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RealEstateMatters

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C&I Council: *2024 Real Estate Outlook*

Following are selected highlights of remarks by Mark Fitzgerald and the High Real Estate Group leadership team to the Lancaster Commercial & Industrial Real Estate Council at their 38th annual meeting in February 2024. You can download the slide presentation here: https://bit.ly/3UHpAgg or by visiting highassociates.com and clicking on "News" in the top navigation bar.

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Exploring the Strength of Retail Investment Appetite

By: Powell Arms – Senior Vice President & Managing Director – Retail Division, High Associates Ltd.

As part of this year's Commercial & Industrial Real Estate Council discussion, we looked at changes in capitalization rates (the rate of return that an investor anticipates from a real estate investment) across commercial asset classes in the last twelve months. All asset classes have seen a decline in transaction volume year over year. However, unlike all other asset classes, cap rates for grocery-anchored retail centers have remained largely unchanged. This steadiness of cap rates for grocery-anchored retail while treasury rates increased demonstrates that investors are now willing to accept a lower return premium than they would have a year ago, which generally means the investments are viewed as less risky. Let's take a look at some factors that are contributing to this trend.

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President's Message

Thank you to everyone who attended this year's Lancaster Commercial and Industrial Real Estate (C&I) Council meeting. For those who were unable to make it or are interested in learning more, please visit https://bit.ly/3UHpAgg to download the slides.

In this issue of Real Estate Matters, we cover the essence of my remarks at the meeting and those of our asset class leaders. Together, we explore what lies ahead for the economic recovery and how it specifically impacts each asset class. The last four years have left their mark, but amidst all the change, the real estate markets stand resilient and poised for growth.

One other exciting development from 2023 was our December announcement that High Real Estate Group joined High Industries in its ownership transition to High Foundation. This innovative ownership structure will allow us to direct dividends from our real estate holdings directly to High Foundation, supporting important initiatives for social and environmental impact in the Lancaster community. The shift in ownership embodies The High Philosophy, a legacy of trust and innovation spanning three generations. We are proud to be a part of this new structure and look forward to contributing to the betterment of our community.

I look forward to seeing what lies ahead for the remainder of 2024.

Mark

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Exploring the Strength of Retail Investment Appetite continued from page 1

Consumer Behavior Shifts in Retail Post-Pandemic

The retail landscape witnessed significant changes during and after the pandemic. Consumers, who were initially confined to online shopping, are now returning to brick-and-mortar stores. According to the Cumming Group's 2023 Market Analysis Recap, a remarkable 82% of sales now originate from physical retail locations, while online sales have declined from their peak levels in 2020. Notably, even digital native brands like Warby Parker are recognizing this trend and actively expanding their presence in physical stores.

This consumer-driven appetite for brick-and-mortar shopping has led to several positive outcomes for landlords:

1. **Higher Absorption:** Retail spaces are being absorbed at an accelerated rate due to increased foot traffic and consumer activity within physical stores.
2. **Lower Vacancy:** The national vacancy rate has plummeted to 4.3%, the lowest since CBRE began measuring 18 years ago.
3. **Higher Rents:** According to Cushman & Wakefield, starting rents have reachedtheir highest levels since 2007.
4. **More Store Openings:** In 2023, slightly more than 1,000 stores opened than closed, according to Coresight research.

These improvements are fueled by the consumer's preference for an in-store shopping experience. As a result, the supply and demand balance has tilted a bit to the landlord, with moderation, as we will describe below.

Enhancing Rent Stability in Retail Centers

These combined factors have greatly increased the stability of the rent roll – the revenue generated by a retail center – and have a direct impact on the income stream of the property. Retail leases typically span 5 to 10+ years, providing a consistent and

predictable cash flow. As a result, retail centers benefit from increased financial stability, making them attractive invest-ments for those seeking steady returns.

