Q3 2023

Volume 4, Issue 3

SPERRY NEWS YOU CAN USE

A Word From Our President

What to do? For owners, investors, and funds alike it appears it is a question of waiting and counting on a new price equilibrium to enter the market. Given today's continuing tightening of credit and the prevailing interest rate environment, likely to remain in place throughout 2024, prices will have to adjust if transaction volume is going to see more deals across the commercial real estate sector mid-to-late 2024. There are plenty of properties listed and available, however transaction volume is reportedly down across the industry in the range of 50–70%.

There is a lot of capital waiting to be placed, but until prices find that much needed stability, this capital is likely to remain on the sidelines.

Opportunities are largely limited by pricing expectations and tight credit terms. Correctly priced assets will attract a lot of attention, but going out to market with unrealistic pricing, hoping to catch a desperate buyer, is a game of folly. Consulting with a SperryCGA agent who knows the market dynamics and setting the correct price, will achieve the right result.

For those properties where the loan is coming due in the next 18-24 months, borrowers may risk the lender looking to require additional equity in the deal to 'right size' the loan amount and achieve the required DSCR. SperryCGA has created a Commercial Property Resolution Team (Sperry C.P.R.) which provides consultation, and our national C.P.R. team is ready to assist owners to better understand their loan options.

I hope that you enjoy reading this newsletter - it's packed once again with original content. In its pages, you will hear from Sperry market experts around the country. Reach out to them and ask how they can assist you with navigating today's markets.

NEWS INSIDE THIS ISSUE:

Q2 2023 REAL ESTATE CYCLES ACROSS THE U.S. & 54 METROS, 5 PROPERTY TYPES - Dr Glenn Mueller

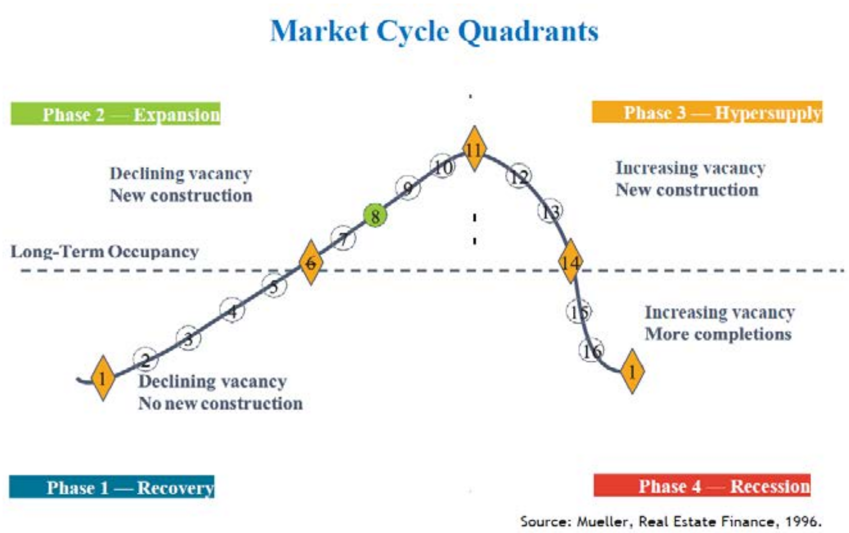
by: TED C. JONES, PhD
CHIEF ECONOMIST
SVP, STEWART TITLE

U.S. Commercial real estate sales hit a record $912.5 billion in 2021 and then posted a second best $730.7 billion in 2022 according to data from ***MSCI-Real Capital Analytics*** using individual and portfolio property sales of $2.5 million and greater across the U.S. The first graph shows the volatility of commercial sales annually since 2007, which prior to recent years had been the best on record.

Rising loan and cap rates commencing in Q4 2022 and continuing are eroding commercial real estate sales and values across the country. Total U.S. commercial real estate transaction volume year-to-date as of July 2023 was down a massive 59 percent with a staggering plunge of 74 percent for the month of July according to MCSI - Real Capital Analytics data. If the first two quarters of commercial real estate sales in the U.S. for 2023 follow the same seasonality of sales tallied from 2013 through 2019 (a period with minimal market shocks), sales are heading to $319.3 billion in 2023, down 56.3 percent from 2022 and the lowest seen since 2012.

The plunge in sales varies across property types and markets, however. One size does not fit all when talking about commercial real estate. One metro, for example, may have a tight office market while other cities are more than 30 percent vacant. And in those with 30 percent plus office vacancy, industrial space may be 3 percent or less empty. Key to optimizing returns is knowing where individual markets are heading across multiple property types.

Dr Glenn Mueller's quarterly **Commercial Real Estate Cycles** report gives an overview on what is going on in commercial real estate across the country with specifics for 54 metros including Apartments, Industrial, Office, Retail and Hotel properties. Dr. Mueller defines four distinct phases in the commercial real estate cycle providing decision points for investment and exit strategies. Long-term occupancy average is the key determinant of rental growth rates and ultimately property values. Ideally, **Phase 2 - Expansion** is the best quadrant for real estate investor performance as shown in the following graphs and discussion. Most graphs in this summary are taken directly from Dr Mueller's Q2 2023 report and are copyrighted.



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Across the cycle, Dr. Mueller describes rental behavior within each of the Phases, using **Market Levels** ranging from 1 to 16. Equilibrium occurs at **Market Level 11** in which demand growth equals supply growth – literally the sweet spot. The equilibrium **Market Level 11** is also the peak occupancy level.

