

BBCC 2023 CRE Update

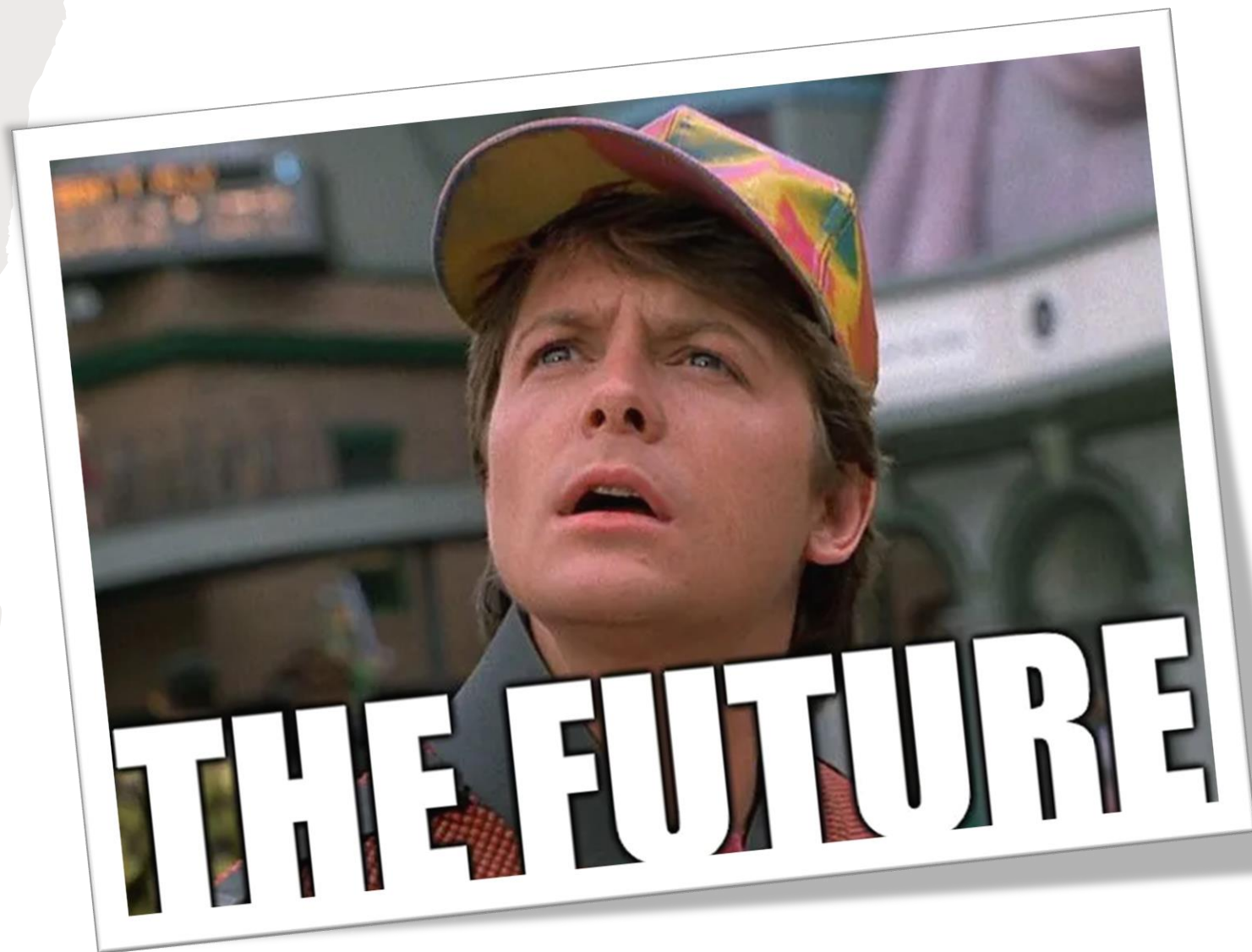
Todd Szymczak

NAI Farbman / Farbman Group



CYA DISCLAIMER

- You are about to be presented with a number of facts and a number of opinions.
- Facts are facts but may have been selected to support my opinion on the future.
- Opinions are often wrong or subject to change based on new facts.
- Many facts and figures are based on wide market trends and....
- REAL ESTATE IS HYPER-LOCAL

