THE IMPACTS OF COVID-19 ON REAL ESTATE

Prepared for:

Chapter 13 – Buckeye Chapter

MAY 11, 2021

CBRE

AGENDA

- INTRO
- MACRO
- OFFICE
- RETAIL
- INDUSTRIAL/ LOGISTICS
- MULTIFAMILY
- HOTELS
- CONSTRUCTION COSTS
- RECAP

INTRODUCTION

A LITTLE ABOUT ME & CBRE

CBRE

KYLE N. DRISCOLL, MAI
DIRECTOR – MIDWEST & NORTHEAST, RIGHT OF WAY PRACTICE LEADER

EXPERIENCE, AFFILIATIONS & ACCREDITATIONS

- APPRAISING FOR 14
- MAI DESIGNATED MEMBER
- IRWA – PRESIDENT-ELECT (TERM STARTS AT THE END OF THIS MONTH)
- RIGHT OF WAY CONSULTANTS COUNCIL, BOARD MEMBER
- CANDIDATE FOR R/W-AC THROUGH IRWA
- YOUNG PROFESSIONAL OF THE YEAR FINALIST – NATIONAL LEVEL 2017
- COMPLETION OF THE LITIGATION PROFESSIONAL DEVELOPMENT PROGRAM

VALUATION & ADVISORY SERVICES

Valuation Services

- Appraisal Reports
- Alternative Valuations (Evaluations)
- Valuation for Financial Reporting
- Partial Interest Valuations
- Litigation Support/Testimony
- Right of Way/Eminent Domain
- Debt & Loan Valuations
- Valuation Portfolio Services

Advisory Services

- Consulting/Advisory Reports
- Feasibility Studies
- Market Studies
- Property & Transaction Tax Services
- Due Diligence
- Asset Performance Benchmarking
- Fund Analytics

VALUATION & ADVISORY SERVICES | RIGHT-OF-WAY

CBRE'S RIGHT-OF-WAY VALUATION GROUP IS COMPRISED OF NATIONALLY RECOGNIZED EXPERTS WITH NOTABLE APPRAISAL EXPERIENCE

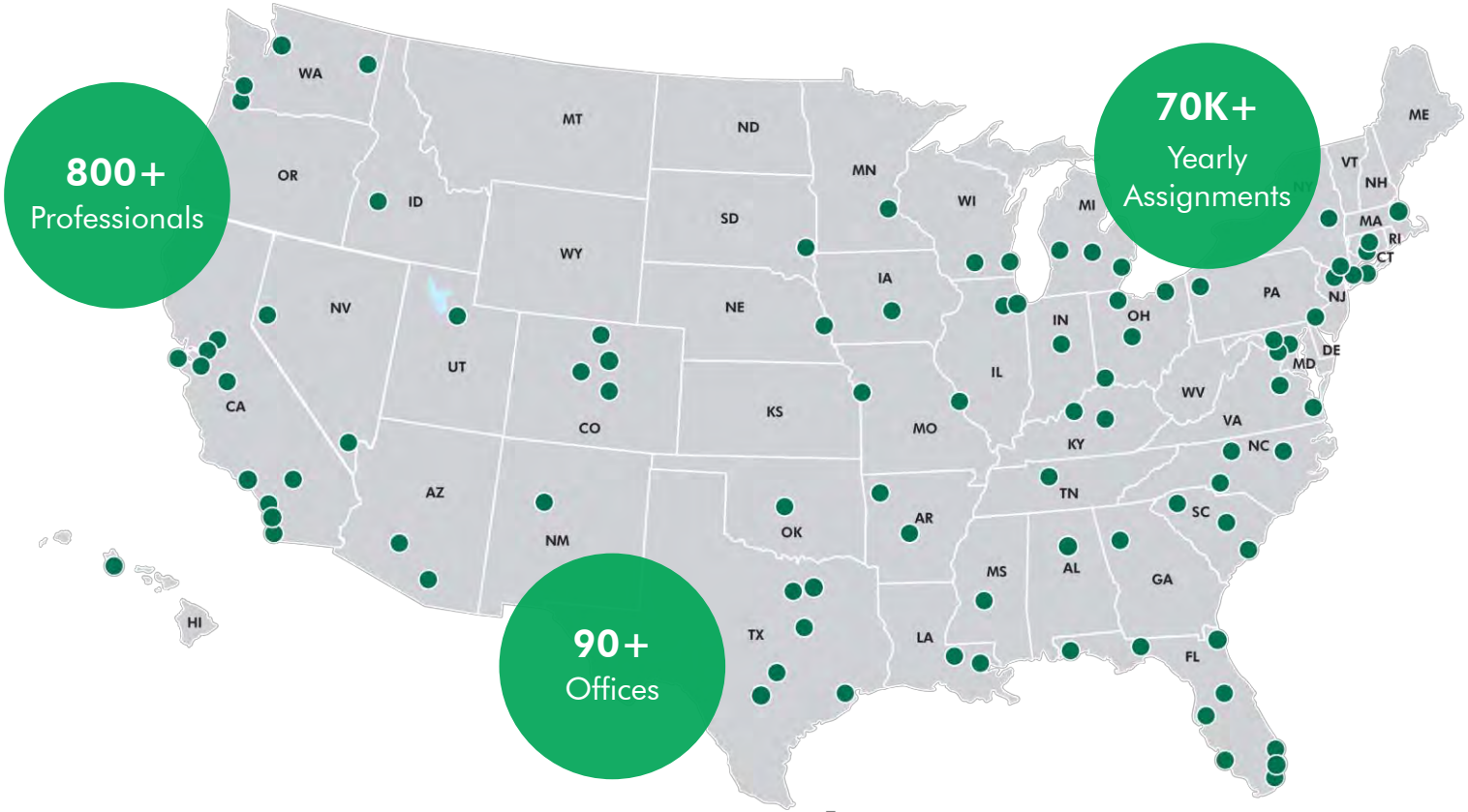
OUR RIGHT-OF-WAY SPECIALTY TEAM PROVIDES A VARIETY OF SERVICES, INCLUDING

- MARKET DATA AND IMPACT STUDIES
- APPRAISAL FOR EASEMENT AND FEE ACQUISITIONS
- PRETRIAL & LITIGATION SUPPORT
- EXPERT WITNESS TESTIMONY
- RIGHT-OF-WAY APPRAISAL REVIEW AND ALL OTHER
- RELATED VALUATION SERVICES

OUR APPRAISERS HAVE BUILT A RECORD OF SERVICING AN ARRAY OF INDUSTRIES, INCLUDING

- OIL & GAS PIPELINE
- ELECTRICAL TRANSMISSION
- UTILITIES
- TRANSPORTATION & PUBLIC WORKS
- MUNICIPALITIES

UNMATCHED NATIONAL REACH | U.S. VALUATION LOCATIONS



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MARKET ANALYSIS - MACROECONOMIC