Phase 1 - Recovery Declining Vacancy, No New Construction

1-3 Negative Rental Growth
4-6 Below Inflation Rental Growth

Phase 2 - Expansion Declining Vacancy, New Construction

6-8 Rents Rise Rapidly Toward New Construction Levels
8-11 High Rent Growth in Tight Market

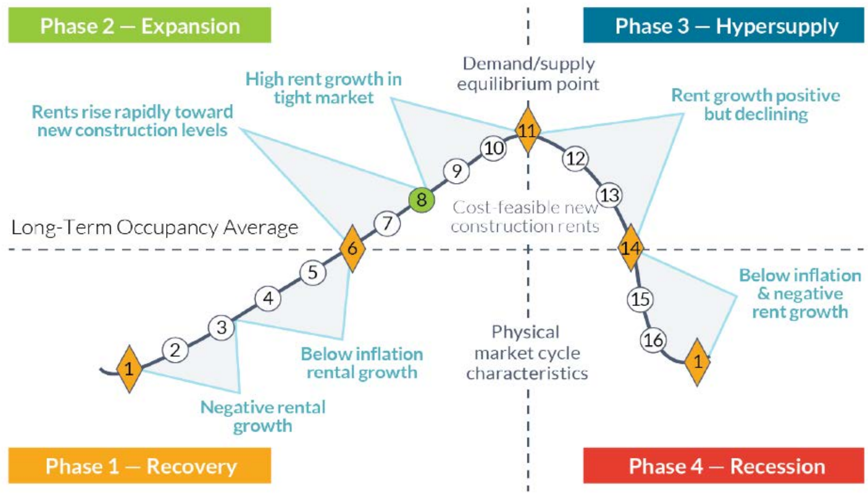
Phase 3 - Hypersupply Increasing Vacancy, New Construction

11-14 Rent Growth Positive But Declining

Phase 4 - Recession Increasing Vacancy, More Completions

14-16, then back to 1 Below Inflation, Negative Rent Growth

Rent Growth across the cycle is characterized as follows:



Source: Mueller, Real Estate Finance, 1996.

Rents and occupancy changes for Q2 2023, as reported by Mueller, are detailed for the U.S. in aggregate in the table. Industrial properties posted the largest annual rent gain up 8.9 percent year-over year followed by retail at 3.8 percent. The 0.8 percent annual rent gain for offices followed massive declines since the onset of the pandemic indicating the market may be nearing a trough along with a move by tenants as leases renew to more upscale, higher-rent properties.

U.S. Q2 2023 Commercial Market Performance

	Occupancy	Rent Change *	
	Change	Quarterly	Annually
Office	-0.3%	0.1%	0.8%
Industrial	-0.3%	1.5%	8.9%
Apartment	-0.3%	1.0%	1.2%
Retail	0.1%	0.8%	3.8%
Hotel	1.0%	1.3%	2.8%

Dr. Mueller's Q2 2023 report shows the current cycle stage from a national perspective across property types. *The ideal rating is* ***Phase 2- Expansion*** *and* **Market Level 11**.

Industrial - R&D Flex, Industrial - Warehouse, Retail - Neighborhood/Community, Retail - Factory Outlet, Retail - Regional Malls & Power Centers and *Hotel* property types were in **Phase 2 – Expansion** in Q2 2023 for the U.S.

Property types at peak performance **Market Level 11** included: *Industrial - R&D Flex, Industrial – Warehouse, Retail – Neighborhood/Community* (think grocery stores), and *Retail – Factory Outlet.*

Article reprinted courtesy of Stewart Title. To continue reading, please click here.

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Stewart Title Guaranty Company
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stewart

MULTIFAMILY EXPENSES RISE AS INSURANCE, OTHER COSTS SOAR

by: PAUL FIORILLA
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YARDI MATRIX
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Multifamily fundamentals have been stellar for nearly a decade, but rising expense costs are creating an ill-timed headwind just as rent growth is decelerating. Expenses for multifamily properties nationally grew by 9.3% on average in the trailing 12-month period ending in June 2023, which is 63% higher than the 5.7% increase during the previous 12-month period, according to Yardi Matrix expert data.

Expenses rose in most every category, but the biggest increase was in insurance, which was up 18.8% on average in the 12 months ending in June 2023, per Matrix.

Other expense categories with large jumps over the last year include repairs and maintenance (14.2%), administrative (11.8%), and utilities and payroll (both 7.8%). Perhaps surprisingly, taxes increased by only 5.9%. The increase in expenses in the period ending in June 2023 represents $740 in additional costs per unit at the average U.S. multifamily property, with the average property operating expense rising to $8,694 per year per unit, according to Matrix.

Rapid expense growth comes at an inopportune time for the industry. After a long bull market, asking rent growth has decelerated and is likely to remain weak in many metros as deliveries hit levels last seen in the 1980s. Also, the big jump in mortgage rates from the 3-5% range to the 6-9% range has produced a large increase in debt-service costs for properties that need new mortgages.

That said, it is important to keep the expense numbers in perspective. Operating expenses represent about 43% of gross income, according to Matrix, and income in recent years has grown more than expenses. Since the beginning of 2013, asking rents have increased 59% nationally.