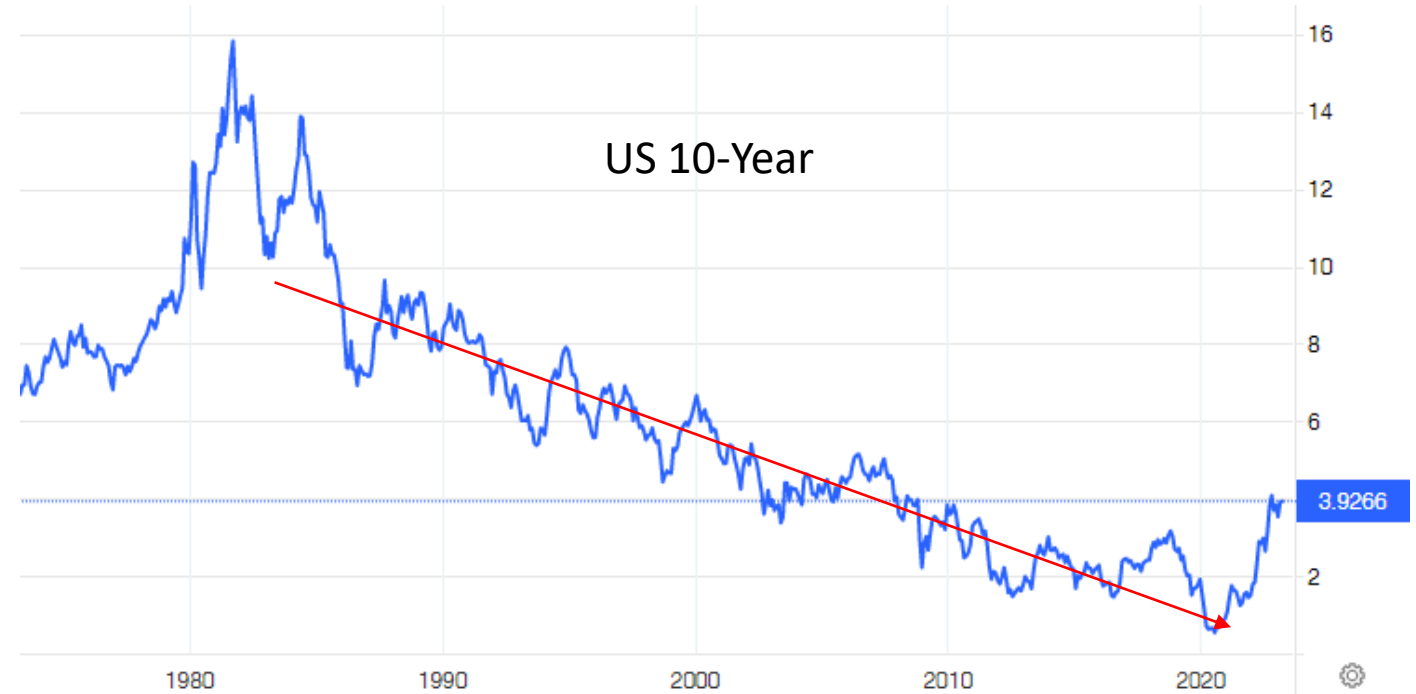
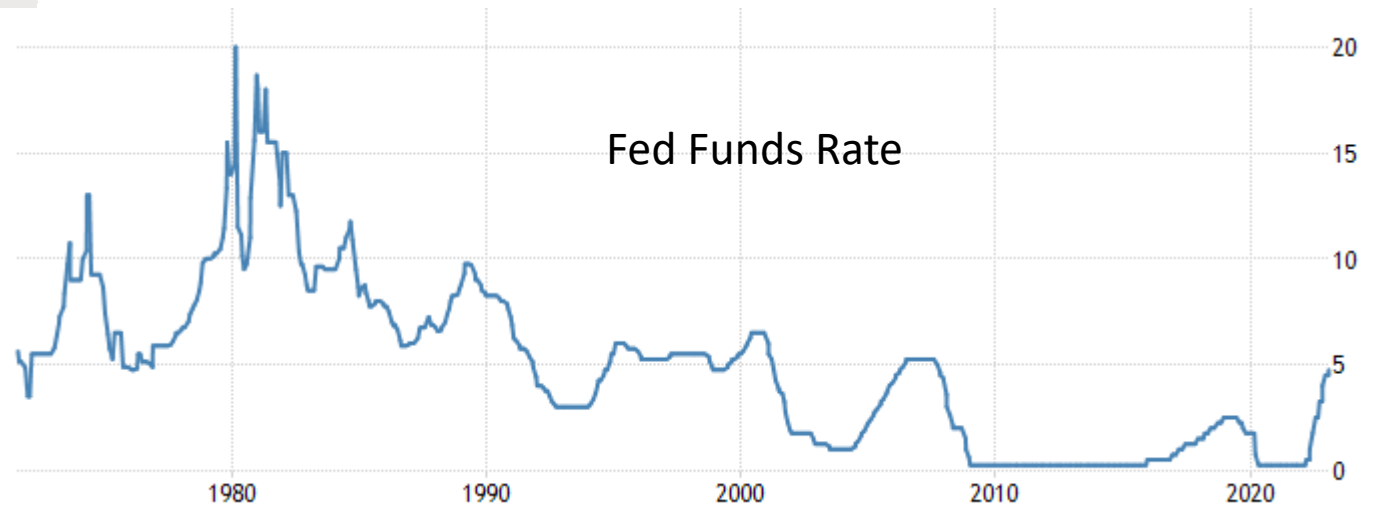


Factors Affecting most CRE

- REFI RISK –

“There are no CASH-OUT refi’s right now. There are a lot of CASH-IN refi’s” – Commercial Mortgage Broker

- Rates are part of the story, but other factors making refinancing hard include DSCR (Debt Service Coverage Ratio) and LTV. Increasing costs and flat rents have eroded NOI in many cases.
- Combined with higher debt costs, an owner cannot carry as much leverage, so they **need to bring more equity to the closing table to refinance.**



Why do we care so much about Real Estate?

- Global Net Worth tied to real estate is greater than all other asset classes combined.
- Residential makes up roughly 90% of that value
- You can feel it and touch it and it surrounds you
- Because you see it and touch it, it is interesting and you think you know what is going on (vs. the bond market)

Global Net Worth 2020

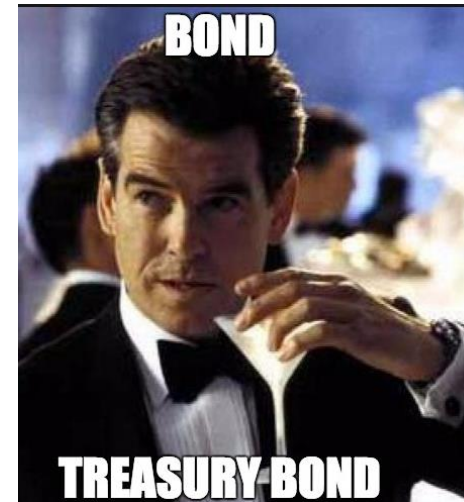
- Real estate = \$280.6T
- Stock Market = \$89.5T
- Broad money = \$95.7T
- Derivatives = \$11.6T
- Gold = \$10.9T
- Crypto = \$0.2T billion

The sum of the above = \$488.5 trillion.

REIT Performance YTD Through 11/30/2022		
Property Type	Average Return	Number of REITs
Office	-32.62%	21
Malls	-32.03%	4
Infrastructure	-31.96%	6
Industrial	-30.12%	13
Land	-29.43%	3
Manufactured Housing	-28.20%	3
Single Family Housing	-24.63%	2
Self-Storage	-23.91%	6
Multifamily	-23.55%	14
Diversified	-21.67%	18
Advertising	-21.58%	2
Health Care	-15.79%	16
Data Center	-10.71%	4
Hotel	-10.07%	17
Triple Net	-9.27%	18
Timber	-5.21%	4
Shopping Center	-4.66%	20
Casino	11.44%	3
Student Housing	14.02%	1
REIT Average	-18.42%	175

Rates HAVE impacted asset values...

- Higher rates have killed the marginal buyer which were driving prices to the moon. Animal Spirits are dead for now.
- Why take risk? 5% Treasury Bills!!!
- Owners have remorse for not selling sooner. Seeing the bubble high prices that we had for 2021 and 2022, they wish they had sold and now hold out hope that those days will return.
- This has resulted in a seller's strike. They want to buy at an 8% CAP, but won't SELL at an 8% CAP.
- Eternal holders should be fine, but if your time horizon is less than forever... The question to ponder – will your rents be higher or lower when you want to sell? Will expenses be higher or lower? What will sales comps look like between now and then? Is there a case to sell now?



