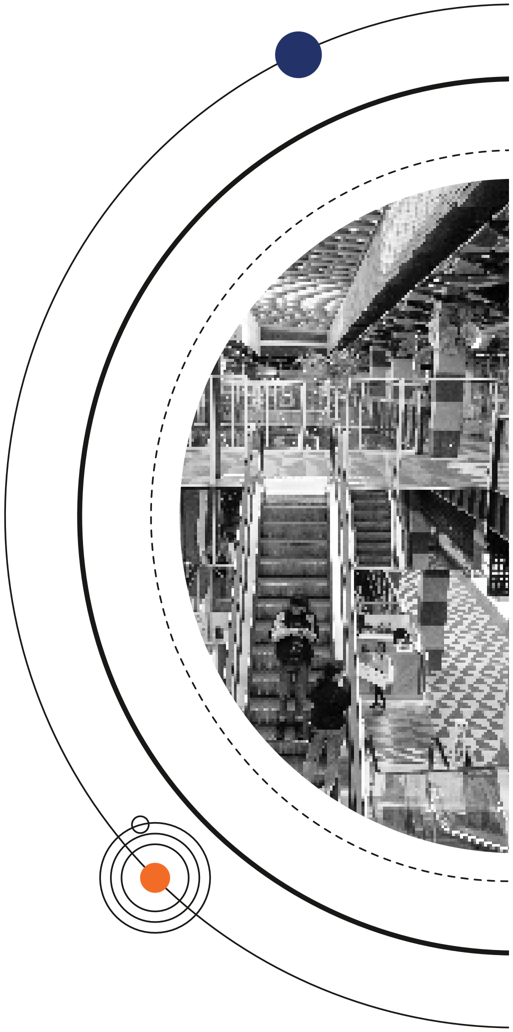
SVN RESEARCH®

SVN INTERNATIONAL CORP.

# Special Report

## A CASE FOR THE LONG VIEW: TAKEAWAYS FROM ULI-PWC EMERGING TRENDS IN REAL ESTATE 2023



# Overview

A consistent theme among investors surveyed in this year's Emerging Trends in Real Estate report by the Urban Land Institute (ULI) and PwC was an eye toward the positive long-term fundamentals of Commercial Real Estate (CRE) rather than the industry's glaring short-term uncertainties.

While the latest survey results construct a consensus about several looming risks to the industry — rising interest rates, availability of qualified labor, and housing affordability, to name a few — future expectations have the dominant hand in steering current investor sentiment.