T-12 Month Increase in Insurance Costs by Category

Expense Category	T-12 Month YOY % Change
Insurance	18.8%
Repairs/Maintenance	14.2%
Administrative	11.8%
Payroll	7.8%
Utilities	7.8%
Management	7.2%
Taxes	5.9%
Marketing	4.9%
Total Operating Expense	9.3%
Total NOI	8.0%

Source: Yardi Matrix, as of 6/23

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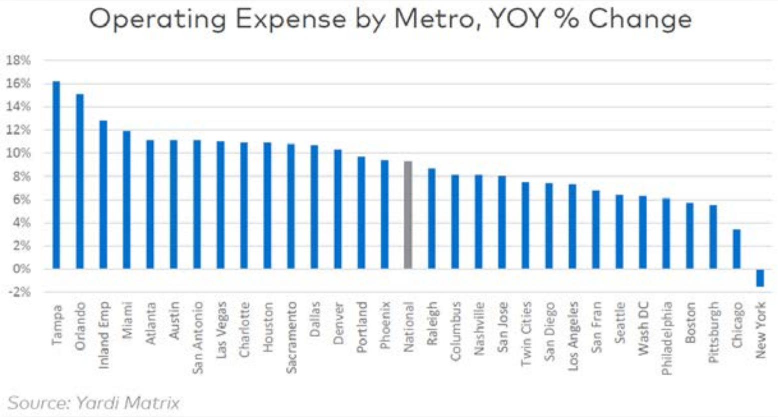
Multifamily Expenses Rise As Insurance, Other Costs Soar

In the 12-month period examined for this report, net operating income increased by $838 per unit nationally, which is almost $100 per unit more than the increase in expenses.

That means most multifamily properties remain ahead of the game and most continue to perform well. Year-to-date through July 2023, nearly 200,000 units had been absorbed, and rents were up a modest 1.5% through August. The national occupancy rate for stabilized properties is 95.0%, per Matrix, below cycle highs but solid by longterm standards.

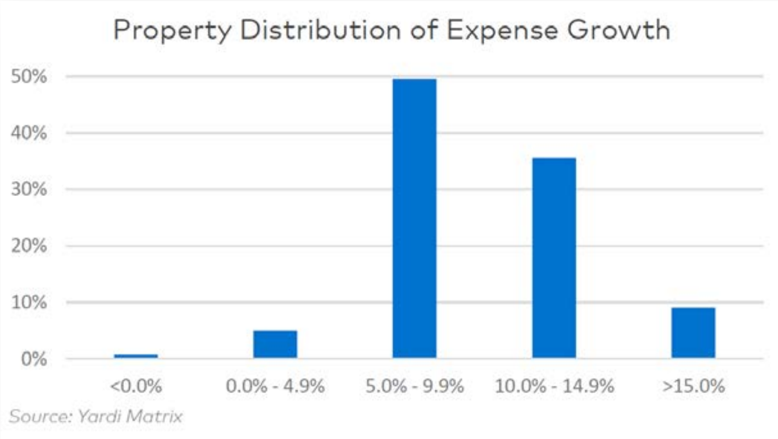


Costs Rise Fastest In Southeast, Southwest

To get a handle on rising expense growth, Yardi Matrix tabulated expenses by category and geographic area by aggregating data on more than 20,000 properties with nearly 5 million units that use Yardi accounting software. This aggregated and anonymized "expert" data is available to Matrix clients. We broke down the increase in expenses in the trailing 12-month period ending in June 2023. The results found that expense growth was widespread, as operating expenses increased between 5.0% and 14.9% in 85% of U.S. multifamily properties in the last year, according to Matrix.

"I've missed more than 9,000 shots in my career. I've lost almost 300 games. Twenty-six times I've been trusted to take the game-winning shot and missed. I've failed over and over again in my life, and that is why I succeed".

- Michael Jordan



Total operating expenses increased by 9.3% on a trailing 12-month basis nationally. By category, insurance recorded the largest increase at 18.8%, followed by repairs/maintenance (14.2%), administrative (11.8%), payroll and utilities (both 7.8%), management (7.2%), taxes (5.9%) and marketing (4.9%). The rapid growth reflects national inflation trends, such as the increasing number of weather-related events that cause property damage, the tight labor market that is driving up employee wages, growing energy costs, and supply-chain issues that increase the cost of materials and appliances.

Regional multifamily expense growth reflected national inflation trends, as costs rose the most in rapid-growth regions, led by the Southeast (11.0%) and Southwest (10.3%). Expenses grew less rapidly in the West (9.0%), the Midwest (8.3%) and the Northeast (5.5%). Despite the increase, expenses remain lower in the regions with the highest year-over-year growth. Properties in the Northeast have the highest expenses per unit at $11,251, followed by the West ($9,325), Southwest ($8,144), Southeast ($8,141) and Midwest ($7,635).

Small metros recorded the biggest jumps in expenses over the last year, led by Huntsville, Ala., where expenses increased by 20.0%. Other tertiary metros with large increases include Spokane, Wash. (18.5%);...

This article has been reprinted courtesy of Yardi Matrix

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SPERRY COMMERCIAL GLOBAL AFFILIATES®

CPR COMMERCIAL PROPERTY RESOLUTION TEAM

SperryCGA has launched a national Commercial Property Resolution (C.P.R.) team of consultants known to maximize the value, and return of capital, from commercial assets.

The C.P.R. team provides immediate underwriting solutions nationwide to real estate clients and financial institutions with loan and challenged assets.

We team with our Strategic Consultants to create, design, implement and execute customized marketing plans for the disposition or loan workout of assets.

CONSULTING SERVICES

ASSET ANALYSIS

- Broker Option of Value (BOV)
- Underwriting
- Asset Preservation

BROKERAGE

- Investment Sales
- Property Management
- Leasing

MARKETING

- Aggressive & Broad Based
- Auction Options
- Potential list to close in 90 days

LOAN WORKOUT SOLUTIONS

- Consulting on Options
- Modifications
- Forbearance Negotiation
- Receivership

LOAN MATURITIES

- High LTV
- Low DSCR
- Extensions
- Bridge

STRATEGIC CONSULTANTS

- Receiver
- Property Management
- Loan Workout Specialist
- Construction Management
- Title
- Attorneys
- Due Dilligence Vendors

“I just taught my kids about taxes by eating 38% of their ice cream”.