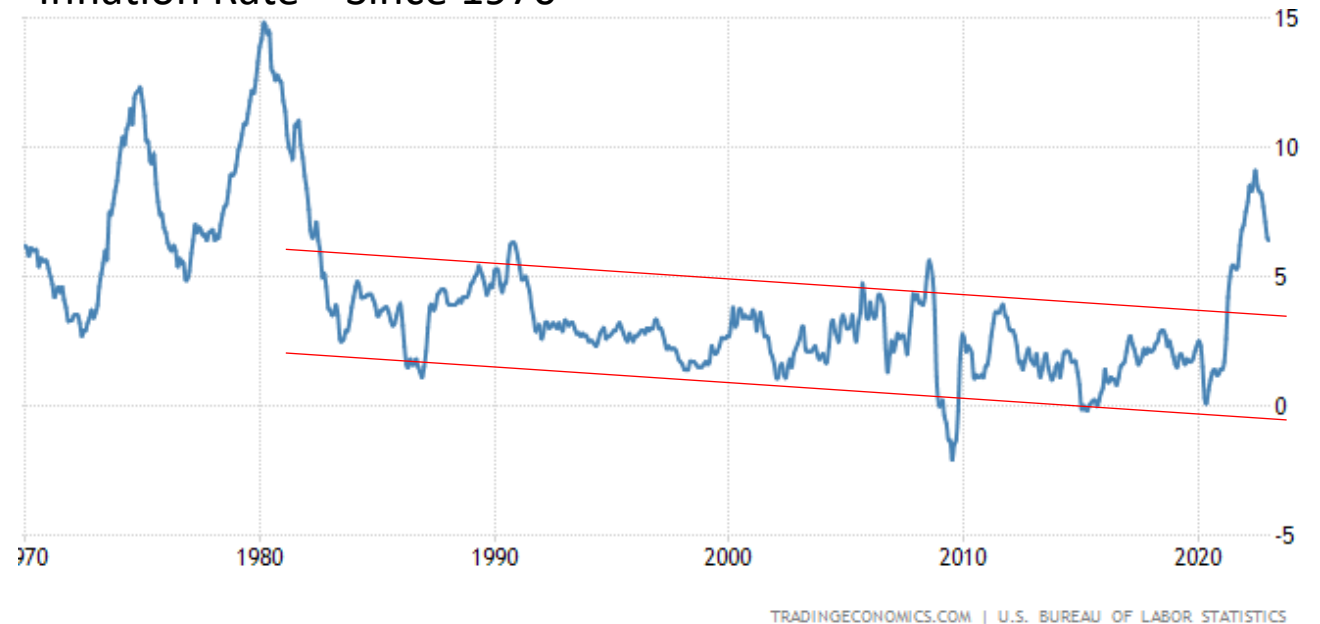
The effects of inflation

- Increasing expenses for owners and tenants alike.
- For some property types, like industrial, rents up substantially, and many operate on Net leases, so tenants eat the increased costs. Winning!
- **Going forward – include CPI adjustments on rent and/or push leases to NNN structure.**
- For properties that operate on gross leases and rents have been flat, you are losing value over time. If you operate a business that looks like real estate (i.e. senior living), you are likely struggling.
- Tenants have seen their operating costs go up (i.e. labor) and may look to save money by reducing their footprint.

Inflation Rate – Past 25 years

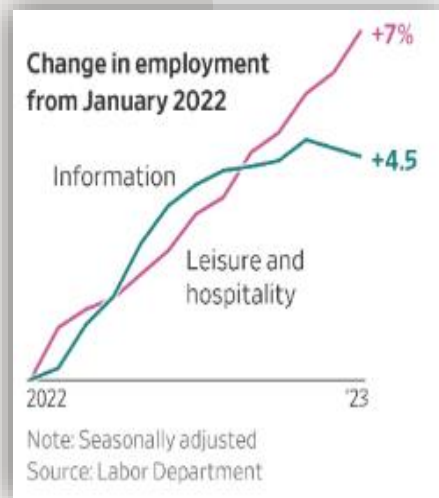


Inflation Rate – Since 1970



Current Tailwinds ...

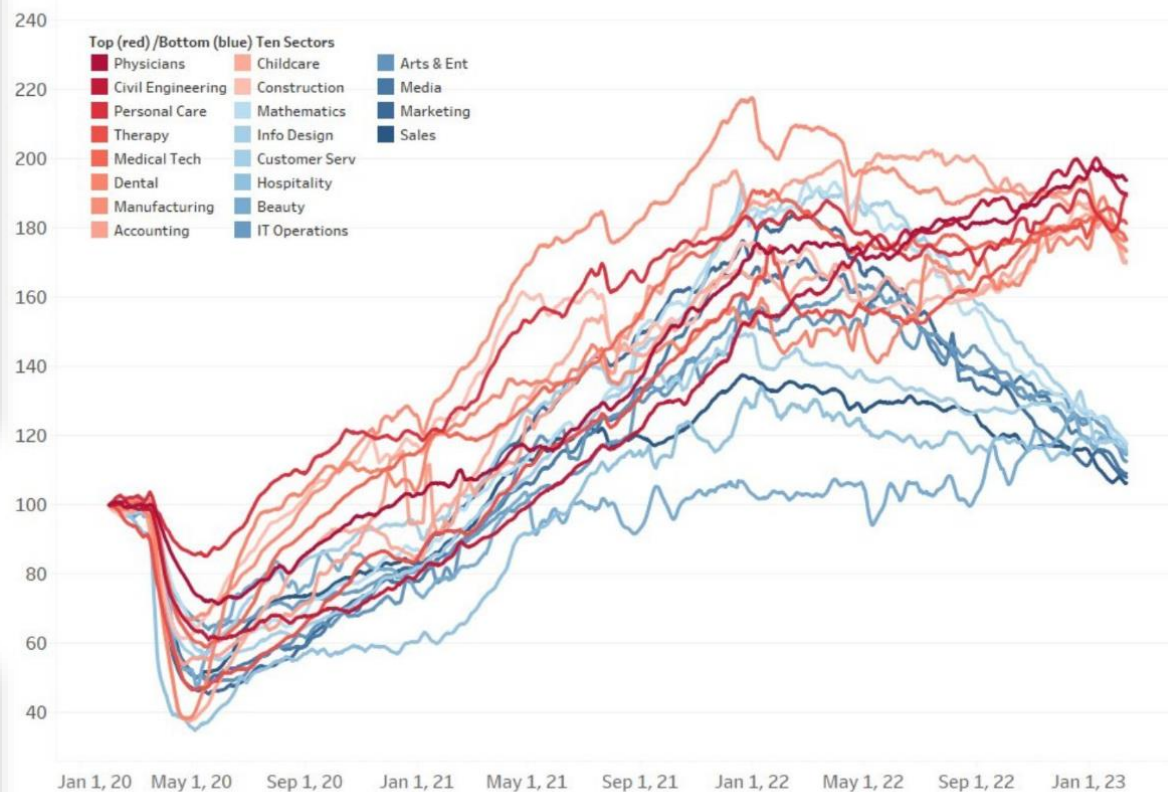
- Strong employment and healthy consumer spending.
- Job market may be getting back into balance – rumors abound that it is getting easier to hire.
- Built in inflation adjustments to SS and Income Tax Brackets will inject about \$350 MM into the economy (annually).



