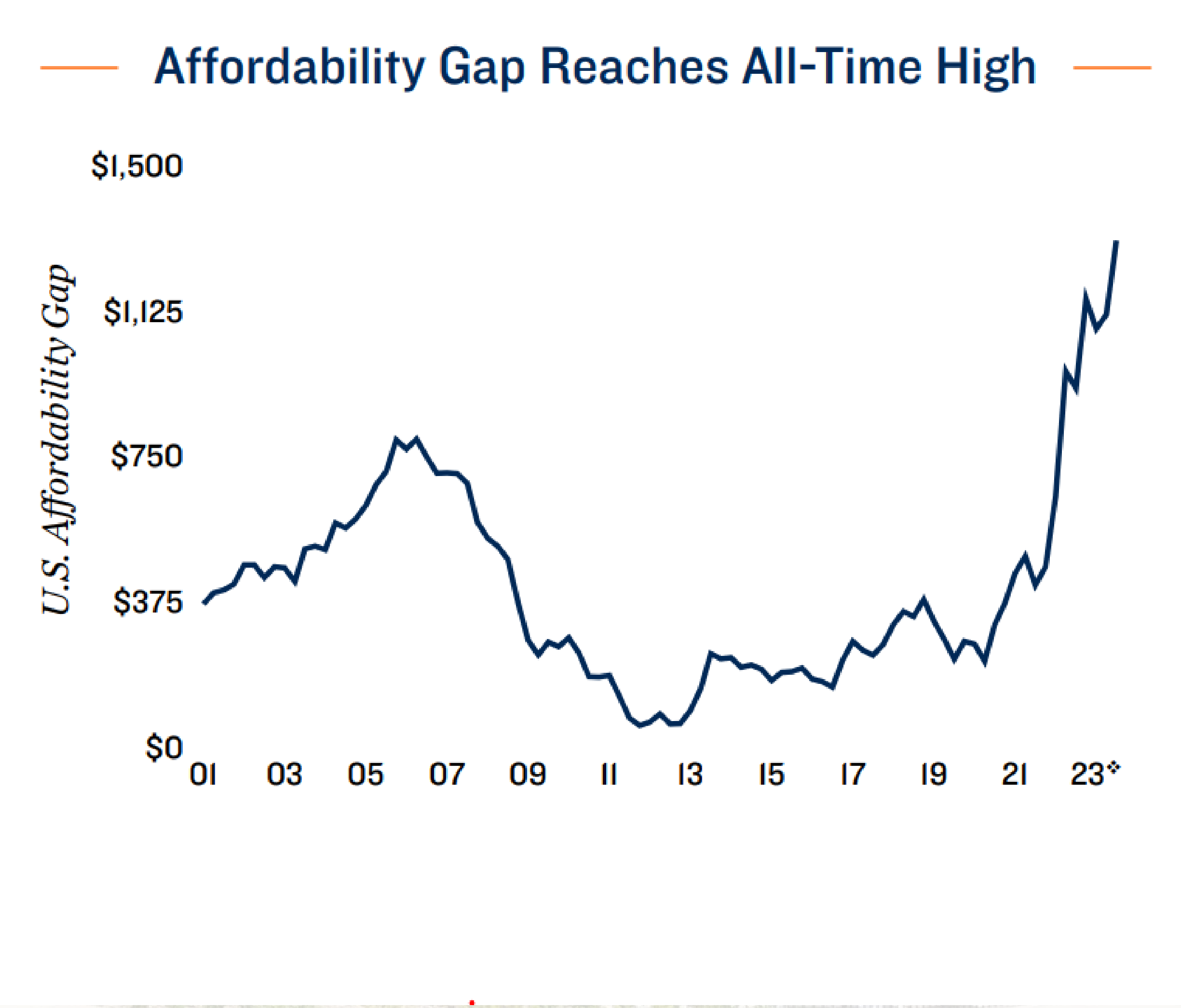



*NOTE: Supply Track data is not an actual forecast of activity, it is a monitor of activity reported on to-date. As more projects are planned and tracked, figures in future periods might go up.*

Source: Dodge Data & Analytics, CoStar, Fannie Mae

# Near Term Headwinds for Multifamily

- Affordability gap between cost of mortgage vs. net effective rent at highest point ever
- >42M households are cost burdened, up 4.9M since 2019
- U.S. household debt balances rose 1.3% to $17.3 trillion in 3Q ‘23, 4.8% higher than the previous year.
- Tax Cuts and Jobs Act (TCJA) expiring 12/2025




Source: Marcus & Millichap, Harvard Joint Center for Housing Studies



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# Powell Arms

Sr. Vice President, Managing Director
Retail Division
High Associates Ltd.

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# Open Air Retail – Crisis Tested and Still Thriving

- Return of Consumer to Bricks & Mortar
- Stability and Growth in Rent Roll
  - Positive Absorption
  - Backfill of failed concepts at substantially accretive marginal returns
    - Our region: Kmart, Bed Bath and Beyond, Christmas Tree Shops all backfilled
- Investor Appetite Increasing
  - Cap Rate Stability
- Supply and Demand Remains in Balance
  - Consumer Trends and Debt Burden
  - Underwriting Criteria: new development versus redevelopment

Source: Coresight Research; High Real Estate Group; placer.ai; Urban Land Institute



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# Questions