- Conan O’Brien

WHY HIRE SPERRY C.P.R.?

SperryCGA C.P.R. team has been built on the cornerstone of cooperation and is recognized as THE international real estate company with a corporate policy, and proven track record, of inviting participation by the entire brokerage community in ALL transactions. This all inclusive approach makes SperryCGA, and the Sperry C.P.R. team of consultants, the perfect choice to meet your real estate requirements and ensure maximum resolution of your assets.

CPR COMMERCIAL PROPERTY RESOLUTION TEAM

SPERRY COMMERCIAL GLOBAL AFFILIATES®

OUR PURPOSE

Since its founding in Sperry Commercial Global Affiliates (SperryCGA) has redefined the commercial real estate industry, having sold billions of dollars of real estate for its clients from Main Street to Wall Street, adjusting to every market and every real estate cycle.

OUR TEAM

Today with the complex and turbulent financial markets, and the rapidly changing real estate marketplace, there has never been a greater need for true "hands on" experience of time-tested professionals. Clients can depend on intelligent solutions and creative strategies, for their real estate investment assets. SperryCGA has responded to meet this need, within its national platform, with a team of seasoned veterans of the real estate industry, who have seen real estate at its very best and its very worst.

RESULTS & BENEFITS

C.P.R. consultants are on the ground to serve any commercial real estate need and provide benefits that produce results for every client it serves including:

- Tried & True Professional Brokers with Extensive Experience in Fluctuating Markets
- Custom Strategies and Underwriting to find Solutions Appropriate for Individual Needs
- Vetted Strategic Partnerships to Offer Several Options
- Local and National Financial Relationships
- Fast-Tracked Marketing Plans

Current Rates

Sperrycap.com

Capital Markets Leader

Sperry RE Capital is a commercial real estate finance company that specializes in debt and equity for real estate transactions. The team has over 100 years combined experience in real estate finance, real estate development, accounting, and commercial brokerage. Sperry RE Capital provides capital market solutions to our client's commercial real estate needs. The rates provided here are for informational use only. For specific quotes, contact your local office today.

Current Index Rates As of 9/18/23

5-Year Treasury	4.45%
7-Year-Treasury	4.41%
10-Year Treasury	4.33%
SOFR	5.30%
10-Year Swap	3.96%

Commercial

Life Companies

Term	Amortization	LTV	Spread	Rate
5-Year	25-30	65%-75%	185-220	6.30%-6.65%
10-Year	25-30	50%-65%	155-190	5.85%-6.20%
10-Year	25-30	65%-75%	185-220	6.15%-6.50%
15-Year	25-30	65%-75%	185-220	6.20%-6.55%
15-20 Year Fully Amortizing		65%-75%	185-220	6.15%-6.50%

Most life company lenders have floors of 2.75% and above. CALL FOR RATES.

CMBS

Term	Amortization	LTV	Spread	Rate
5-Year	30	65%-75%	350-400	7.75%-8.25%
10-Year	30	65%-75%	290-340	6.90%-7.40%

Multifamily

Freddie Mac-Conventional

Term	LTV	DSCR	Spread	Rate
15-Year	80%	1.25x	175-205	6.05%-6.35%
10-Year	55%	1.55x	130-160	5.60%-5.90%
10-Year	65%	1.35x	140-170	5.70%-6.00%
10-Year	80%	1.25x	160-190	5.90%-6.20%
7-Year	55%	1.55x	135-165	5.75%-6.05%
7-Year	65%	1.35x	145-175	5.85%-6.15%
7-Year	80%	1.25x	165-195	6.10%-6.40%
5-Year	70%	1.30x	155-185	6.00%-6.30%
10-Year ARM	80%	1.25x	210-240	7.40%-7.70%

Minimum index floor of 0.50% for all fixed-rate terms

Contact: Hillman Lam hlam@sperrycap.com
646-820-8618

Will Lawyer wlawyer@sperrycap.com
917-704-7708

Fannie Mae-Conventional

Term	LTV	DSCR	Spread	Rate
15-Year	65%	1.35x	170-235	6.00%-6.65%
10-Year	55%	1.55x	135-190	5.65%-6.15%
10-Year	65%	1.35x	125-205	5.55%-6.35%
10-Year	80%	1.25x	155-225	5.85%-6.55%
7-Year	55%	1.55x	130-185	5.70%-6.25%
7-Year	65%	1.35x	140-205	5.80%-6.45%
7-Year	80%	1.25x	165-235	6.05%-6.75%
5-Year	65%	1.25x	170-260	6.15%-7.05%
10-Year ARM	75%	1.00x	265-280	7.95%-8.10%
For loans less than $6MM, increase spread by 10 bps				

Construction Loan Financing

Construction Loans- Please Call Agent		

FHA-221(D) 4 Construction/Permanent

Term	Amortization	LTV	DSCR	Rate
40	40	85%	1.176x	6.40%-6.60%

Before MIP of 0.25% to 0.65%

Life Companies

Term	Amortization	LTV	Spread	Rate
5-Year	25-30	65%-75%	180-215	6.25%-6.60%
10-Year	25-30	50%-65%	150-185	5.80%-6.15%
10-Year	25-30	65%-75%	180-215	6.10%-6.45%
15-Year	25-30	65%-75%	180-215	6.15%-6.50%
15-20 YR	Fully Amortizing	65%-75%	180-215	6.10%-6.45%

Most life company lenders have floors of 2.65% and above. CALL FOR RATES.

CMBS

Term	Amortization	LTV	Spread	Rate
5-Year	30	65%-75%	350-400	7.75%-8.25%
10-Year	30	65%-75%	290-340	6.90%-7.40%

Rates are general in nature and are informational use only. Rates are subject to change at anytime and the information provided is not a commitment to lend. For specific quotes based on your property, contact a Sperry RE Capital representative.