Todd Szymczak / szymczak@farbman.com

Job Postings by Sector

Top (red)/bottom (blue) ten sectors included (ordered)

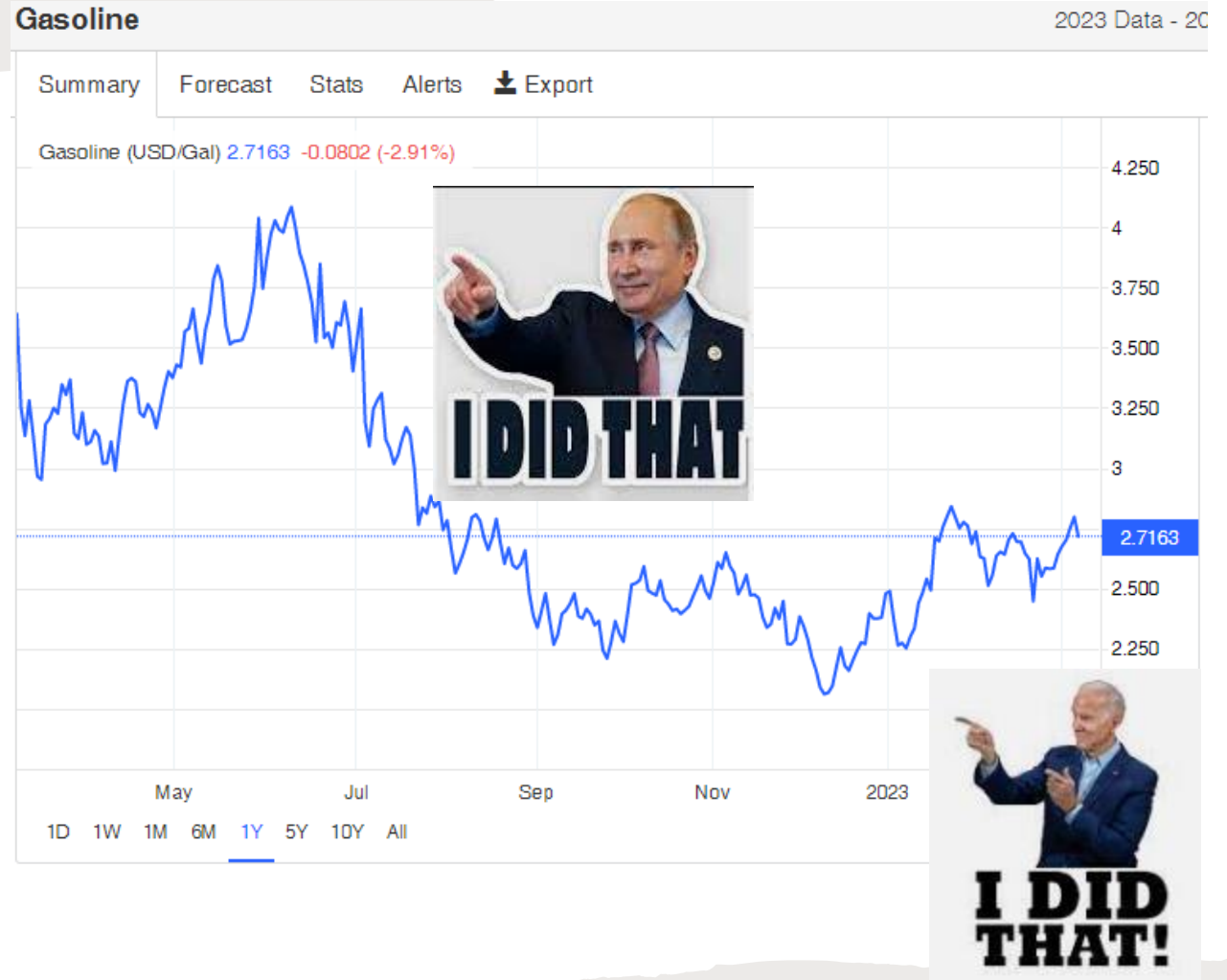


Data Source: Indeed

datascience.arborresearch.com

Current Tailwinds ...