A BRIEF OVERVIEW OF THE OBSERVED AND ANTICIPATED IMPACTS OF COVID-19 FROM A MACROECONOMIC PERSPECTIVE

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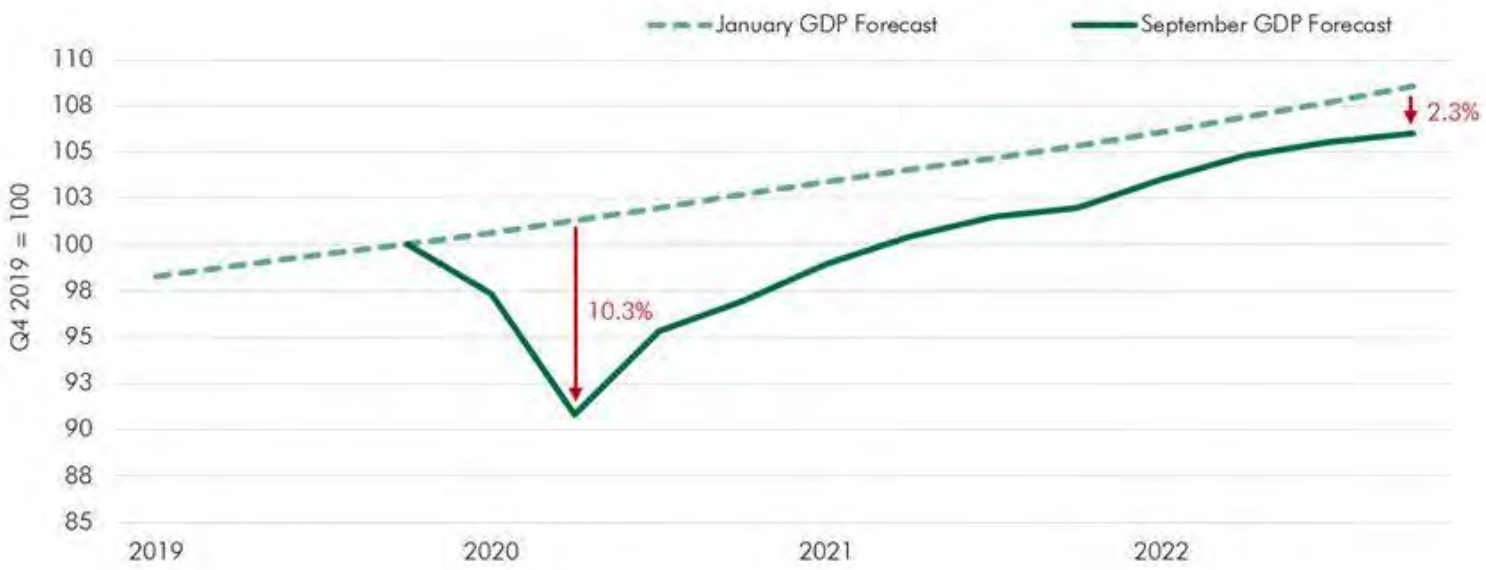
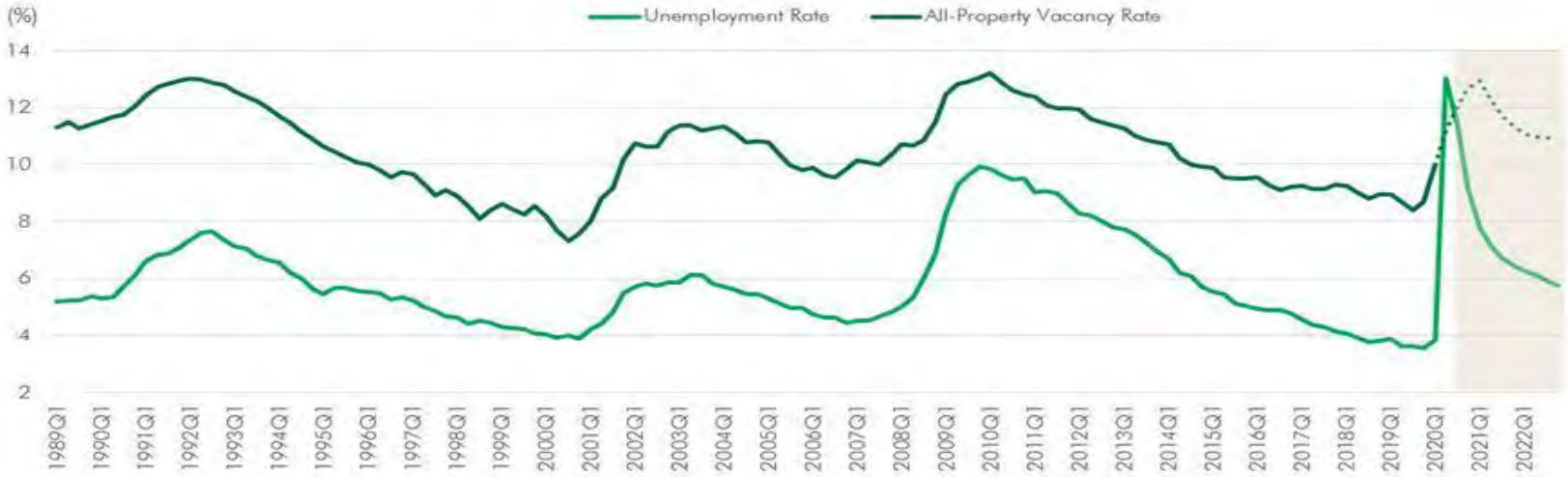
COVID-19 WILL HAVE A PERMANENT IMPACT ON GLOBAL GDP



Source: CBRE House-View, Oxford Economics, September 2020.

UNEMPLOYMENT IS HIGHLY CORRELATED WITH VACANCY

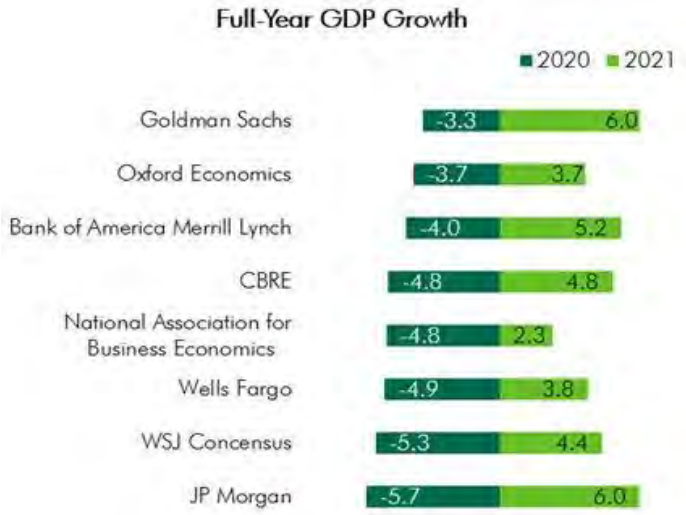
U.S. UNEMPLOYMENT RATE AND ALL-PROPERTY VACANCY RATE

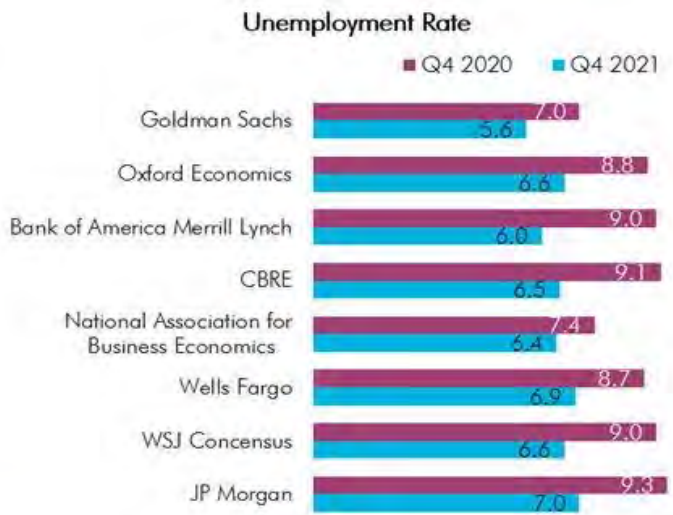


Source: CBRE Econometric Advisors, CBRE House-View, Q3 2020.