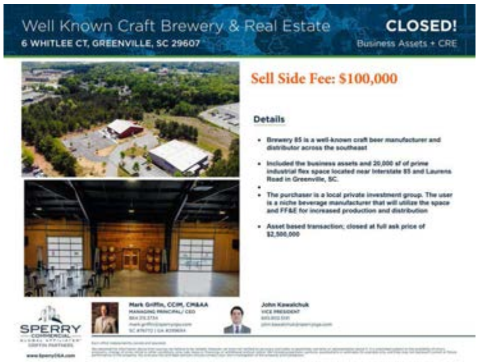
Commercial Real Estate
Debt + Equity
Investment Sales
Loan Servicing

SCAN ME

6 WHITLEE COURT, GREENVILLE, SC 29607

CRAFT BREWERY & REAL ESTATE

$2,500,000 CLOSED!



213 ARNOLD MILL RD, WOODSTOCK, GA 30188

OFFICE PROPERTY

$850,000 CLOSED!

687 MARIETTA HIGHWAY, CANTON, GA 30114

Storefront Retail/ Office Medical

$2,750,000 CLOSED!

1020 THOUSAND OAKS BLVD, GREENVILLE, SC 29607

BUSINESS SALE/ LEASEBACK

$2,918,400 CLOSED!

2611 W BETHANY HOME RD, PHOENIX, AZ 85017

BETHANY WEST SHOPPING CENTER

$5,875,000 CLOSED!

3600 NE 73RD PLACE, SEATTLE, WA 98115

TERRACE VIEW 7 APARTMENTS

$3,100,000 CLOSED!

7004 N ATLANTIC AVE, CAPE CANAVERAL, FL 32920

SPACE COAST CBD

$199,000 CLOSED!

7447 E SOUTHERN AVE, SUITE 107-108, MESA, AZ 85209

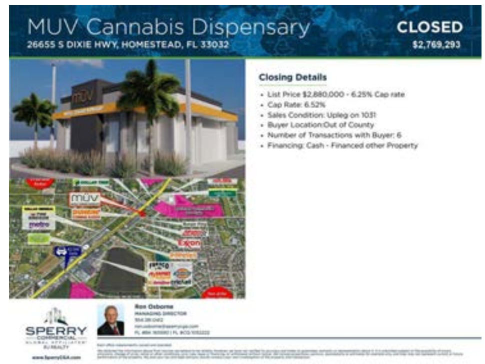
THE COMMONS AT SUPERSTITION SPRINGS

$1,260,000 CLOSED!

13819 W TEST DRIVE, GOODYEAR, AZ 85338

4 ACRE LOT

$4,021,500 CLOSED!



26655 S DIXIE HWY, HOMESTEAD, FL 33032

MUV CBD DISPENSARY

$2,769,293 CLOSED!

4916 BABCOCK ST NE, PALM BAY, FL 32905

TURN-KEY RESTAURANT BUSINESS WITH REAL ESTATE

$1,495,000 FOR SALE!

270 REMINGTON BLVD, BOLINGBROOK, IL 60440

SINGLE-STOREY OFFICE INVESTMENT

$6,495,000 FOR SALE!

827 N MAIN STREET, MARION, OH, 43302

HEALTH CARE BUILDING

$1,310,000 FOR SALE!

1369-1373 LOWRIE AVE, SAN FRANCISCO, CA 94080

MULTI-TENANT FOOD MANUFACTURING WAREHOUSE

CALL FOR PRICING

FOR SALE!

2712 N COCOA BLVD, COCOA, FL 32922

TURN-KEY FURNITURE STORE BUSINESS

$1,290,000 FOR SALE!

4520 SYCAMORE SCHOOL RD, FORT WORTH, TX 76133

MULTI-FAMILY LAND

$2,500,000 FOR SALE!

7553 COMSTOCK AVE, WHITTIER, CA 90602

10-UNIT MULTIFAMILY

$3,000,000 FOR SALE!

LAURENS COUNTY, SC

ESTABLISHED WINDOW & DOOR INSTALLATION

$550,000 BUSINESS & ASSETS!

RAMONA EXPRESSWAY, SAN JACINTO, CA 92583

2 PARCEL MULTIFAMILY LOTS

$2,685,000 FOR SALE!

2301 W DUNLAP AVE, PHOENIX, AZ 85021

DUNLAP EXECUTIVE OFFICES

$2,950,000 FOR SALE!

THE DALLAS-FORT WORTH COMMERCIAL REAL ESTATE MARKET: THRIVING AMIDST GROWTH AND DIVERSITY

by: HEATHER KONOPKA, CCIM
MANAGING DIRECTOR
FORT WORTH, TX
heather.konopka@sperrycga.com

The Dallas-Fort Worth (DFW) Metroplex has long been a focal point of economic activity in Texas and in the United States, and its commercial real estate market stands as a testament to its vibrant and dynamic economy. Diving deeper into DFW, our Sperry Commercial Global Affiliate, Heather Konopka, CCIM, shares intel regarding major employers, population growth, and key highlights, shedding light on why it remains a hotbed for growth, investments and development.

MAJOR EMPLOYERS

The Dallas Fort Worth Metroplex continues to draw major corporations to the Lone Star state for a myriad of reasons; Pro-Business Environment with no state taxes and affordable housing are certainly at the top of the list.

Technology

DFW has witnessed a significant influx of tech companies in recent years, with giants like Amazon, Google, and Facebook establishing major operations in the area. In particular, the northern suburb of Plano has become a tech hub, housing regional headquarters for companies like Toyota and FedEx.