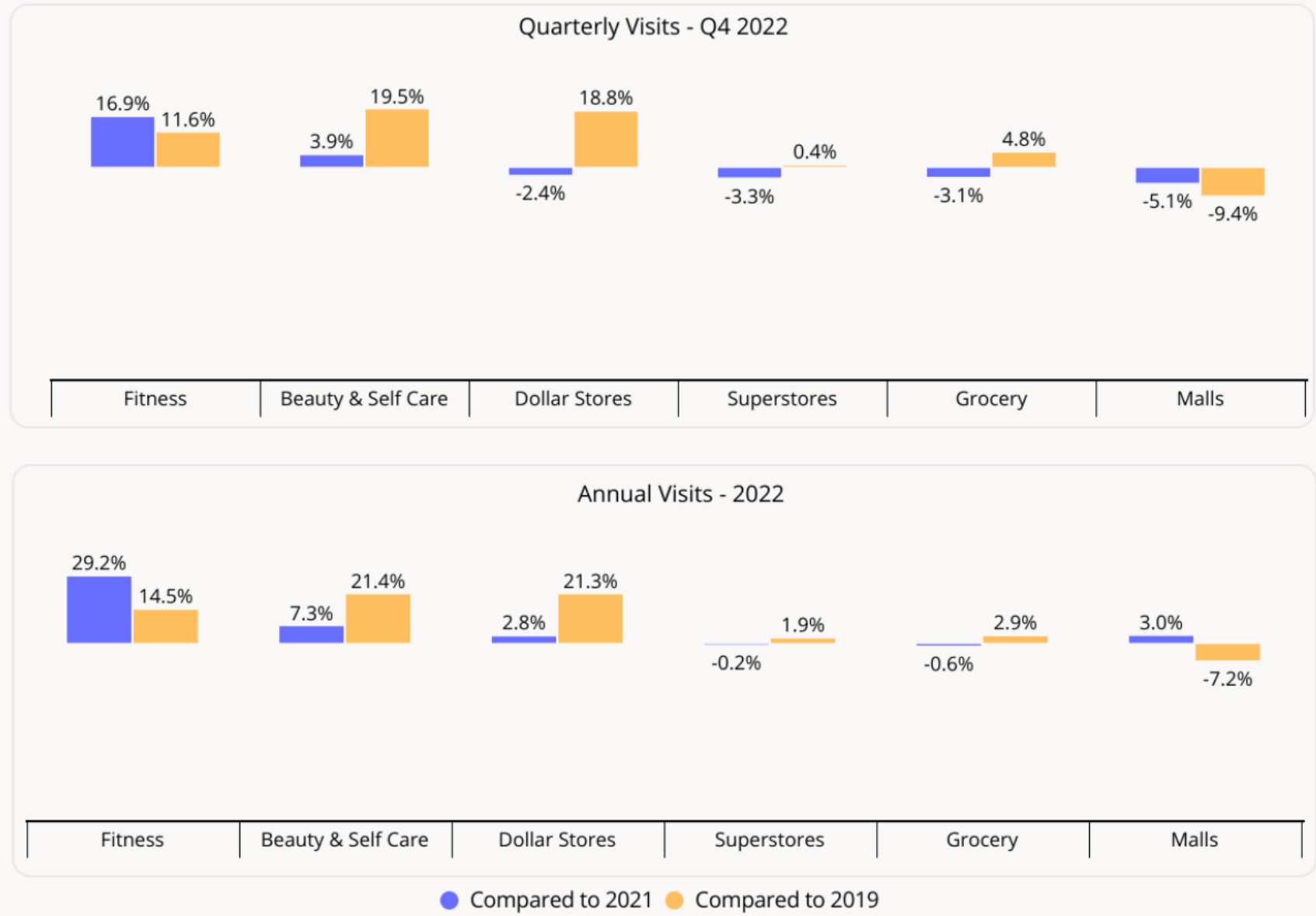
- Do interest rates matter to the general economy when you have a deluge of spending in other areas? Not yet, but rumors are that C&I loans are showing stress which may begin showing up in the general economy.
- \$1T Infrastructure Act + \$738B Inflation Reduction Act + \$53B CHIPS Act + \$800B in State Aid from CoVID (much of which has not yet been spent).
- Increased defense spending works its way through the economy.
- For DET – Autos are strong right now... but will car sales slow down when backorders clear? Are Chinese EV's in our future?



Retail

- Retail – overall positive. Buyers want it and lenders are OKAY with it.
- Most Retail came out of CoVID better than expected and consumer spending is strong overall.
- You are hearing of some retailers closing stores, but that happens every winter after the holidays... some that are struggling try to hold on then fold if the holidays don't change their fortune.
- Some categories are doing better (Fitness). Some are struggling (Malls)

Change in Visits Across Select Industry Sectors



Retail

- Highly Specific to Location and Property
- Malls – the strongest are doing okay (Somerset, Village of RH). The weakest will get redeveloped (Eastland, Northland, Summit Place, maybe Lakeside). Class A malls doing well... many others will likely end with redevelopment in the next decade
- Over the past decade the industry has perfected data collection, and now target their store locations down to the zip code where their sales and returns are coming from.
- Highly likely that RH and Crate and Barrel (CB2) has data that shows that the highest concentration of internet sales and Somerset sales came from this zip code – choosing to place a store there.
- 48009 – Walkable, low-crime, high density of current clients



Fairlane Town Center being sold again, this time to 'mall scavenger' Kohan

By: Kirk Pinho

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Fairlane Town Center in Dearborn, built in 1976, is getting yet another new owner.



Most Popular

- 'Billboard queen' Joumana Kayrouz is overhauling her law firm

High-end brands Balenciaga, Breitling open at Somerset Collection

By: Jay Davis

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Credit: Balenciaga



Most Popular

- 'Billboard queen' Joumana Kayrouz is overhauling her law firm

Office – It's complicated

- Many more tenants downsizing than growing
- Debt is VERY tough – lenders calling us ask about **PHYSICAL occupancy**, not just economic occupancy. Low lease renewal is assumed, more equity needed to buy or REFI
- Many loan terms mature in 2023-2024, so things could get interesting
- Spaces under 5000 SF have an active market, 5k-10k moderate demand, and spaces over 10k are slow. Over 25k extremely slow.

"you look stressed"
thanks.. it's the stress



PROPERTY REPORT

Office Landlord Defaults Escalate as Lenders Brace for More Distress

The growing number of distressed office buildings reflects a recognition by owners and lenders that the robust return to office they had hoped for isn't likely ever to materialize.

Peter Grant | February 21, 2023



PROPERTY REPORT

Pimco Is Saddled With a \$1.7 Billion Default in Office-Market Meltdown

The company had one of the biggest defaults during the pandemic period after its acquisition of Columbia Property Trust.

Peter Grant and Konrad Putzier | February 28, 2023



PROPERTY REPORT

As Americans Work From Home, Europeans and Asians Head Back to the Office

Return-to-office rates in Paris and Tokyo have climbed to more than 75%, while the U.S. is often stuck around half.