U.S. ECONOMIC FORECASTS COMPARED

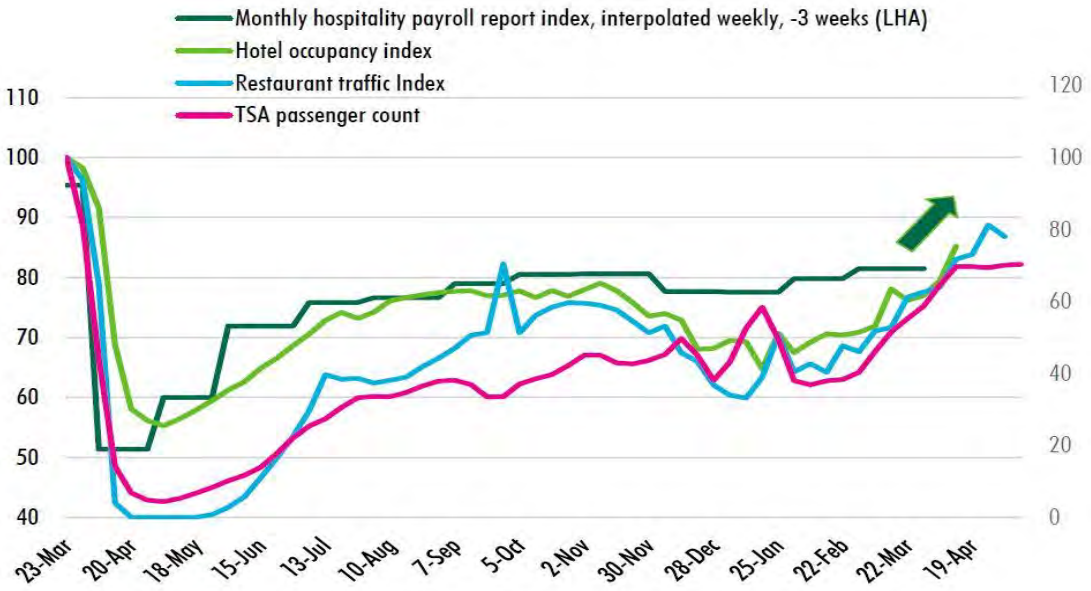
REAL GDP GROWTH AND UNEMPLOYMENT RATE (%)



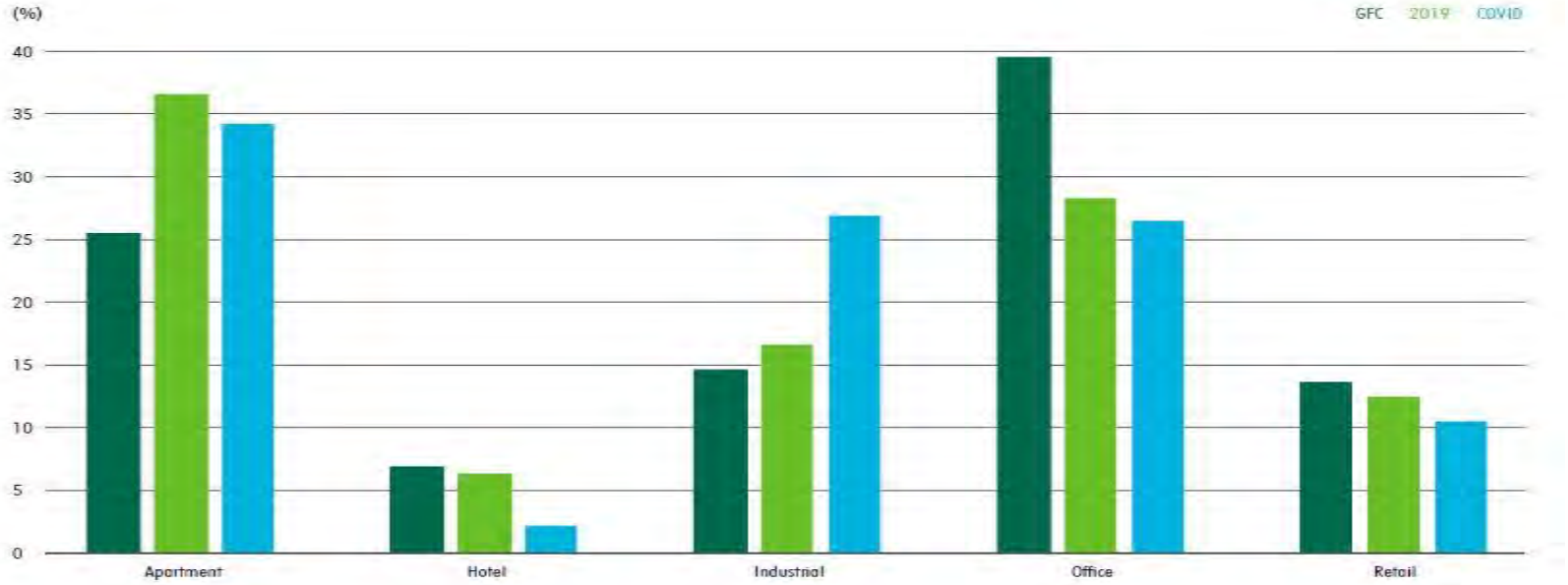


PRE-PANDEMIC UNEMPLOYMENT = UNDER 4%; CURRENT UNEMPLOYMENT = ABOUT 6%

TOTAL EMPLOYMENT AND HOSPITALITY ACTIVITY INDEX, MARCH 1ST, 2020, = 1



INVESTOR PREFERENCES HAVE SHIFTED



Note: Proportion of investment by property type during Global Financial Crisis (GFC), 2019 and COVID-19 era.
Source: CBRE Research, Real Capital Analytics, Q3 2020.

CAP RATES FOR MAJOR PROPERTY TYPES IN THE U.S

Source: CBRE Econometric Advisors, Q3 2020.

KEY TAKEAWAYS & OBSERVATIONS

- Market participants were expecting a rebound between the second half of 2020 and first half of 2021. However, due to increased cases following initial reopening efforts in Q2 2020, the US economy lost some momentum, resulting in a potential prolonged recovery timeline. Given current state of vaccinations, the commercial real estate market will begin to normalize mid-late 2021.
- Pace of the recovery will depend in large part on containment of the pandemic, vaccinations, mandated restrictions and policy responses.
- Unemployment has continued to improve from its April 2020 highs, however, there still is a gap between current and pre-pandemic levels.
- Fiscal and monetary supply for the economy have been unprecedented and, together with pent-up demand, are expected to enable a relatively sustained return to normalcy once health-oriented concerns are alleviated. If a second wave of the virus can be managed effectively, high rates of growth can be expected in 2021.
- A "V" shaped recovery is broadly anticipated for the broad economy, whereas real estate is likely to lag somewhat with a “swoosh” shaped recovery expected. There will be short term disruptions that will impact rent collections, near-term vacancies, rent growth, and lease-up across most property types.
- As the economy continues to recover, so does the overall demand for real estate. Long-term technological and demographic trends, such as digitalization, will change investor preference and push the industry to evolve, but investment opportunities and capital for real estate will remain.

MARKET ANALYSIS - OFFICE

COVID-19 IMPACTS

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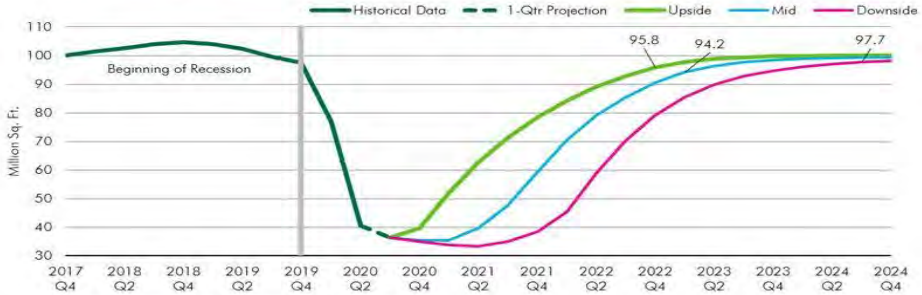
OFFICE DOWNTURN TO STABILIZE IN 2021

U.S. OFFICE LEASING VOLUME MORE "U" THAN SWOOSH?