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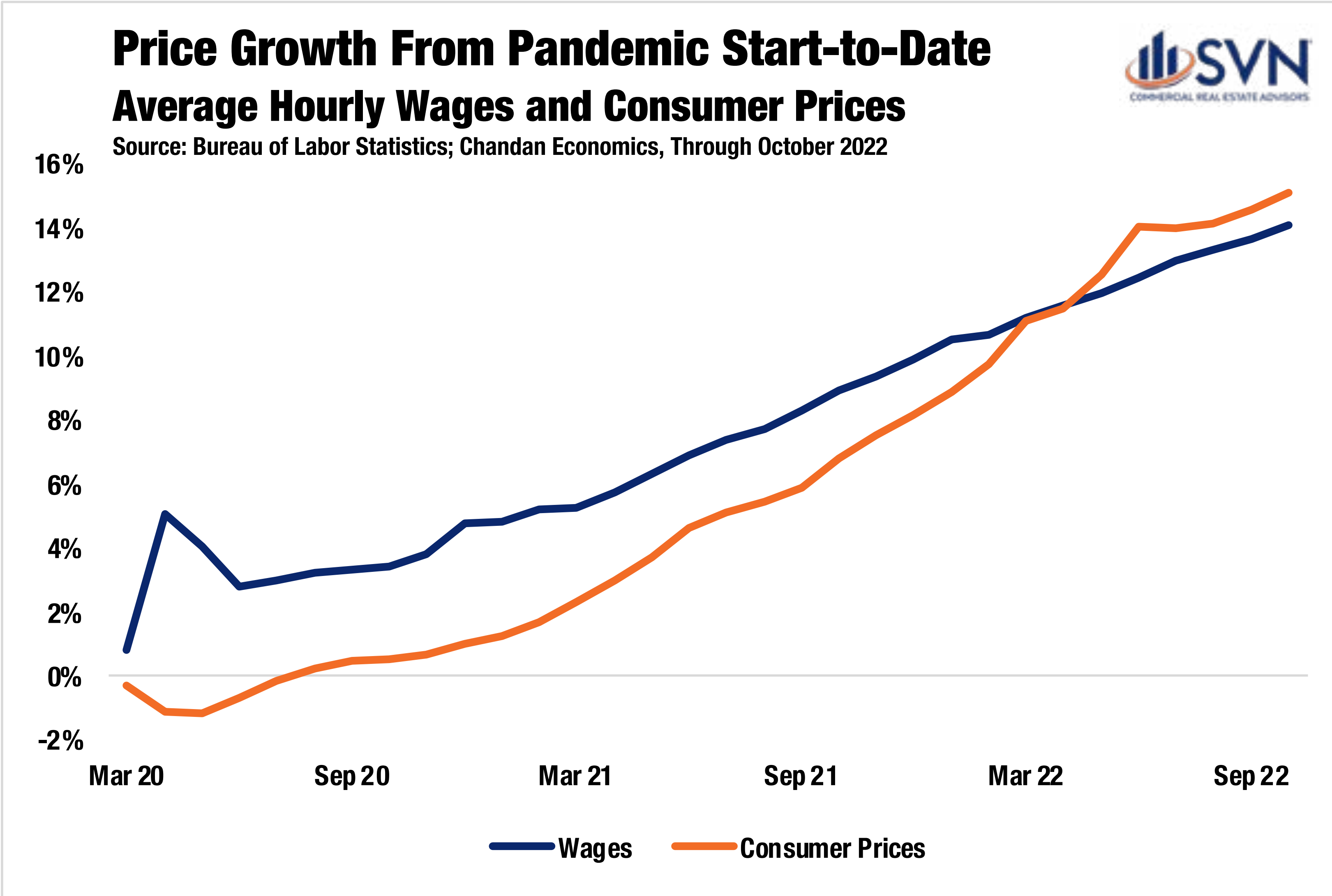
# The Big Picture

As discussed in SVN Research's most recent Special Report, the Federal Reserve's interest rate hikes and elevated recession risks are immediate risks to CRE values and transaction activity. However, beyond cyclical headwinds, CRE's long-term fundamentals remain strong.

US labor market fundamentals lie at the foundation for CRE's resiliency. Since the Fed began raising interest rates in March of this year, job growth has maintained an average increase of 350,000 new payrolls per month while the unemployment rate stands at 3.7%, moving just ten bps over the same period. Employment sentiment and outcomes strongly correlate with on-time rent payments for apartment renters. Meanwhile, high employment levels are keeping consumer spending levels robust, leaving their mark on the Industrial, Retail, and Office sectors.

Still, things are shifting. Swelling mortgage rates amid record home prices are reducing homebuying demand, moving more housing activity into the rental market. Further, inflation poses a real risk to purchasing power if left unchecked. While by some measures, US households maintain a modest rise in purchasing power relative to before the pandemic, a Chandan Economics analysis of BLS data suggests that since May of 2022, consumer prices have outpaced wages relative to their pre-pandemic levels.



Price Growth From Pandemic Start-to-Date
Average Hourly Wages and Consumer Prices
Source: Bureau of Labor Statistics; Chandan Economics, Through October 2022
SVN
COMMERCIAL REAL ESTATE ADVISORS
16%
14%
12%
10%
8%
6%
4%
2%
0%
-2%
Mar 20
Sep 20
Mar 21
Sep 21
Mar 22
Sep 22
Wages
Consumer Prices

# Multifamily: Long-Term Migration and a Flight to Safety

Percolating beneath the Multifamily sector in recent years has been a fundamental shift in household formation and preferences. As discussed in Emerging Trends, even before the pandemic, the millennial generation kicked off an uptick in rent-by-choice and rent-by-necessity demand in the Apartment sector. The pandemic and ensuing spread of remote work added a new accelerant to rental demand, turbo-charging the sector's growth.