Konrad Putzier | February 28, 2023

Breakdown of Office Maturities

'23-'24 Maturities by State

CA	255	14.4	12,343,332,783
NY	131	7.4	10,345,888,519
IL	52	2.9	2,639,775,349
TX	107	6.0	2,535,291,389
VA	72	4.1	1,825,780,062
PA	273	15.4	1,671,952,745
FL	196	11.0	1,351,790,986
MA	20	1.1	1,171,266,753
WA	40	2.3	939,907,474
DC	18	1.0	805,964,618
GA	26	1.5	785,144,637
NJ	47	2.6	782,391,290
CO	26	1.5	584,339,469
AZ	72	4.1	544,489,187
MI	48	2.7	510,419,326
NC	32	1.8	464,137,268
CT	24	1.4	452,515,723
MO	33	1.9	397,085,137
MD	32	1.8	382,782,880
TN	21	1.2	303,841,460
OH	31	1.7	265,254,979
MN	80	4.5	253,191,786
KS	2	0.1	250,467,697
UT	9	0.5	204,695,102
DE	6	0.3	190,503,083

'23-'24 Maturities by MSA

New York-Newark-J...	158	8.9	10,867,772,525
San Francisco-Oakl...	51	2.9	5,076,903,875
Los Angeles-Long B...	93	5.2	4,589,233,178
Washington-Arlingt...	93	5.2	2,745,236,952
Chicago-Naperville-...	51	2.9	2,627,499,955
Philadelphia-Camde...	232	13.1	1,490,365,530
San Jose-Sunnyvale-...	45	2.5	1,458,011,137
Boston-Cambridge-...	21	1.2	1,183,187,281
Dallas-Fort Worth-A...	47	2.6	1,155,489,492
Houston-The Woodl...	41	2.3	1,025,604,088
San Diego-Carlsbad,...	42	2.4	1,002,284,114
Seattle-Tacoma-Bell...	36	2.0	856,560,342
Miami-Fort Lauderd...	80	4.5	837,013,849
Atlanta-Sandy Sprin...	26	1.5	785,144,637
Denver-Aurora-Lak...	25	1.4	581,092,163
Phoenix-Mesa-Scott...	72	4.1	544,489,187
Kansas City, MO-KS	15	0.8	446,890,685
Detroit-Warren-Dea...	32	1.8	435,374,237
Charlotte-Concord-...	8	0.5	318,424,222
Bridgeport-Stamfor...	15	0.8	312,900,905
Austin-Round Rock, ...	9	0.5	261,100,834
Minneapolis-St. Pau...	80	4.5	253,191,786
Tampa-St. Petersbu...	75	4.2	248,835,855
Pittsburgh, PA	13	0.7	229,865,250
Baltimore-Columbi...	9	0.5	200,830,336



Headwinds for 2023 and Beyond

What is going to happen to Office Properties?

National Office Maturities

233 w/
DSCR
below
1.40

Maturity Year Stratification				
▲ Maturity Year	Loan Count		Allocated Balance	
	#	%	Amount	%
2023	331	39.5	22,221,847,158	51.2
2024	508	60.5	21,156,128,084	48.8
Total	839	100.0	43,377,975,242	100.0

Occupancy Stratification				
Occupancy	Loan Count		Allocated Balance	
	#	%	Amount	%
Up to 49	40	4.7	688,407,700	1.6
50 - 59	31	3.7	931,700,108	2.1
60 - 69	62	7.3	2,427,224,816	5.6
70 - 79	95	11.2	4,413,086,642	10.1
80 - 89	167	19.8	7,890,088,647	18.1
90 - 94	86	10.2	5,283,746,649	12.1
95 and up	202	23.9	9,914,059,243	22.8
n/a	162	19.2	11,947,997,945	27.5
Total	845	100.0	43,496,311,750	100.0

228 below
80%
Occupancy

Year Built Stratification				
▼ Year Built	Property Count		Allocated Balance	
	#	%	Amount	%
2006 - or later	288	16.2	7,213,742,072	16.6
2001 - 2005	173	9.8	2,239,505,343	5.2
1996 - 2000	272	15.3	3,071,890,623	7.1
1991 - 1995	42	2.4	1,588,811,279	3.7
1981 - 1990	520	29.3	8,474,811,177	19.5
1971 - 1980	233	13.1	6,836,170,031	15.8
1961 - 1970	99	5.6	4,963,151,156	11.4
1951 - 1960	27	1.5	2,457,258,901	5.7
1941 - 1950	13	0.7	276,309,817	0.6
1940 - or prior	95	5.4	6,114,349,009	14.1
n/a	12	0.7	141,975,835	0.3
Total	1,774	100.0	43,377,975,242	100.0

DSCR (NOI) Stratification				
DSCR (NOI)	Loan Count		Allocated Balance	
	#	%	Amount	%
Up to 0.89	97	11.6	2,728,111,604	6.3
0.90 - 0.99	19	2.3	776,823,331	1.8
1.00 - 1.09	24	2.9	533,349,713	1.2
1.10 - 1.19	26	3.1	1,526,047,983	3.5
1.20 - 1.29	32	3.8	1,164,759,166	2.7
1.30 - 1.39	35	4.2	4,320,044,396	10.0
1.40 - 1.49	49	5.8	1,820,111,175	4.2
1.50 - 1.59	44	5.2	1,689,961,027	3.9
1.60 - 1.69	54	6.4	1,506,806,925	3.5
1.70 - 1.79	53	6.3	2,165,736,156	5.0
1.80 - 1.99	91	10.8	3,096,242,846	7.1
2.00 and up	296	35.3	21,671,310,876	50.0

Office – It's complicated

- The positive – If you own office in Bham, BH and RO, you are more fortunate than most office owners.
- Nationwide – suburban office doing better than CBD offices
- The amenity that is most desired now is a short commute and a busy office. Other amenities – easy parking, walkable to lunch spots, community assets
- Office Conversions – TOUGH – only work well in the right location and right building