The dependable income stability offered by typical grocery-anchored centers is attracting investors who once hesitated due to the "retail apocalypse"— a period marked by the surge of online shopping during the 2010s. Investors adopting a portfolio strategy in commercial real estate must consider not only the steady income stream from retail assets but also the need to rebalance their portfolios. As multi-family and industrial values experience slight declines, and office values decline more significantly, the balance shifts. The grocery-anchored sector remains resilient, offering a beacon of stability in an ever-evolving market.

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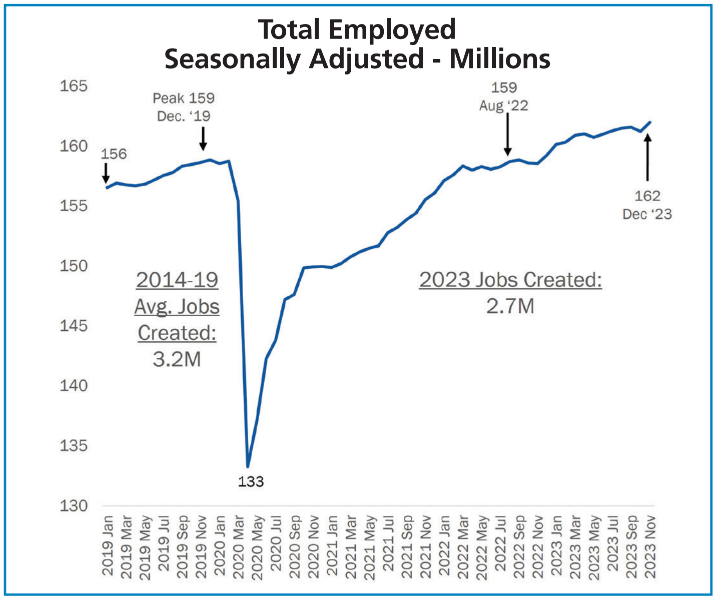
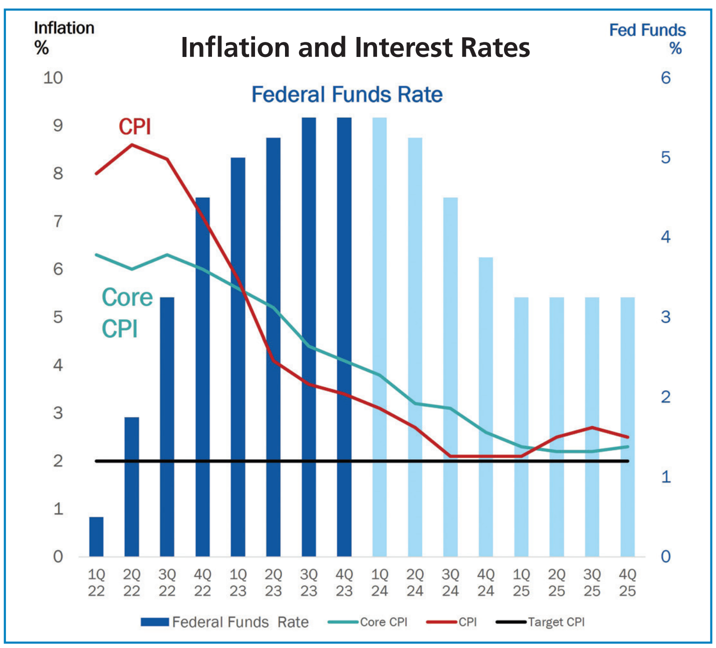