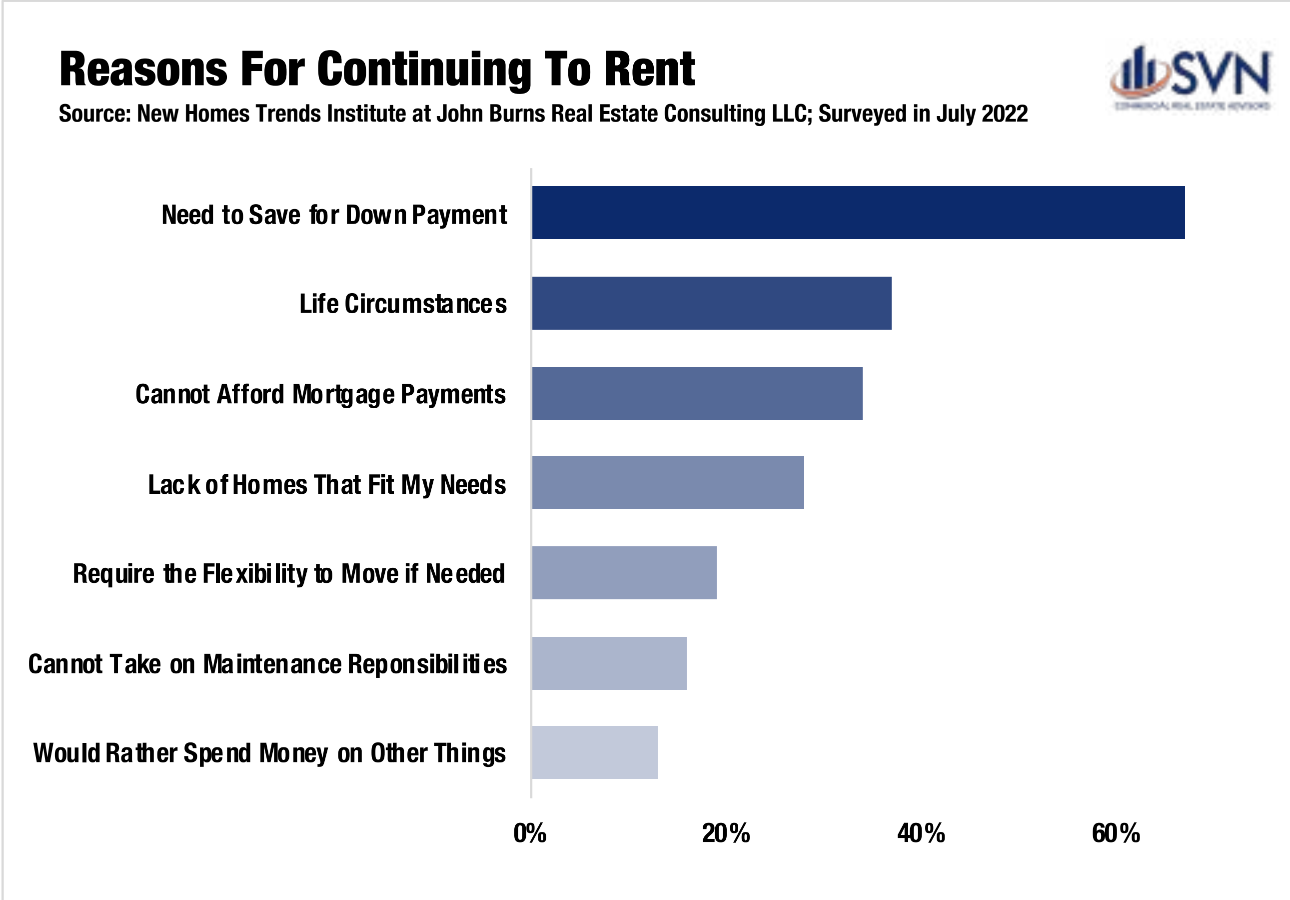
While higher interest rates should calm sector tailwinds a bit, the pre-COVID demographic shift still exists, and work-from-home migration — while likely past peak, remains a force. According to the 2022 State of Remote Work survey by Owl Labs, those who elected to work remotely in 2022 rose by 24% from 2021, while those working in a hybrid set-up increased by 16%. Furthermore, as the Fed's quantitative tightening pushes capital toward risk-minimizing investments, residential real estate remains a favorable destination.

# Single-Family Rentals: Expensive Mortgages Amid a Housing Shortage

Like Multifamily, Single-family rentals (SFR) are poised to benefit from post-pandemic migration patterns. Moreover, as many local markets face supply shortages of adequate housing and zoning reforms struggle to make traction, the glow of single-family assets has grown even brighter.