U.S. office leasing volume – three scenarios



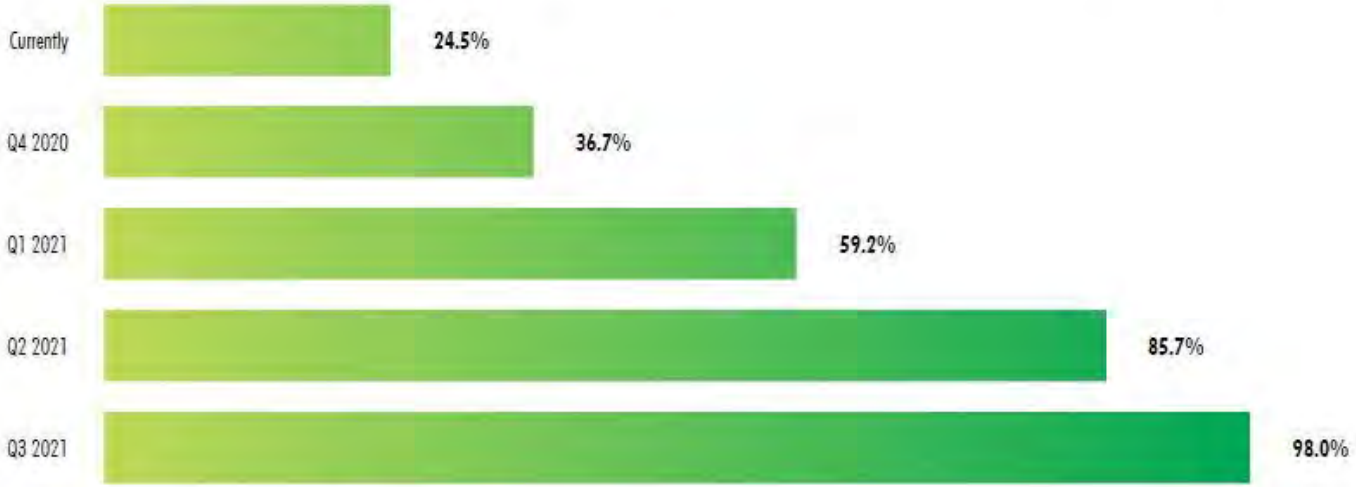
Note 1: Indexed from 2 years before the presumed start of the recession.
Note 2: Historical data has been normalized through noise reduction.
Source: CBRE Research, CoStar, Q3 2020.

FIGURE 8: U.S. OFFICE MARKET RENT FORECAST (Y-O-Y CHANGE)

Source: CBRE Econometric Advisors, Q3 2020.

IMPACT OF REMOTE WORKING ON SPACE DEMAND

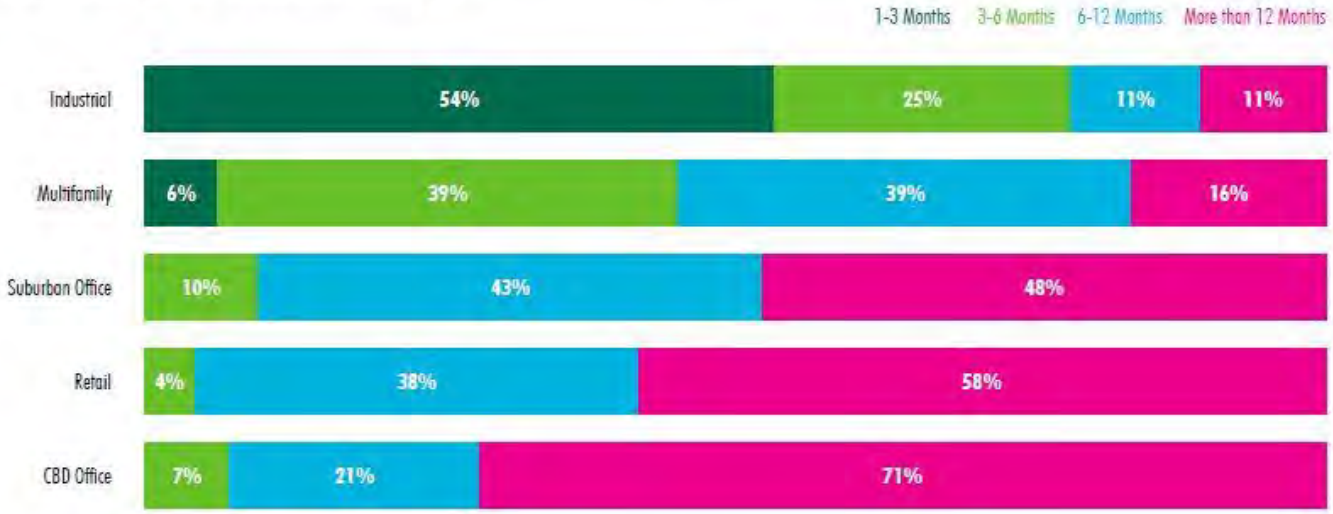
FIGURE 9: OFFICE RE-ENTRY PLANS BY % OF RESPONDENTS – LIKELIHOOD OF RETURNING TO THE OFFICE IN THE NEAR TERM



Note: Respondents who said they'd return to the office. Excludes responses of "unsure".
Source: CBRE Occupier Sentiment Survey, September 2020.

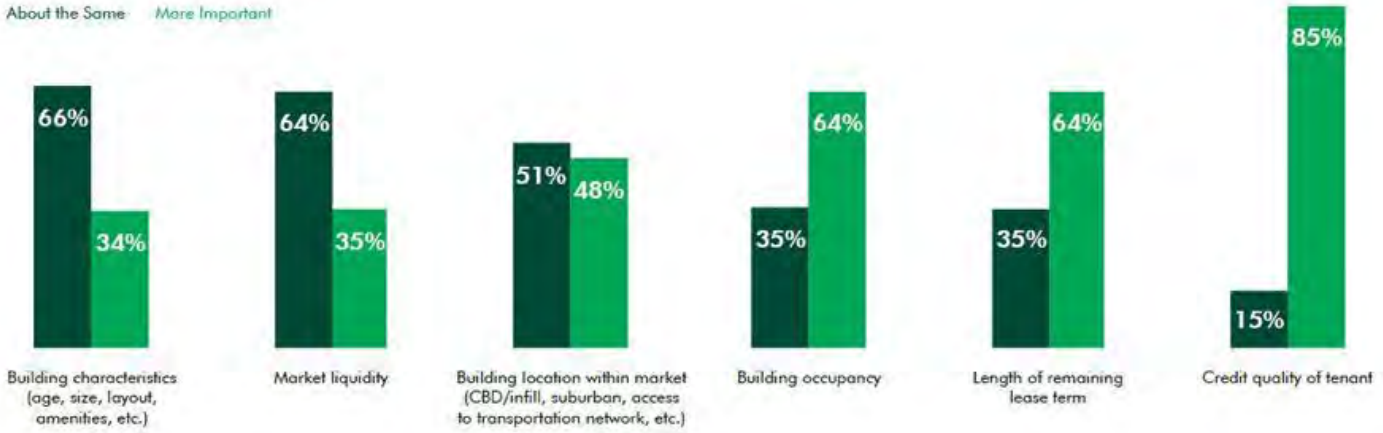
UNCERTAIN SPACE DEMAND WILL CAUSE LESS INVESTMENT

FIGURE 10: SURVEY QUESTION: HOW LONG DO YOU THINK IT WILL BE BEFORE INVESTMENT ACTIVITY RETURNS TO PRE-PANDEMIC LEVELS?



Note: Cap Rate Survey Special Report Q3 2020 conducted during August 2020.
Source: CBRE Research, September 2020.

FACTORS IN INVESTOR BUYING DECISIONS



Note: Survey conducted during August 2020. For factors where shares do not total 100%, <1% of respondents indicated that it was less important than in Q1 2020.
Source: CBRE Research, September 2020.

KEY TAKEAWAYS & OBSERVATIONS

- Repricing on office deals nationally varied significantly depending on profile, participants' motivations and stage of the sale process when COVID began impacting the market more significantly in March 2020. A general range of 0-15% has been observed among national data points and in discussions with market participants, with most deals that were repriced having been completed with adjustments of 3% to 10%.
- Sellers who do not have pressure to sell are largely taking a "wait it out" approach as opposed to selling at a significant perceived discount.
- Core assets and core market are expected to outperform ("flight to quality" for investors) whereas transitional (non-stabilized, value-add) and riskier assets are the most impacted. Class A space will like rebound quicker.
- Assets with significant remaining term and credit tenancy would be expected to see the smallest impact.
- Leasing is largely in a holding pattern with tenants putting deals on hold. Tenants do not want to commit amid uncertainty and have generally just hit the pause button, rather than repricing or asking for concessions/discounts at this time.
- Deals getting done must have some "catalyst" to spur activity; in most cases this is an upcoming lease expiration.
- A large share of recent leasing activity has been short-term renewals that are mutually agreeable to tenants seeking to delay decision-making on long-term commitments and landlords eager to maintain occupancy/cash flow on occupied spaces with significantly diminished near-term prospects to backfill new vacancies.