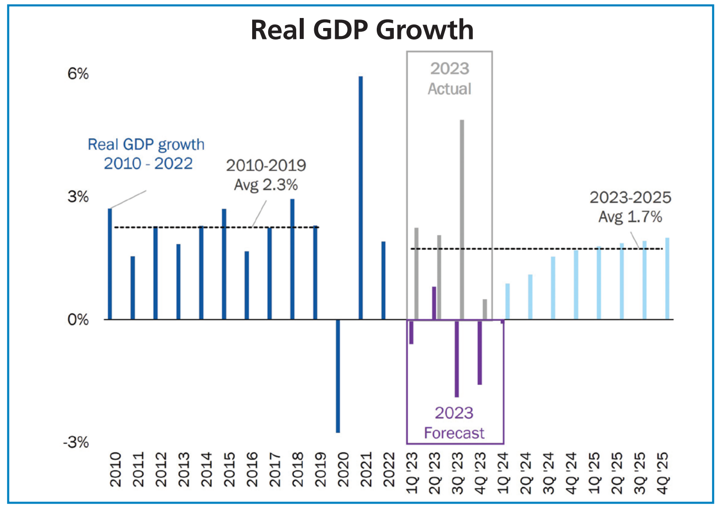
Source: US Bureau of Labor Statistics

Employment Trends – There were strong employment gains across most sectors in 2023. Leisure and hospitality, government, and other services turned positive. During the 2023 calendar year, there were 2.7 million jobs created, lower than the five-year average of 3.2 million leading up to the pandemic.



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

Inflation and Interest Rates – Since the start of the pandemic, over, $6 trillion was pumped into the economy, causing significant inflation. Of the $6 trillion, nearly $2 trillion is left to be spent. In March 2023, the federal funds rate went up to 5.5% where it remains today. Inflation was 3.3% year over year for 2023 and was running at 3.1% year over year in January 2024. It is expected to continue declining throughout 2024 but is not expected to hit the Fed's 2% target.



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

GDP Projections – Consumers continue to drive gross domestic product (GDP). In 2023, the GDP growth outperformed the forecast of less than 1% showing the disconnect between what happened and what the Feds anticipated would happen. This time last year, 61% of economists surveyed by the Wall Street Journal projected a recession in the next 12 months. Today, only 39% project a recession in the next 12 months.

Real Estate Investment Sentiment – National sentiment for industrial and multi-family remains relatively strong. Office had a significant reduction, while retail saw modest improvement. Development saw positive movement in the hospitality and retail space; however, high interest rates and construction costs make it difficult to justify new construction. We are optimistic about 2024 when we expect to see more new products enter the market.

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

Source: PWC Real Estate Investor Survey 3Q 2023

Cap Rate Trends – Cap rates increased on all property types except retail, where they went down slightly. Increases averaged 40-50 basis points. Additionally, debt and equity underwriting are becoming more restrictive. With all the uncertainty in the market, lenders are becoming more conservative as they continue to get comfortable with current interest rates.

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Lancaster Market – *Key Observations by Asset Class*

Office and Industrial

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Office – No new office projects were completed in 2023. There are two buildings planned for delivery in 2024. Class A occupancy is relatively stable at 92.2%. Class A & B experienced a 2% rate growth in 2023. Rent is expected to increase by 0% - 1% in 2024. Class A space is renting between $23 to $29 per square foot and Class B & C are renting between $11 to $17 per square foot. Net absorption for Class A space was 35,800 square feet, and vacancy rates decreased from 7.5%. to 4.9%. Class B & C office space had negative absorption of 49,100 square feet and vacancy increased from 5.6% to 6.8%. Business centers went from a negative absorption of 44,500 square feet in 2022 to a positive absorption of 37,300 square feet in 2023 and a vacancy rate of 15.3%.

Industrial – Three new projects were completed, adding 649,600 square feet to the market, bringing current available space to 1,382,900 square feet. Four projects are under construction, totaling 821,500 square feet. For industrial space, there was a negative absorption of 133,300 square feet in 2023. Vacancy increased from 2.4% to 5.5% and rents saw an 8% average increase. New product is being marketed from $8.25 to $9.00 a square foot. Flex space is leasing at $10.50 a square foot, a 4-6% increase. Flex had a negative absorption of 115,600 square feet.