According to a review of American Community Survey data by the Joint Center for Housing Studies at Harvard University, one-in-three households spent north of 30% on housing costs in 2020. Using the latest data available, the national share of cost-burdened households rose from 28.4% in 2019 to 29.9% during year one of the pandemic.

A hot streak for home prices over the past two-plus years has priced many would-be homebuyers out of the purchase market. With mortgage rates recently climbing above 7%, several of these households are moving into the rent-by-necessity category. As detailed in *Emerging Trends*[1], when surveying current renters who also believe homeownership




is important[2], 67% cite their need to save for a down payment as a reason they continue to rent. 34% cite mortgage unaffordability as a reason. SFR has ascended as a reasonable alternative for individuals and families longing for the space and amenities provided by a single-family home without the expensive mortgage.

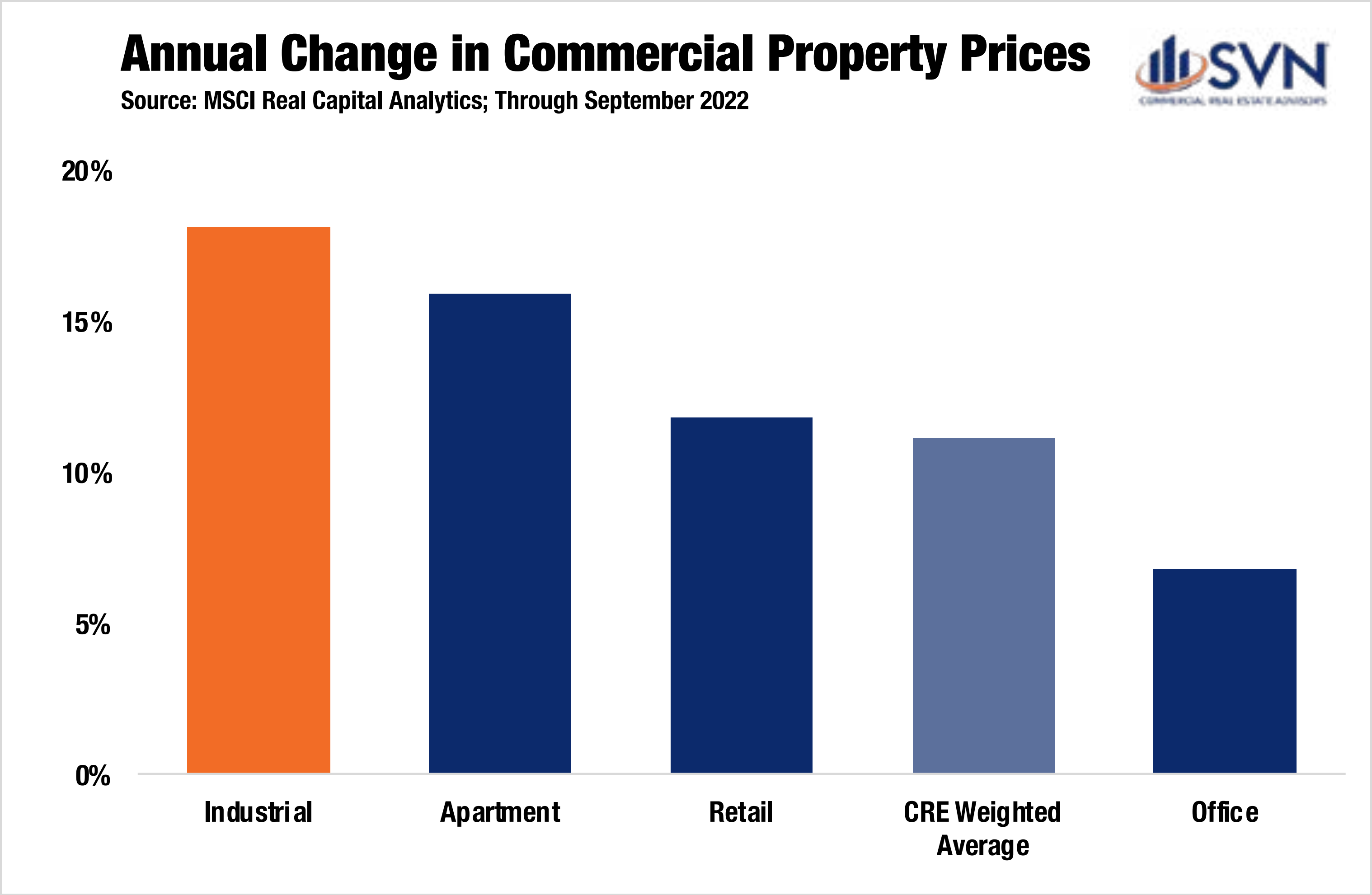
[1] Analysis of data provided by New Home Trends Institute/John Burns Real Estate Consulting LLC and Pro Builder.