KEY TAKEAWAYS & OBSERVATIONS

- Most are anticipating slowed/flat rent growth in the near term (12-36 months depending on market and property/user profile), with full and widespread recovery to pre-COVID levels not projected until at least 2022.

MARKET ANALYSIS - RETAIL

COVID-19 IMPACTS

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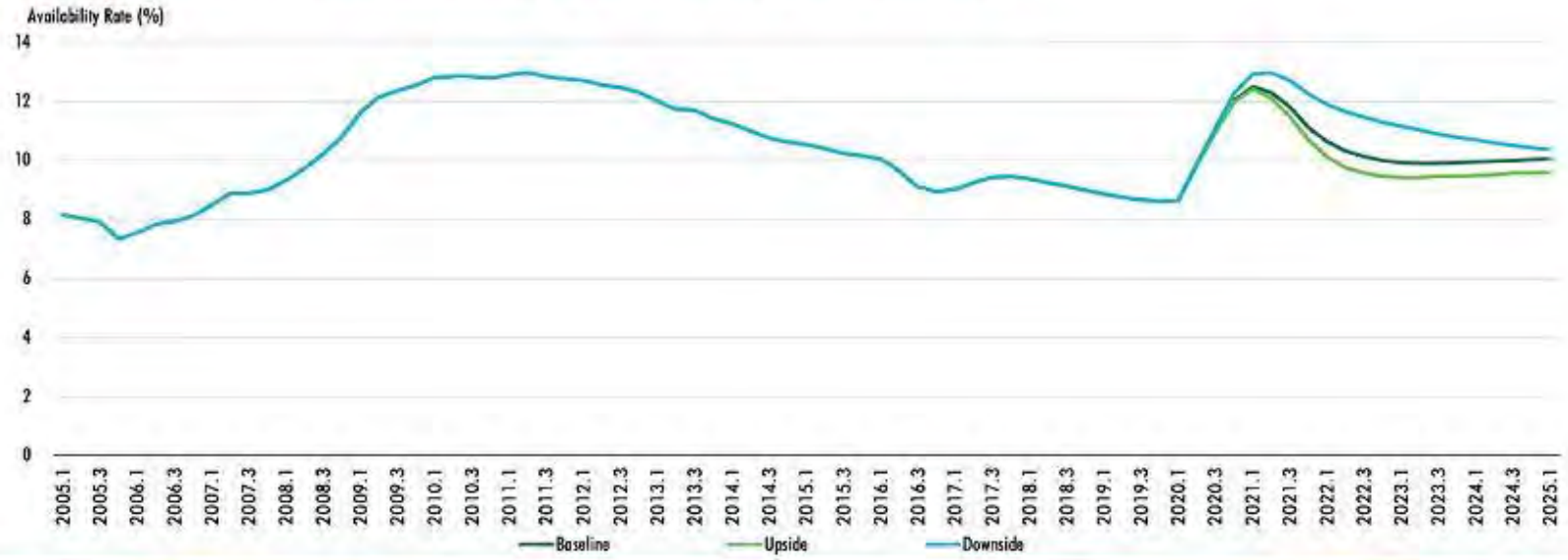
REVERSAL OF RECORD E-COMMERCE GROWTH

Source: CBRE Research, U.S. Census Bureau, September 2020.

BANKRUPTCIES & STORE CLOSURES AND THE PENDING ADAPTIVE REUSE/CONVERSION OF CLASS B & C

FIGURE 3: Forecasted Availability Rate for Different Scenarios



KEY TAKEAWAYS & OBSERVATIONS

- Brick-and-mortar retail sales are expected to grow in 2021 as e-commerce sales decline after the 2020 COVID-fueled surge.
- New opportunistic and emerging retailers will capitalize on market conditions to absorb some of the vacancies from bankrupt retailers and store closures
- Adaptive reuse and conversion will drive the repositioning of Class B and C Malls, which have been hardest hit by COVID restrictions.
- Private Capital will lead to investment activity as institutional investors largely retreat from non-core assets and urban markets that face a significantly longer recovery.

MARKET ANALYSIS – INDUSTRIAL/LOGISTICS

COVID-19 IMPACTS

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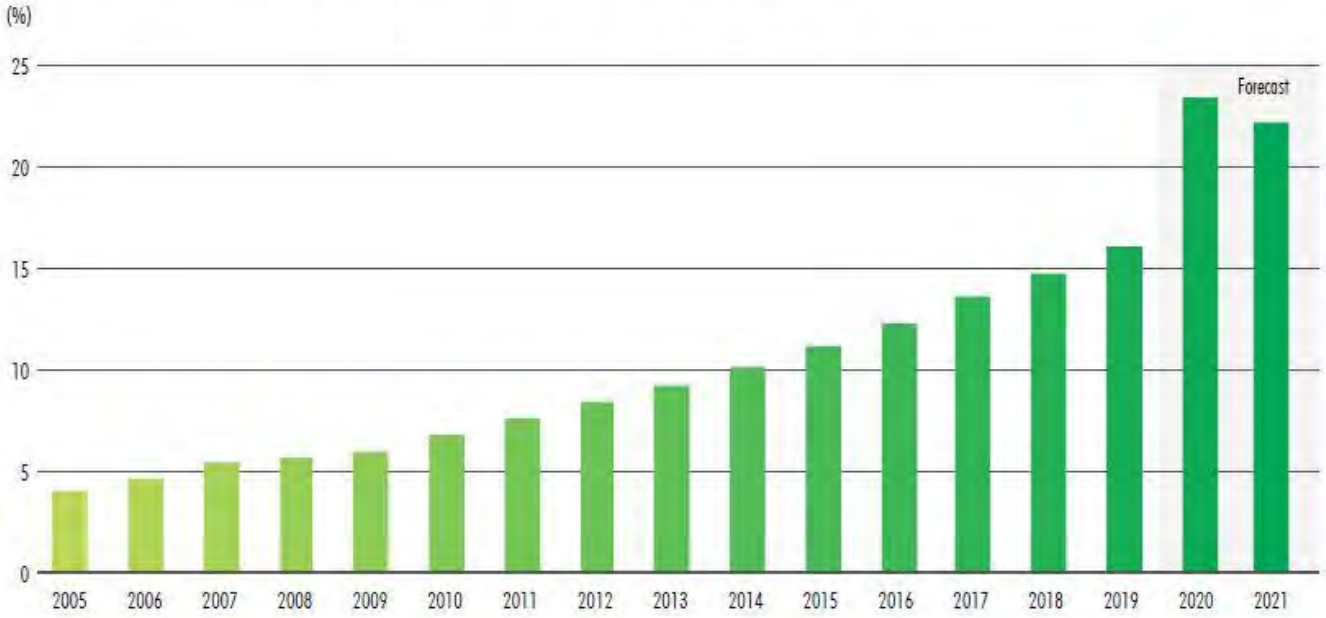
E-COMMERCE WILL DRIVE DEMAND