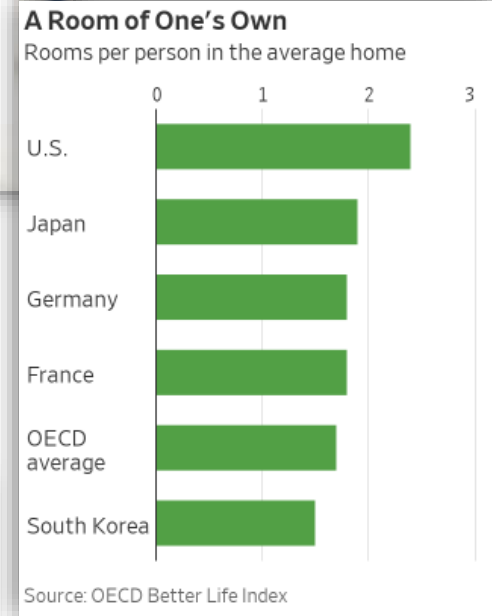


Suburban
Home
Office

Hip Urban
Office
Building

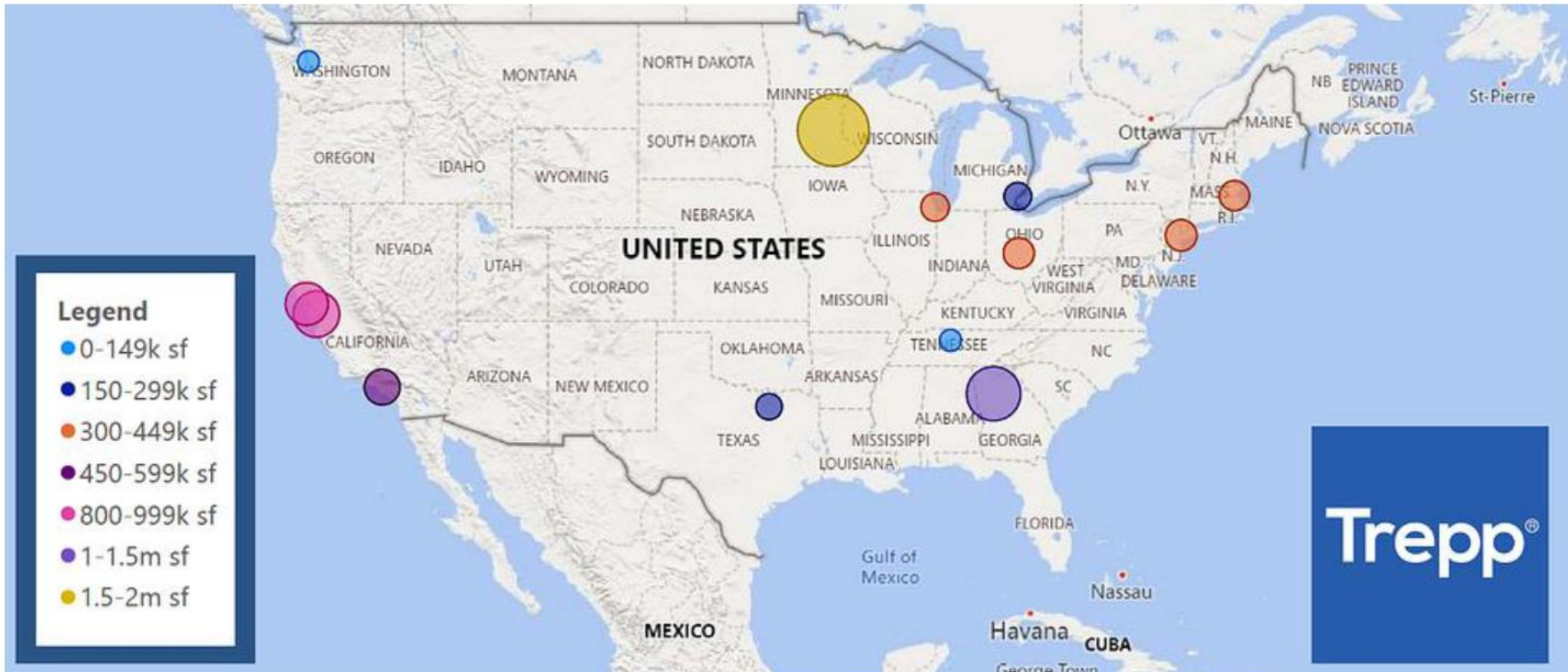
Bigger homes, longer commutes and a tighter labor market help explain why Americans spend less time in the office than Europeans and Asians, workplace consultants say.

Living arrangements are one reason for the difference in work habits. Americans are more likely to live in spacious suburban houses. That makes it easier to set up a home office away from distractions. Hong Kong's small apartments, for example, often house multiple generations, [making working from home](#) less appealing.



Office Sublease Availability (10-22) – Nationwide

Trepp®



What is not being talked about???

Hot Take: Less office space may be less productive
Are tenants being short sited by reducing space?



Office – is the office of the future the office of the past?

- **OPINION WARNING**

- Anecdotal – Some new office trends (Hot Desk / Hoteling) may be suppressing office attendance.
- Negative Feedback from EE's at local large F500 firms removing private cubes and replacing with hot desks.
- Looks cool in pictures – but does it work to get your best work done and feel like a comfortable work home?
- What if people don't want couches at work? What if they want private work space to concentrate more?

__ IT WAS a bold experiment in creating the office of the future. There were no offices, no desks, no personal equipment. And no survivors. __

In the end, the employees of the TBWA Chiat/Day advertising agency did what former boss Jay Chiat had wanted them to do all along. They got the hell out of the office.

Wired Magazine - 1999

The agency held a grand opening in December for its new, decidedly nonvirtual workspace in Playa del Rey. There, everybody has a desk and a hardwired phone. Some have screened-off workstations called "nests," others are in cave-like enclosures called "cliff dwellings," but everyone's got personal space of some kind. The theme this time around - there are still clients to impress and reporters to hook - is "Advertising City." The building is divided into client-based "neighborhoods." There is an artificial park with ficus trees and benches, and a gleaming basketball court. It feels a little like Pleasantville. If the message sent to employees by the virtual office was, "Get your assignment and hit the road," this one is saying something entirely different: Stay a while. Stay all night. Hell, you can live here. Which makes obvious sense in a business that is fueled by twentysomethings pulling late-nighters.

Still, it's hard to say what the legacy of the virtual gambit is. For the people who lived through the experiment it may be a newfound appreciation for any kind of wall. Unlike the rest of us, they no longer harbor fantasies about working on the beach. And they're more aware of the delicacy of the bonds that link a company's workforce. Spencer learned one other thing: "Deep down, we're all still cave dwellers," he says.

Forbes Magazine - 2018

It sends the message that employees don't matter

Employers frequently say their employees are their biggest asset. But when the company can't even be bothered to let you have a permanent desk, then the opposite message is sent. Put another way; hot desks mean you don't matter to the company.