Healthcare

The healthcare sector plays a vital role in the DFW economy, with major institutions like Texas Health Resources and Baylor Scott & White Health headquartered in DFW. These institutions drive both employment and demand for medical office space.

Finance

The DFW area is home to several financial institutions, including Schwab, Fidelity, Bank of America, JPMorgan Chase, and Goldman Sachs. This concentration of financial power creates a strong demand for office spaces in the DFW area with two of those located in Westlake.

Energy

With Texas being a leader in the energy sector, it's no surprise that many energy companies have a significant presence in DFW. Energy giants like ExxonMobil and Chevron Phillips Chemical are among the top employers in the region, fueling demand for industrial and office space.

PRODUCT DIVERSITY

DFW has experienced remarkable population growth over the past few decades, making it one of the fastest-growing metropolitan areas in the country. This population surge has had a profound impact on the commercial real estate market in several ways:

Residential

D.R. Horton & Meritage are just two of DFW's prominent residential developers that remain bullish despite an uptick in interest rates. The demand for housing has skyrocketed over the last 5 years and is anticipated to add another 2,000,000 residents over the next five years reaching nearly 8.5 million people; all of this is driving the need for retail and mixed-use developments, creating opportunities for commercial real estate investors.

Retail

The influx of residents has created a strong consumer base, increasing demand for retail spaces. As of mid-year 2023, occupancy has maintained a record-high level despite two legacy retailers, Bed Bath & Beyond and Tuesday Morning closing their doors.

Office
The influx of young professionals has led to a boom in the co-working and flexible office space sector. Companies like IWG, parent company of Regus and several other coworker labels, have established a significant presence in DFW, catering to the evolving work preferences of the population.

Industrial
The region's strategic location at the crossroads of major highways has made it a logistics and distribution hub. E-commerce giants like Amazon and FedEx have built massive fulfillment centers in DFW to serve the growing demand for online shopping.

Multifamily
With a diverse and expanding population, there is a continuous need for multifamily housing units. Developers are actively building build for rent housing, apartment complexes and condominiums to meet this demand.

MARKET STABILITY
DFW's economy has demonstrated resilience during economic downturns, with relatively stable property values and rental rates compared to other major markets. This stability is a strong draw for investors seeking safe havens for their capital.

Infrastructure Investments
The DFW area has witnessed significant investments in infrastructure, such as transportation and utilities. The Dallas-Fort Worth International Airport, one of the busiest in the world, and the expansion of major highways have further facilitated business growth and connectivity.

Quality of Life
DFW offers a high quality of life, with a mix of urban and suburban living options, excellent schools, cultural amenities, and a relatively low cost of living compared to other major metropolitan areas.

Pro-Business Environment
Texas, in general, is known for its business-friendly policies, including no state income tax. This pro-business environment has attracted a steady stream of companies and entrepreneurs, contributing to the vitality of the commercial real estate market.

CONCLUSION
Dallas-Fort Worth is a great place, whether it is investing in commercial real estate, relocating your company or seeking a better quality of life! The DFW market stands as a testament to the region's economic vitality and growth. With a diverse range of major employers and a surging population, it continues to be a hotspot for real estate investors and businesses looking to capitalize on the opportunities presented by this dynamic area. As DFW continues to evolve and expand, the DFW Metroplex will remain a vibrant and lucrative region for years to come. Feel free to reach out to Heather Konopka, CCIM, for your investment and or company relocation needs.

TECH MARKETS PERFORMANCE INDEX: AI INVESTMENT BOOSTING OFFICE MARKETS

by: DAVID CAPUTO
DATA SCIENTIST
MOODY'S ANALYTICS

The national office market has been on rocky footing for a few years now, but better leasing activity combined with limited construction prevented vacancy rate spikes as expected this quarter – **vacancy actually fell to 18.8%, while rent grew by 0.2%.** What else was happening in Q2? Artificial intelligence (AI) investment skyrocketed in the tech sector.

Here is a quick update on how tech markets fared in the second quarter of 2023, as well as some specific market activity highlights worthy of continued attention with some in-depth analysis on AI's impact on the tech sector.

OFFICE VACANCY UPDATES

In the first quarter of 2023, Moody's Analytics updated tech designations based on how the metros performed over the past year. To recap, New Orleans, Ventura, and Greensboro dropped out of the emerging markets designations, while Salt Lake City and Oklahoma City were bumped up into that group. Even though the designations have been updated, the 2023 Q2 results are following the old pattern: emerging markets saw their office vacancy rate decline by 70 bps, favorable in comparison to established tech markets which stayed flat while the national average declined by 20 bps.

The driving force behind the emerging markets' vacancy decline were standout markets Nashville, Knoxville, and Buffalo. Nashville's vacancy boasted a 340 bps drop, Knoxville experienced a 160 bps decline, and Buffalo followed behind with a decrease of 90 bps. Of all the tech and emerging markets covered, 12 saw vacancy drops while 14 markets that saw a vacancy increase or flat movement.

Rank	Designation	Market Name	Vacancy Chg (BPS)
1	Emerging	Nashville	-340
2	Emerging	Knoxville	-160
3	Emerging	Buffalo	-90
4	Tech	Chicago	-90
5	Emerging	Greenville	-80
6	Tech	Baltimore	-60
7	Tech	Boston	-30
8	Tech	Atlanta	-20
9	Emerging	Miami	-20
10	Tech	New York Metro	-20

Source: Moody's Analytics CRE

Established tech metros lagged behind emerging metros and the national average, so it is not surprising to see that the worst performing metros this quarter were in this designation. Denver, Dallas, San Francisco, and Washington, DC were the main culprits: they saw vacancy increases of 100 bps, 90 bps, 60 bps, and 60 bps, respectively. The worst emerging market performer was Norfolk, which saw a vacancy increase of 50 bps. This was the only emerging market that saw an increase of over 10 bps in the second quarter.