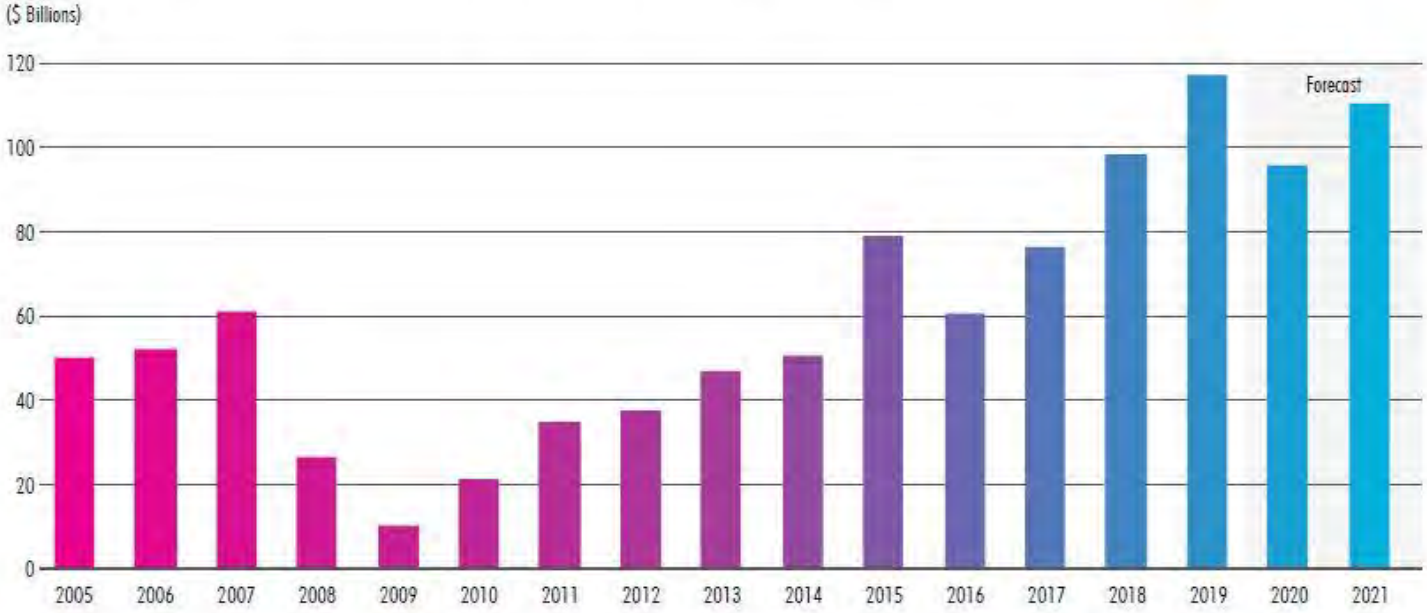
FIGURE 12: E-COMMERCE SALES PENETRATION (% OF TOTAL RETAIL SALES)



Source: CBRE Research, U.S. Census Bureau, October 2020.

INVESTORS WILL SEEK NEW OPPORTUNITIES

FIGURE 13: TOTAL U.S. INDUSTRIAL SALES VOLUME FORECAST



Source: Real Capital Analytics, CBRE Research, Q3 2020.

KEY TAKEAWAYS & OBSERVATIONS

- After a bumpy period and slow deal volume in mid-2020, demand in industrial capital markets is once again robust, though still varied depending on deal size and profile.
- Sales volume is expected to increase and remain strong into 2021.
- Vacancy rates have held steady nationally amid continued positive net absorption.
- Most new leasing activity is for distribution/warehouse space in the big box/bulk segment (100,000 SF and above).
- Rents continue to rise in most markets for new construction/good quality product; less growth is evident for non-core markets and properties. Some market segments that have held steady or seen slight declines to date are expected to see a return to rent growth in 2021.
- While Class A distribution space is likely to be in highest demand for the foreseeable future, older and lower tier industrial properties are expected to be well suited to benefit from long-term changes such as increased safety stock/inventories, potential reshoring of manufacturing and associated materials storage.

MARKET ANALYSIS – MULTIFAMILY

COVID-19 IMPACTS

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PATH TO FULL RECOVERY IN 2021

FIGURE 14: MULTIFAMILY URBAN SUBMARKETS – CHALLENGES AND CONSIDERATIONS FOR RECOVERY

	FACTOR	CHALLENGES	RECOVERY PATH & CONSIDERATIONS IN 2021
Economy	Income	Loss of job, reduced income, loss of confidence in future income and employment opportunity.	Most industries recovering steadily (though not all, such as entertainment, tourism, hospitality, retail).
COVID-19 Related	WFH/WFA	With work-from-home/work-from-anywhere practices common for office workers, living near the workplace is far less relevant.	Most office workers back at office by Q1, but "new norm" more likely 30% to 60% at office translating to less emphasis on living in close proximity to work.
	Urban Amenities	Limited availability of entertainment, restaurants/bars, cultural amenities, sports, etc.	Urban amenities continue to return through 2021 (pace partly dependent on vaccine diffusion process); 80-90% back by end of 2021.
	Public Transit	Many renters uncomfortable taking public transit; private transportation options limited, too expensive or impractical in many cities.	Once a vaccine is widely available and widely distributed, fear factor should subside fairly quickly.
	Living Space	More living space desired as renters spend more time at home.	This should diminish as people go back to school and work; however, hybrid nature of both will likely be a feature of the "new normal."
	Outdoor Space	Many renters desire greater access to outdoor options as an outlet for long hours in apartments.	Continued opening up of public outdoor amenities will mitigate this factor; still, some renters will continue to move to less dense areas.
Secular Trends	High Rents	Cost-benefit calculus: with less benefits from urban living, justification of high cost of urban living comes into question.	As urban living conditions improve, high rent becomes less of factor; reductions in urban rents will entice some new residents; however, some renters who became accustomed to more affordable suburban rents may not return due to costs.
	Lifestyle	Millennials moving into life stages where urban living is often traded in for less-dense housing options in other submarkets and/or markets.	Likely to continue to put downward pressure on urban multifamily demand; urban living seems to be appealing to Gen Z, but it's a smaller cohort (smaller number in each age group).

Source: CBRE Research, Q4 2020.

INCREASED MULTIFAMILY INVESTMENT IN 2021

FIGURE 15: MULTIFAMILY INVESTMENT TO REBOUND WITH 33% GROWTH IN 2021

*2020 forecast is based on actual numbers through September.
Source: CBRE Research, Real Capital Analytics (historical), Q4 2020.

MARKET ANALYSIS – HOTELS

COVID-19 IMPACTS

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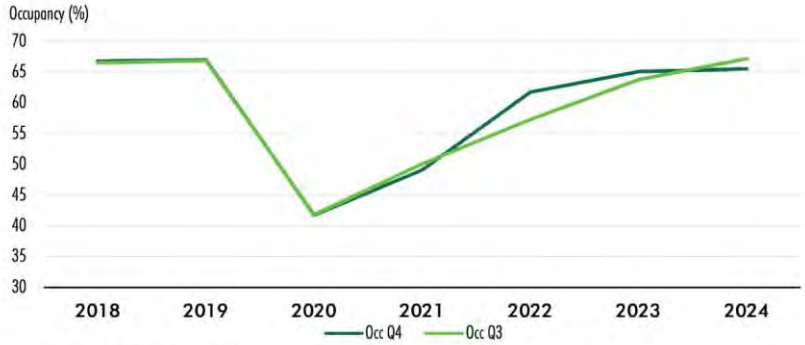
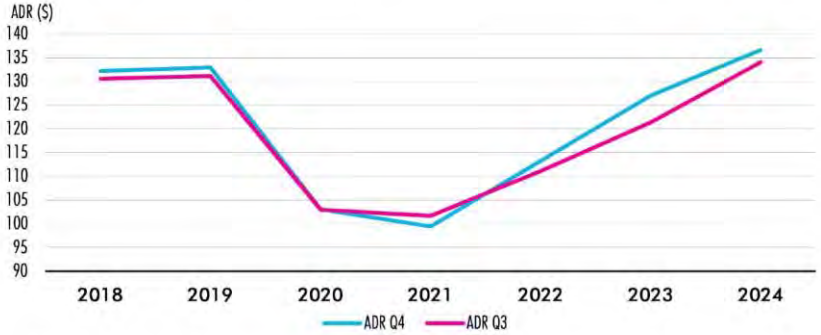
OCCUPANCY & AVERAGE DAILY RATE (ADR)

Figure 1: Occupancy Forecast Comparison



Source: CBRE Hotels, Kalibri Labs Q4 2020.