Multi-Family

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In 2023, rent growth in the U.S. slowed more than projected, while Lancaster outperformed. Lancaster's growth was 3.5% last year and is forecasted to increase by 3.8% this year. Currently, there are 736,000 new units that are expected to deliver nationwide in 2024, more than double the historical average. Locally, there are 20 new projects, with a total of 4,000 units proposed and being planned. Owners are focused on maintaining occupancy versus rent growth until the supply is absorbed. Meanwhile, the affordability gap between the cost of a mortgage versus net effective rent is at its highest point ever. More than 42 million households are cost-burdened, up 4.9 million since 2019. At the same time, national rental rates went up 0.9% in 2023 and are projected to increase by 2.4% in 2024. Availability of workforce housing is limited, and there is an immediate need to provide quality workforce housing – both locally and nationally.

Retail

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Driven by a strong consumer preference for convenience shopping, community/neighborhood centers have the lowest vacancy rates in 20 years. Suburban outperforms urban retail as downtown demand is impacted by employees continuing to work from home. In 2023, there were 2,000 more new stores that opened than closed. Rent went up 3.6% in 2023, and 2024 is expected to see a projected increase of 1.5%. In 2023, retail saw the largest increase in investor appetite over all asset classes.

Navigating Construction Trends in Pennsylvania: Challenges and Opportunities

By: Rich Pagano, Vice President of Business Development, High Construction Company

In 2024, the construction markets in Central and Southeast Pennsylvania are adapting to a dynamic environment influenced by both short-term challenges and long-term demographic shifts. The multi-family market, for example, is experiencing headwinds due to increased construction costs, higher interest rates, and more stringent lending requirements. However, these challenges occur within the context of favorable long-term trends that are anticipated to drive a rebound in this sector.

During 2023, numerous shovel-ready multi-family projects were put on hold, awaiting more favorable conditions. As the economy stabilizes and inflationary pressures ease, these projects are expected to move forward, playing a crucial role in revitalizing the multi-family market. With this anticipated, High Construction is actively preparing its team and trade partners to be ready for rapid mobilizations.

In contrast to multi-family, the hospitality market in Southeast Pennsylvania is experiencing significant activity in the first quarter of 2024. This growth is primarily fueled by suburban and dual-brand hotels. The increased demand can be attributed to several factors, including multi-year delays on new vertical projects, as well as the changing dynamics of business travel due to workplace trends, the rise in remote work, and other post-COVID lifestyle changes.

On the industrial and manufacturing front, Southeast Pennsylvania is experiencing a mix of challenges and opportunities. Increased construction costs and higher interest rates have tempered the number of construction projects starting compared to the highs of 2023. However, strong demand fueled by the continued expansion of e-commerce is expected to continue driving robust growth in 2024.

Although our regional construction market faces short-term challenges, there are encouraging signs of recovery and growth in key sectors. The multi-family sector is poised for a rebound, supported by long-term demographic trends. The hospitality market experiences growth due to changing travel patterns, and the industrial and manufacturing sector thrives despite cost pressures. These dynamics paint an optimistic picture for the future of our construction industry.

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PEEPS® Sweet Suite

To celebrate the Easter season, our newest hotel the Home2 Suites by Hilton in Easton, PA teamed up with PEEPS® to transform one of its rooms into a magical wonderland full of PEEPSONALITY!

The PEEPS® Sweet Suite was open for a limited number of stays leading up to the Easter holiday, and guests were thrilled to see playful PEEPS® decorations, pillows, plushies, toys, and of course, the famous marshmallow treats.

The PEEPS® factory was just a bunny's hop away from the hotel, and guests were given the chance to experience a V.I.PEEP tour of Just Born's headquarters in Bethlehem, PA. They got to taste freshly hatched PEEPS® Marshmallows and snag photo ops, including the possibility of seeing the iconic PEEPSMOBILE® or PEEPS® Chick mascot!

It was truly an unforgettable experience for all.

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Scan the QR code to take the survey now!
If you have any questions or concerns, reach out via email to **marketing@high.net.**

Thank you in advance for your participation!
We eagerly await your thoughts and ideas.

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