[2] Those surveyed were 18 years and older with a household income of over $50,000.

# Industrial: E-commerce Normalization, But Demand Still Outpaces Inventory

Despite goods inflation and supply chain disruptions, Industrial continues to benefit from robust consumer spending. According to MSCI Real Capital Analytics, prices in the Industrial sector grew by 18.1% in the year ending September 2022 — outpacing its peers. Recent growth is a reduction from the sector's 2021 record-highs, but its sustained double-digit price growth indicates the structural repositioning of Industrial assets post-pandemic.

While rebounding in-person shopping was met with a pullback in online purchases, e-commerce remains the future. As analyzed in *Emerging Trends*, the number of shoppers who utilized same- or next-day delivery during the 2021 holiday season was relatively steady compared to the year before.




Despite an evident shift back to in-person shopping relative to during the pandemic, the convenience of shopping online remains. E-commerce's staying power will keep it a key market driver for both Industrial and Retail assets.

# Office: Hybrid Work is the Future, but the Rest We're Figuring Out

As the work-from-home versus work-from-office wars rage on, the Office sector has seen the middle-ground scenario playing out: hybrid arrangements are now the norm. However, beyond the future of hybrid work, there is little consensus about where Office goes from here.

*Emerging Trends* singles out a few resilient sub-sectors in the face of recent headwinds to the asset class. Data Centers maintain high demand, seeing both organic growth before the pandemic and increasing growth since then as more of our day-to-day lives moved online. Vacancy rates have plummeted in many major markets in America, with the largest footprint located in Northern Virginia, followed by capacity in Northern California and Texas. The Phoenix, Chicago, Columbus, Northern New Jersey, and Atlanta metro areas also stand out as Data Center hotbeds, among others.