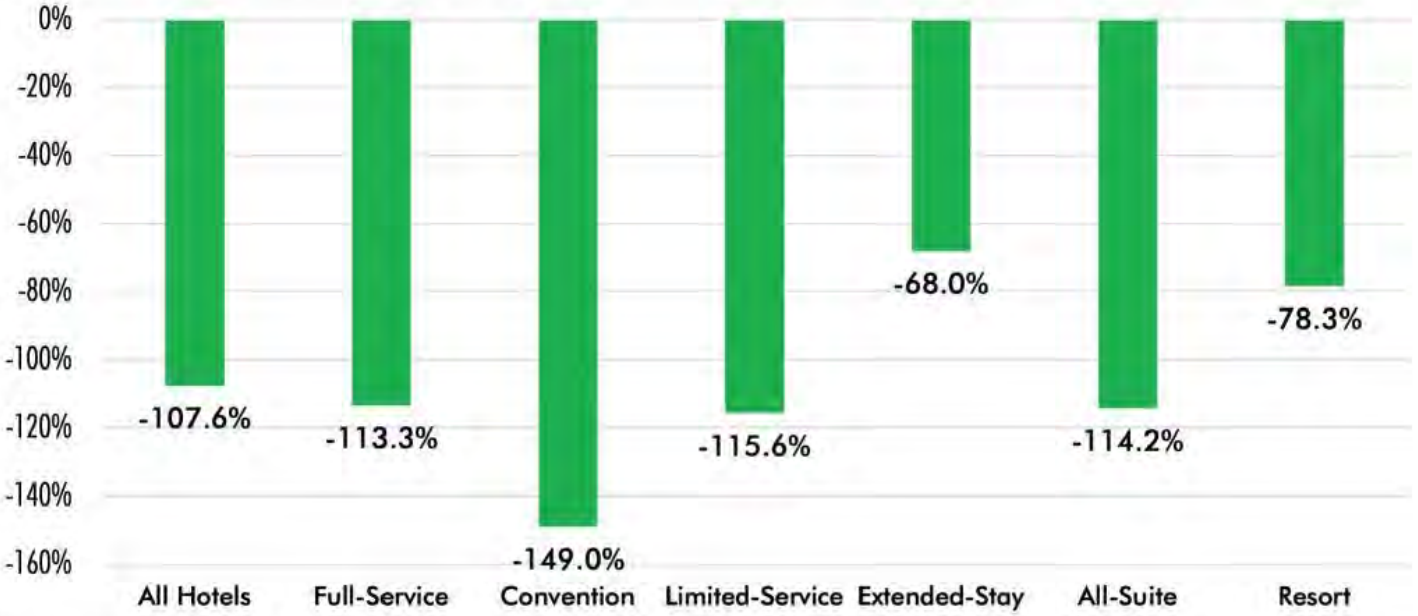
Figure 2: ADR Forecast Comparison



Source: CBRE Hotels, Kalibri Labs Q4 2020.

THE SUFFERING

Figure 3: Hotel EBITDA | Dollars Per Available Room: Y-o-Y Change – December YTD 2020 vs December YTD 2019



Source: CBRE Hotels Research, Same-Store Sample, Open All Twelve Months

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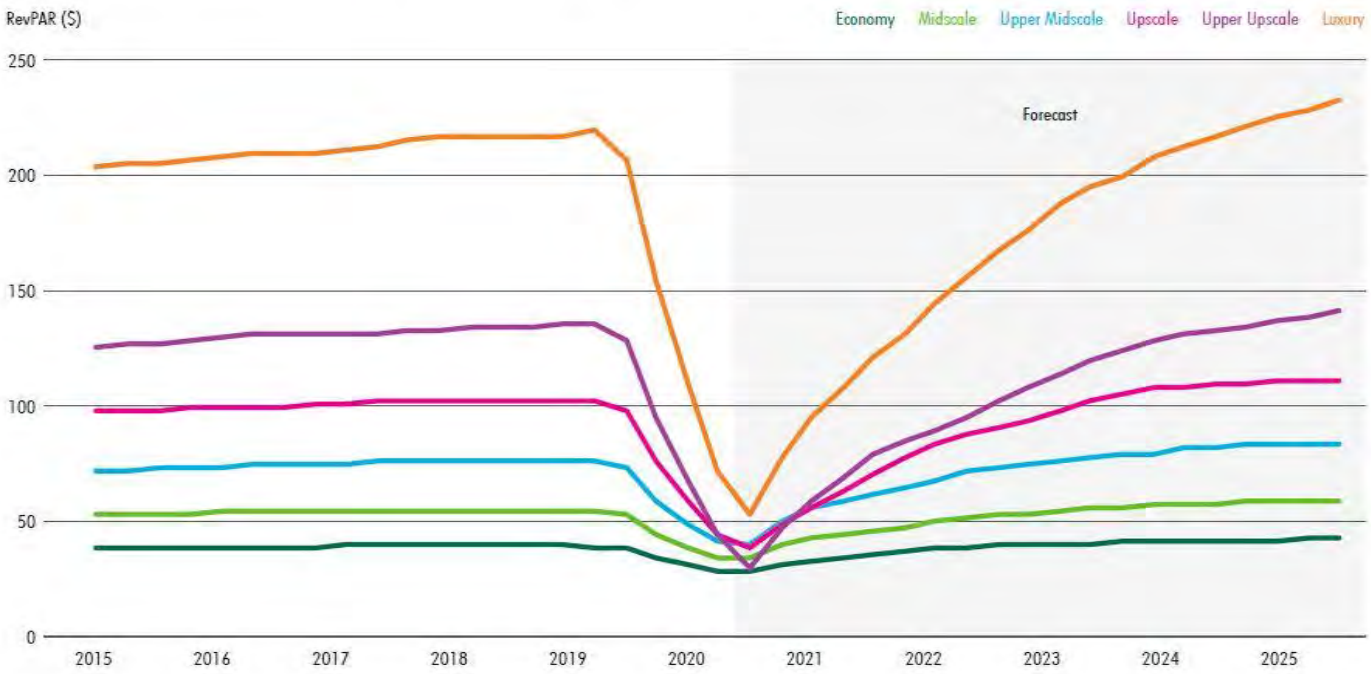
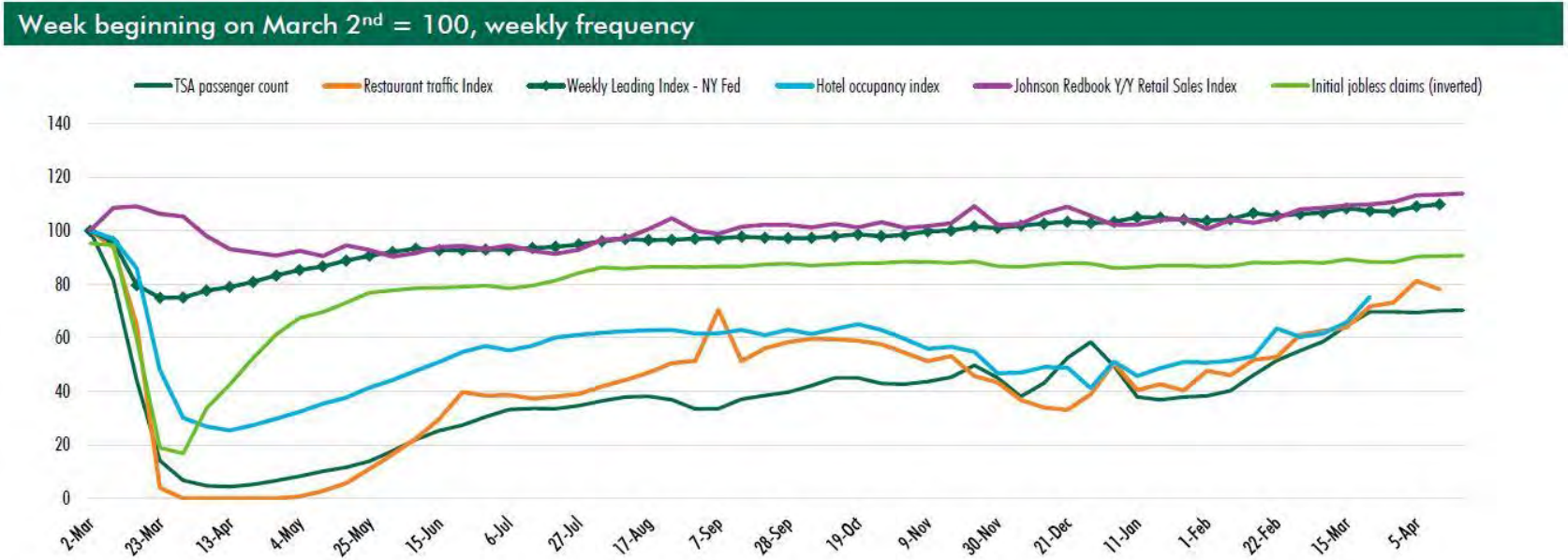
CHAIN SCALE RECOVERY

FIGURE 17: NATIONAL NOMINAL REVPAR BY CHAIN SCALE (Q4-CENTERED AVERAGE)



Source: CBRE Hotels, Kalibri Labs, Q2 2020.

