Delaware Commercial-Industrial Real Estate Outlook

May 16, 2021

Jay L. White – Apex Realty Advisory

Discussion Agenda

- **Commercial Real Estate 2022 - US/Delaware**
- **Economic Landscape**
  - GDP growth
  - Rising Interest Rates
  - Federal Reserve Strategy
- **Commercial Real Estate Fundamentals**
  - Retail
  - Office
  - Industrial
  - Apartment
- **Commercial Real Estate Investment**
  - Market summary
  - Cap rates
  - Market sales

Economic Landscape

- GDP grew by 5.7% in 2021 and contracted 1.4% in Q1 2022 due primarily to the trade deficit. It is forecast at 3.7% in 2022 & 2.4% in 2023.
- Lower interest rates supported economic growth and spending, but also inflation
- The Fed also announced it will make aggressive monetary policy to include as many as 6-7 rate hikes to combat rising inflation in 2022
- Need to adjust to the new interest rate environment
- Labor markets are coming back
- Strength of US dollar
- Recession fears overblown but growth will slow

Commercial Real Estate Fundamentals

Delaware Commercial Real Estate Fundamentals Overview

State of Delaware - May 2022 Commercial Real Estate Fundamentals							
	Current 2022	Vacancy Rates			SF Under	Average	Past 12 mos.
Sector	MSF Inventory	1Q 2020	1Q 2022	10-Yr Range	Construction	Asking Rent	SF Absorption
Retail	54.9	6.0%	5.3%	4.6% - 6.0%	223,000	$20.47	389,000
Office	47.5	9.4%	9.6%	7.6% - 11.1%	448,000	$24.11	126,000
Industrial	58.9	2.5%	2.6%	3.5% - 15.4%	0	$7.89	7,100,000
Multifamily	67,639 units	2.9%	2.5%	2.5% - 7.3%	1,790 units	$1,333	941 units

Source: Co-Star & compiled by Apex Realty Advisory, LLC

➢ Retail was hard hit by the pandemic, but core sales were up 0.5% in March 2022 over February & 6.8% over March 2021 sales. The wild card is in the form of elevated gas prices, consumer spending & balancing physical bricks/mortar stores and e-commerce.

➢The retail sector is poised to achieve net positive absorption as retailers regain their confidence in business expansion.

➢ The restaurant industry adapted to consumer needs and community needs, but are now wrestling with rising food, labor, and occupancy costs.

- The office sector is in a state of unpredictability as tenant demand is uncertain as companies continue to balance working from home and returning to the office.
- The Delaware industrial sector is poised for additional growth with new logistic space deliveries and “onshoring” of manufacturing.
- The local apartment market is growing thanks to in-migration and people movement due to the pandemic.
- Supply chain disruptions, rising construction costs, and increasing interest rates may help damper the risk of overbuilding in both of these sectors.
- Hospitality experienced an extremely positive upward rebound at resort areas versus hotels catering to business or convention travelers.
- Persistent housing shortages reflects a robust need for dwellings while reduced health restrictions have increased foot traffic for retailers and hotels.

- The COVID-19 pandemic caused a short recession & precipitated change in the commercial real estate market across all sectors.
- Owners, tenants, and brokers all had to adjust. By year end 2020, softened operating fundamentals became relatively stable.
- Commercial market participants anticipated big changes in 2021 with the delivery of more residential, multifamily, and industrial buildings to meet strong demand.
- Factors that didn't materialize in 2021 included a wave of hotel, retail and office asset distress.
- Hotels were saved by easing of travel restrictions and continued accommodations by lenders.
- Retailers made a surprising rebound in 2021 with more physical stores opening than closing for the first time since 2017.
- Office fundamentals are in flux and depend upon medical, urban or suburban buildings. Hybrid remote/in-office scheduling will impact space demand needs.

Commercial Real Estate Investment

- Commercial real estate is a long-term investment that allows investors to focus on demographic and macro trends as opposed to ‘daily noise’.
- CRE investment yields have outperformed the stock market over the past 20 years. Top returns since 2000:
  - **S&P 415%, Apartments 458%, 461% Retail, and 848% for Industrial.**
- Demand for desirable properties is being met with abundant capital for investment due to inflation concerns and historically low-cost debt.
- Initial cap rates (yields) on commercial real estate have compressed substantially over the past decade as investment demand increased.
- Strong underlying property fundamentals and expectations for above average rent growth will likely attract investors and thus slow substantial upward movement in cap rates.
- Multifamily commodities are uniquely positioned, given their short-term nature, to simply reprice their rents during inflationary periods in order to offset higher nominal interest rates.
- Supply chain disruptions continue to underscore the critical roles of many industrial facilities.

Commercial Real Estate Sales Activity: May-21 – Jan-22

- Brandywine Nursing & Rehab Center – sold May 2021 for $19 million
- Eagle Meadows Apartments – sold June 2021 for $48 million
- The Edge at Greentree Apartments – sold June 2021 for $51.5 million
- Carillon Woods Apartments – sold August 2021 for $43 million
- Millcreek Shopping Center – sold September 2021 for $29.2 million
- Spring Gardens Crossing – sold September 2021 for $56 million
- The Crescent Building – sold October 2021mfor $83 million
- Glasgow Commons Land – sold October 2021 for $46 million
- Crossings at Limestone – sold October 2021 for $19.75 million
- Iron Hill Apartments – sold October 2021 for $32.1 million
- Amazon Boxwood Fulfillment Center – sold October 2021 for $392 million
- Southgate Apartments – sold November 2021 for $19 million
- DuPont Chestnut Hill Labs – sold November 2021 for $40 million
- Scott Run Business Park Land – sold November 2021 for $40 million
- Clayton Court Apartments – sold December 2021 for $12 million
- Cheltenham Village Apartments – sold December 2021 for $14 million
- Sandcastle Motel – sold December 2021 for $13.2 million
- Reserve at Mill Creek Apartments – sold December 2021 for about $18.3 million
- Christiana Mills Apartments – sold January 2022 for $49 million

The Outlook

- Numerous forces continue to put upward pressure on inflation: global supply chain disruptions, production shutdowns, labor shortages, etc.
- Watch the 10-year Treasury yield;
- The Federal Reserve raising of the Federal Funds rate over in 2022 to combat inflation;
- Episodes of volitivity & fixing the supply chain;
- Watch the labor market & employment growth;
- Growth of the medical and life sciences industry;
- Delaware's statewide real estate tax re-assessment by mid-2024;
- Rising interest rates and their impact;
- Pricing pressures & the impact of inflation.

Apex
Realty Advisory