> **"It takes a great deal of courage to stand up to your enemies, but even more to stand up to your friends".**
>
> **- J.K. Rowling**

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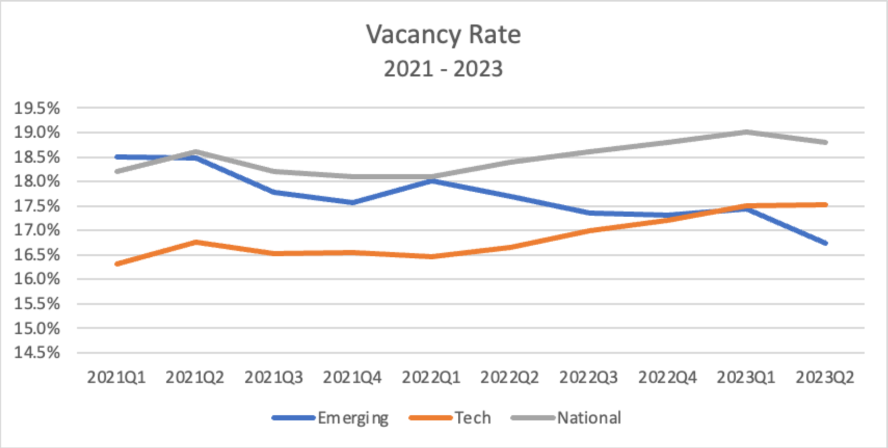
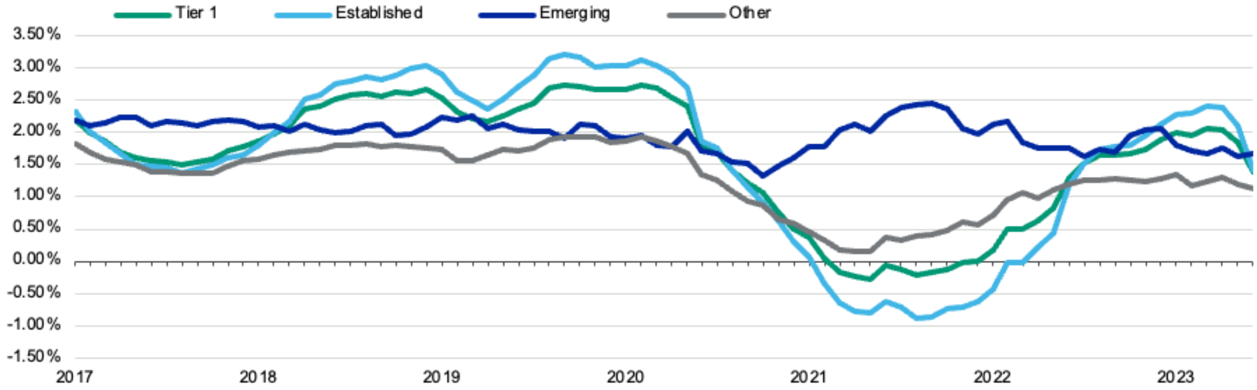


Out of the 11 emerging markets, Norfolk was the only emerging market with a rent drop, but it was only a minor 0.1% decline. Out of the 15 established tech markets, rents dropped in only three. San Francisco saw a sizable drop of 0.7% while Austin and San Jose decreased 0.2% and 0.1%, respectively.

While the biggest occupancy and rent declines occurred in San Francisco this quarter, concern should be minimal. The metro remains the top market in CBRE's 2022 Scoring Tech Talent report for the 10th consecutive year. Despite the lagging office numbers, both the tech talent pool and the amount of tech roles remains higher than any other market. San Francisco is in a position to reinvent itself and support the shifting economic fundamentals it faces, according to the Moody's Analytics CRE Tale of Two Cities report. Headquartered by OpenAI, emerging focus on generative artificial intelligence (GenAI) will give the city a much needed boost in popularity as companies begin to focus on the expanding new technology. This is supported by the fact that for the first half of this year all AI fundings have gone to San Francisco-based firms.

OFFICE RENT UPDATES

Similar to last quarter, both designations of tech markets and the national average are again moving positively in unison. Emerging markets led the way with 0.4% rent growth but established markets and the national average weren't far behind as both grew by 0.2%. **Emerging markets showing the strongest growth has been a common theme since the pandemic.** The strongest performing metros were littered with both emerging and established markets as the top four overall markets consisted of emerging markets Knoxville (1.1%) and San Bernardino (0.7%), and established markets Dallas (0.9%) and Baltimore (0.7%).



Rank	Designation	Market Name	Asking Rent % Chg
1	Emerging	Knoxville	1.10%
2	Tech	Dallas	0.90%
3	Tech	Baltimore	0.70%
4	Emerging	San Bernardino/Riverside	0.70%
5	Emerging	Miami	0.60%
6	Tech	Colorado Springs	0.60%
7	Tech	District of Columbia	0.50%
8	Tech	Boston	0.40%
9	Emerging	Salt Lake City	0.40%
10	Tech	Raleigh-Durham	0.40%

Source: Moody's Analytics CRE

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> **'If you can't explain it simply, you don't understand it well enough".**
>
> **- Albert Einstein**

MATURING LOAN OPTIONS

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Interest rates are up, leverage on new loans is generally down, and new loan volumes are down. Refinancing a loan at maturity is much more painful now than it has been in the past. So, what are your options when your loan is maturing?