CONTINUED LEISURE TRAVEL NEEDED FOR FULL RECOVERY



MARKET ANALYSIS – CONSTRUCTION COST

COVID-19 IMPACTS

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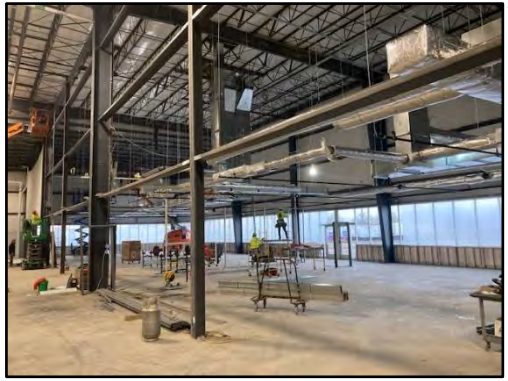
DETROIT INDUSTRIAL TRENDS

Observed Trends

- Significant Materials Cost Increases
  - Insulation, +30% since Q4 2020
  - Structural Steel & Metal Roofing, +40% since Q4 2020
  - Grid & Ceiling Tile, +10% Q1 2021
  - Drywall, +20% Q1 2021
  - Asphalt Binder, +10% Q1 2021
  - Lumber, +20% Q1 2021
  - Copper, +20% Q1 2021

- Significant Lead Time Increases
  - PEMB Steel, >20 weeks
  - Pre-cast panels, >30 weeks
  - Switchgear & Transformers, >30 weeks

- Tightening of RFP Deadlines & Change Orders
  - GC's are shortening duration of price freezes
  - Requires clients to make faster project decisions to "lock in" costs



MATERIAL LEAD TIMES

All,
Wanted to get this out there so everyone is aware.
We are seeing significant increases in lead times and availability when it comes to the following materials.

Exterior Steel Studs – 6 weeks from Approved Cold Formed Shop Drawings
Interior Steel Suds – 4-5 weeks
Fiberglass Batts (typical sizes R-11 and R-19) – 4 weeks
Fiberglass Batts (R-25 and up) – 6 weeks or more
Mineral Wool Insulation – 12 – 16 weeks
Drywall Mud is also in shortage. Make sure your subs have this accounted for.
Typical Gyp Board has not been an issue so far. Anything different from typical 5/8" type X should be checked on as availability can vary from week to week.

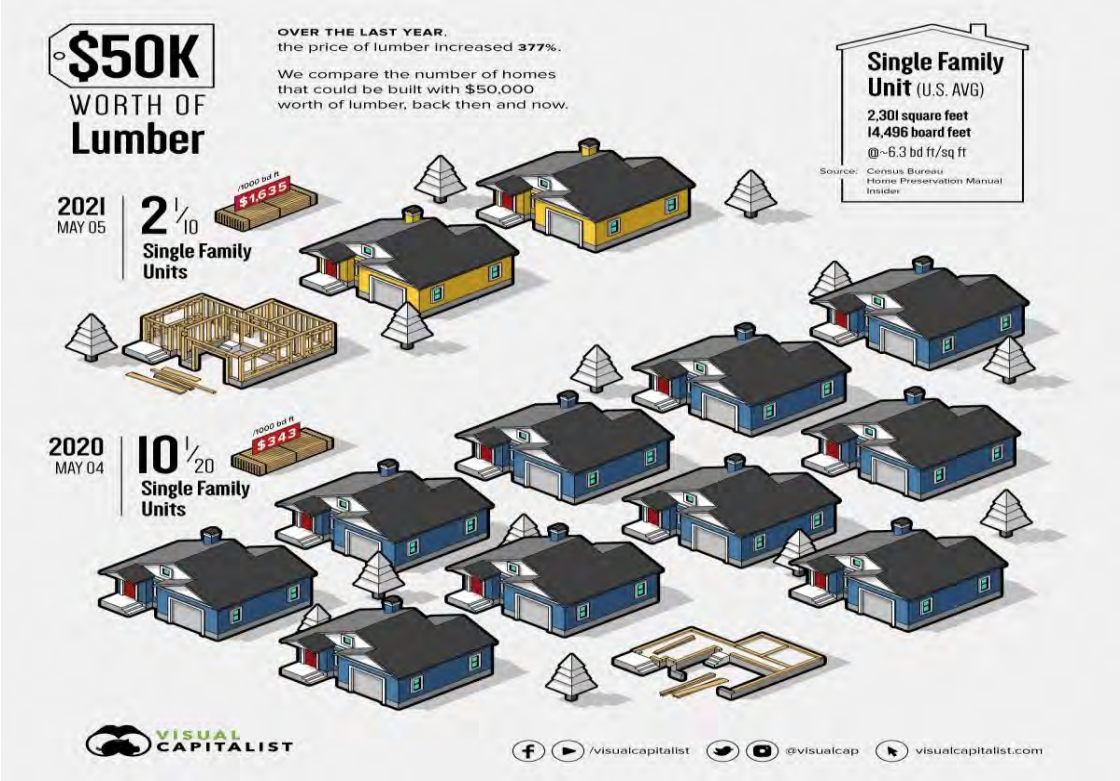
Please account for these times when figuring the start of this work (whether it's self-performed or not) if these times are covered you should not have any issue with materials.

Thanks
Aaron Stoy
Steel Stud/Drywall Trade Superintendant
J.H. FINDORFF & SON INC.
Builders Since 1890
300 South Bedford Street | Madison, Wisconsin 53703
Direct: 608.225.2961
astoy@findorff.com

CHARACTER COMMUNITY CRAFTSMANSHIP

PRICE OF LUMBER

PRICE OF LUMBER



MARKET ANALYSIS – RECAP

COVID-19 IMPACTS

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KEY TAKEAWAYS & OBSERVATIONS

- 2020 will be remembered in commercial real estate for many things, but perhaps none more so than an acceleration of certain trends that benefited some sectors but punished others.
- Industrial and logistics have thrived in the COVID era, while others like office, retail, and hotels have suffered.
- Real estate conditions will start 2021 in a state of flux. Certain sectors will grow strongly, but a full recovery will be held back by the continued influence of COVID-19. By spring and summer there will be a rebirth and renewal of real estate as a vaccine is widely deployed and further government stimulus drives the economy forward.
- Industrial & logistics enters 2021 with the strongest fundamentals and investor interest. CBRE anticipates the absorption of another 300 million sq ft of industrial space on the back of e-commerce growth. With fast-recovering employment levels, the multifamily sector will shrug off the impact of the crisis in the first half of the year.
- It will take the second half of 2021 for the office sector to begin returning to normal or begin to undergo a permanent change. Only when workers can safely return to the office will the long-term effects of remote working become clear.
- Although the retail footprint will continue to contract in 2021, what remains will be stronger, more interesting, more convenient and more experiential.
- Increased leisure travel will help the hotel sector in 2021 but a full recovery is not expected to start until group and business travels resumes in 2022.

THANK YOU

FOR MORE INFORMATION, PLEASE CONTACT:

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cbre.us/valuation

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