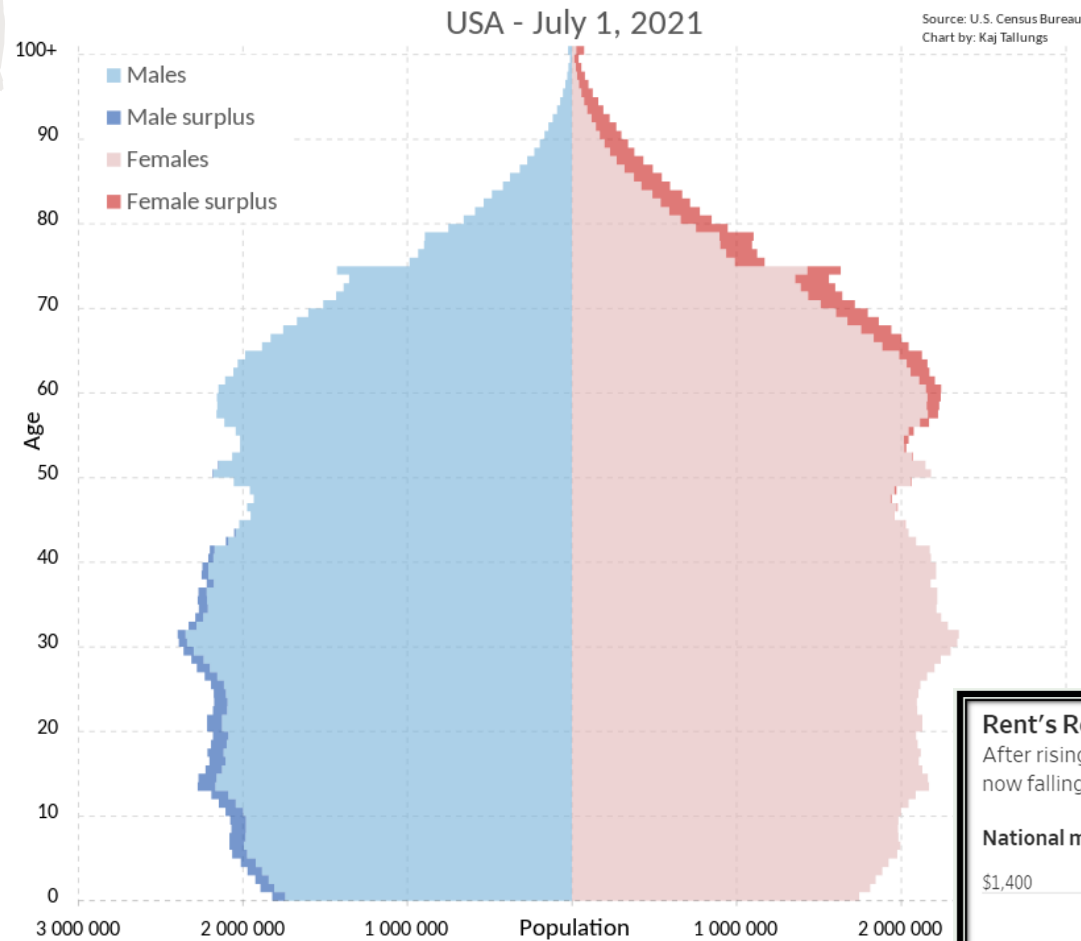
When will office workers want to live at the office again?



Todd Szymczak / szymczak@farbman.com

Multifamily

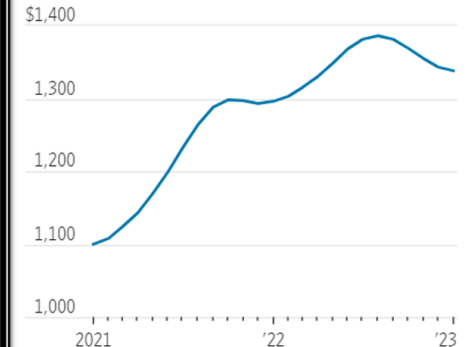
- Most MR Multifamily bought pre-CoVID is doing fine. If you were able to capture the rent increases of 2021-2022, you have likely outpaced inflation...
- New Supply is mostly small units. Lots of Studios and 1-Beds. Older supply that is renovated offers larger units. Why? ROI PSF being maximized... but are there too many of those units and not enough for families?
- Senior Living properties have struggled to recover from CoVID. Prior to CoVID there was a LOT of this product built, increasing supply and at the same time more seniors are delaying moving into senior focused housing. Expenses way up. Could Demographics help soon?
- Some student housing markets are overbuilt, rents not keeping up with expenses. Could Demographics be a challenge?
- Overall – not much distress in Multifamily but expect some special situations.



Rent's Retreat

After rising for two years, apartment rents are now falling on a monthly basis.

National median rent



Source: Apartment List median rent estimates for new leases

Multifamily – Class A

- Birmingham, Royal Oak, Ann Arbor and Grand Rapids are tops. Downtown Detroit is weak... but guessing okay longer term.
- Debt is available for MF, but underwriting is getting harder. Land Cost and Taxes are a big issue with new properties in high end markets like Birmingham and Ann Arbor.
- Market is seeing a LOT of new supply. Expect the new supply will be absorbed. As more high-end options are available, more modest apartments that have not been updated may only be able to compete on price. Oversupply will eventually hurt the low end most.

RET approx. \$9k / unit



Unit Mix >>

Beds	Units	Avg SF	Asking Rent/Unit	Asking Rent/SF
1	2	1,175	\$4,738	\$4.03
2	16	1,390	\$5,475	\$3.94
3	8	1,510	\$8,213	\$5.44
Totals	26	1,410	\$6,261	\$4.44



Industrial

- Trade war + CoVID supply shocks + Ukraine Supply shocks = let's keep more of that HERE.
- The “Re-Shoring” story you hear about is real. Won't last forever, but it is very real right now. Very tight supply in industrial of all types and sizes.
- Replacement cost for industrial is very high, over \$150 PSF, making existing supply worth much more.
- Virtually no delinquency in Industrial.
- Debt is easy to get right now, lenders love industrial
- Nothing grows to the moon... at some point we will have enough.
- Maybe this time is different

Things that make you go HMMMMMM....



Industrial real estate is flourishing, but needs more space

Crains – March 6th, 2023

According to a fourth-quarter report from the local offices of New York City-based brokerage firm Newmark, active industrial and warehouse construction hit a two-year high at 7.5 million square feet, with 82 percent of that being Class A bulk warehouse facilities.

This year alone, developers are expected to bring to the market 16 new spec warehouse developments with over 5 million square feet of space. That figure rivals the past 10 years combined, a period during which there were 23 spec warehouse buildings with 10.2 million square feet, according to Newmark. The vacancy rate is just 3.4 percent.

A study by Commercial Search, a division of Yardi Systems Inc., says that the Detroit market has the 13th highest amount of industrial construction taking place, clocking in at 10.5 million square feet. Other Midwestern cities like Chicago (27 million square feet), Indianapolis (15.7 million square feet) and Columbus (13 million square feet) outpace the metro region. The company says nationwide there is more than 690 million square feet under construction, besting last year's previous all-time high of 592 million square feet.

In Closing...

- This time COULD be different
- Demographic trends and the way we live are much different now (Baby Boom retirements finally happening, less immigration)
- Construction costs and energy costs likely stay at a higher level than pre-2020
- New Cold-War(s)... less global economic cooperation
- It's an amazing time to be alive!