1. Know you will need to have plenty of cash to close on the lower LTV new loan;
2. Request an extension on your existing loan;
3. Sell the property;
4. In some cases, you may even elect to hand the property back to the lender.

Now, let's go through each of these options in more detail:

Obtain a new loan to pay off existing loan

For some property types, this option is virtually non-existent. The capital markets are frozen for office deals. For other types of properties, getting a new loan may not be as difficult, however, the average LTV for new loans is likely much lower than the current LTV on the existing loan. Not to mention the interest rate increase from the existing loan. All of this may make getting a new loan not a viable option in today's market

Request an extension on your existing loan

Since extending the current loan is likely the solution in so many situations, it is important to understand how lenders and servicers are handling extensions.

First, understand that lenders are at an advantage when they know you have few options, and you are desperate to extend your loan. They smell blood in the water! What else are you going to do but accept whatever terms they are willing to give for an extension? Unfortunately, even when owners have a good relationship with their lender, they are finding this to be the case. All of us are ultimately in the business of making money, right? When we see good opportunities to make money, we go for them! We can't fault the lenders and servicers for doing the same thing even when it doesn't "feel fair".

That's what lenders seem to be doing these days. They know you have no real other option but to accept their terms and they are doing what we are all in the business of doing… making money. It is unfortunate, but we are seeing them charge obscene amounts for an extension. Many owners wind up with two options: (a) accept the lender's high fee offer to extend, or (b) go find a hard money lender somewhere to refinance. The latter option *is exactly what the lender is hoping for. The current lender is the lender of last resort.*

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Sell the property

Selling the property may be the best option for some owners. The obvious challenge is that the buyer will need to find their own financing and they will experience the same challenges obtaining a new loan (higher rates, lower LTV). The key here is to allow plenty of time for the sale and closing and be sure the closing occurs prior to the maturity date. Lenders are charging default interest and many other fees if the loan is not paid off on the maturity date.

Give property back to lender

This sounds easy enough. You simply put your "keys" in the mail and mail them to the lender. That's how it used to work. Today's non-recourse loans have carve outs that cause the loan to become recourse. Many of these can be triggered during the process of handing back the loan. So, if you chose this option, seek good advice before pursuing it.

The best thing to do if you have a maturing loan is to keep all your options open as long as possible and approach the lender with plenty of time to pivot to the best solution. The best advice I can give to anyone with a loan maturity is to plan ahead. Speak to your debt advisor at least six months prior to the maturity date to figure out what your options are and how your lender is handling extensions, so you are prepared!

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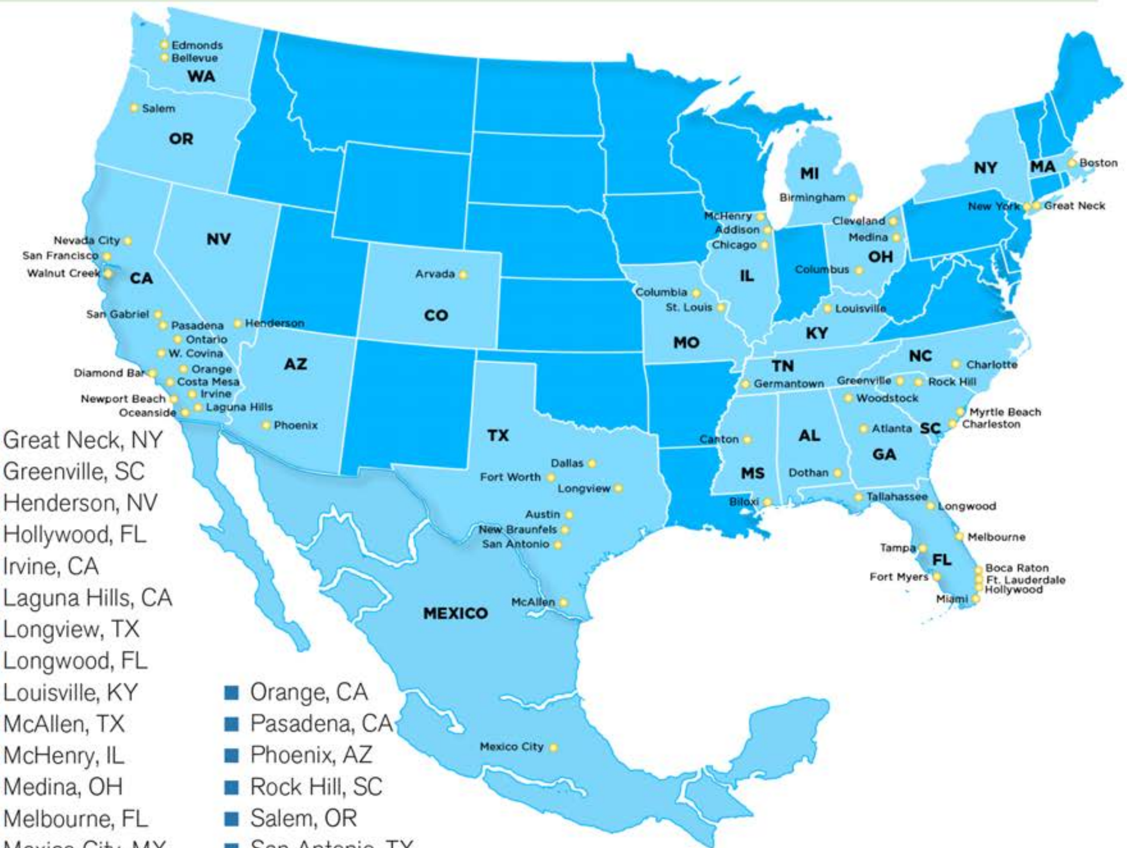

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