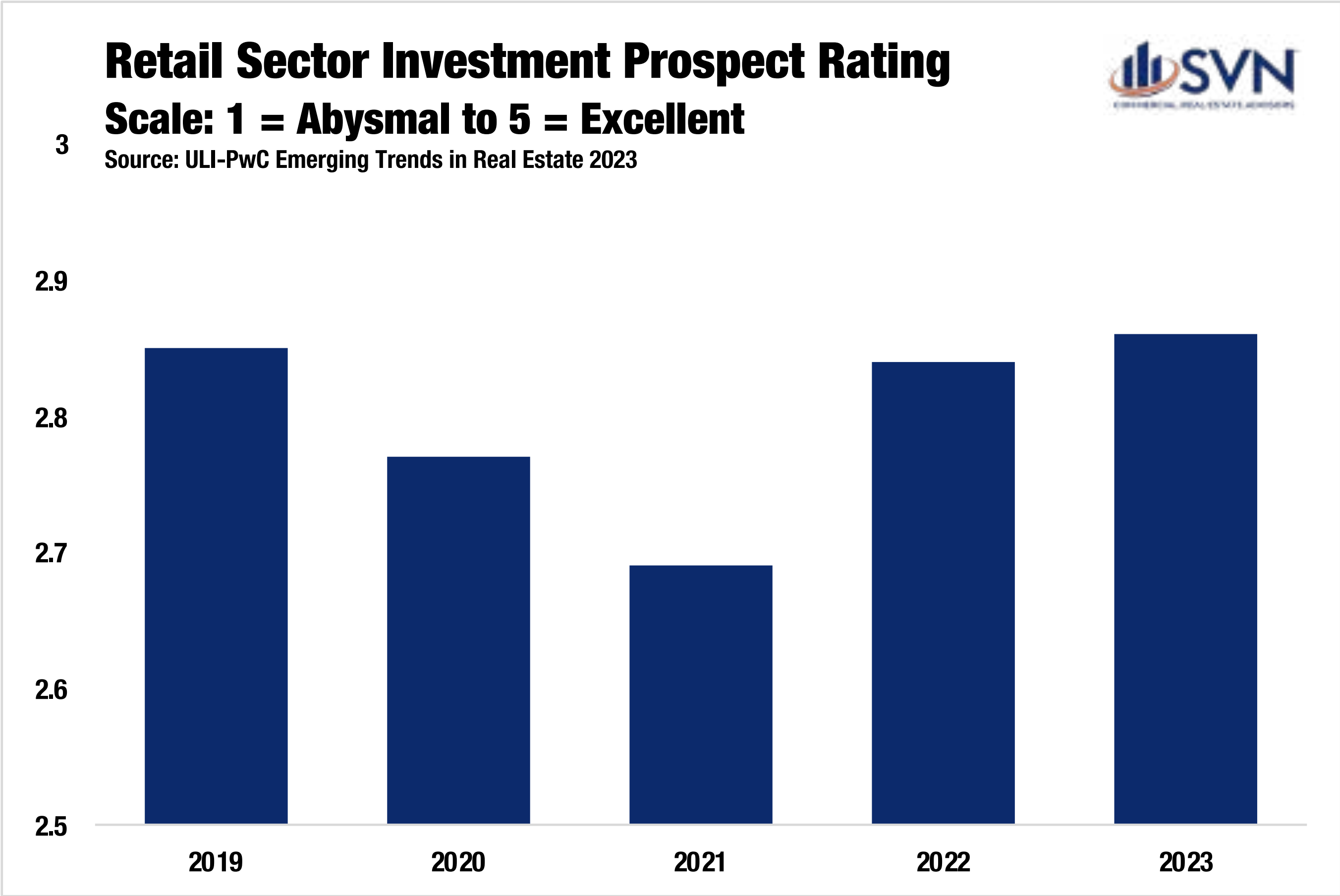
Medical Office has also established itself as a growth vehicle in the Office sector. The subset is backed by a growing healthcare sector that accounts for roughly 11% of American workers and almost one-fifth of spending as a percentage of US GDP. Medical Office Buildings (MOBs), which serve as facilities for outpatient services, tend to use longer lease terms and are more likely to renew due to the nature of their services. The asset class is also a reliable recession investment. According to Emerging Trends' analysis, occupancy remained above 90% throughout the Great Financial Crisis of 2008–2009.

# Retail: Wary Optimism

The term that captured Retail sector sentiment as described by *Emerging Trends* was "wary optimism." For the past decade, a structural shift towards e-commerce has sparked some soul-searching in Retail real estate; however, during the pandemic, the more reliable subsets of Retail presented the most significant challenges to asset values.

In-person services such as gyms, restaurants, and entertainment venues felt the brunt of lockdowns and reduced economic activity. COVID stimulus efforts, including PPP loans and direct cash injections into consumers' wallets, helped increase retail sales in 2021. According to an SVN Research analysis of MSCI Real Capital Analytics, deal volume surged by 88% in 2021 over 2020's total.

While growth has slowed in 2022 in the face of inflation scarring, Retail's post-pandemic rebound means that many of the sector's sharpest challenges are in the rearview. Those surveyed in this year's report gave Retail in 2023 its highest investment prospect rating since before the pandemic.




According to the *Emerging Trends* analysis, a multi-industry expansion in Retail space acquisition is taking place, with automotive, convenience stores, gyms, cosmetics, pet stores, and sporting goods — among others, planning space expansion. Meanwhile, aggressive expansion continues in the Grocery space, while dollar stores and discounters continue to play a vital role in driving Retail growth as it has over the past decade.

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SVN International Corp. (SVNIC), a full-service commercial real estate franchisor of the SVN® brand, is one of the industry's most recognized names based on the annual Lipsey Top Brand Survey. With over 200 office locations serving 500+ markets, SVN® provides sales, leasing, corporate services, and property management services to clients across the globe. SVN Advisors also represent clients in auction services, corporate real estate, distressed properties, golf & resort, hospitality, industrial, investment services, land, medical, multifamily, office, retail, self-storage and single tenant investments. All SVN offices are independently owned and operated. For more information, visit www.svn.com.

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