# Lancaster Real Estate Market Overview

February 13, 2019

# Presenters

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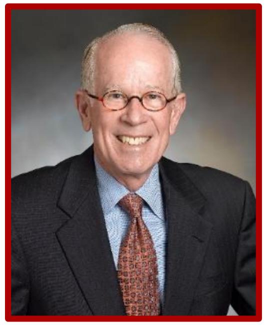

Sr. Vice President, Managing Director
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## Brad Mowbray

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# Mark Fitzgerald

President & Chief Operating Officer
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# Macro Economic Assumptions

| | 2018 Actual | 2019 Forecast |
|---|---|---|
| Total GDP | 2.9% | 2.25% to 2.5% |
| Consumer Price Index | 2.4% | 1.9% to 2.1% |
| Unemployment | January-December | |
| National | 4.1% to 3.9% | 3.6% |
| State | 4.8% to 4.2% | 4.5% |
| Lancaster | 3.6% to 3.4% | 3.0% |
| 10-Year Treasury | 2.65% | 2.75% to 3.25% |
| Credit Environment | Ample availability, competitive rates, looser underwriting, higher LTV | Ample availability, competitive rates, looser underwriting standards |

Source: Federal Open Market Committee, Wells Fargo Securities, Bank of America

# Upside/Downside Risk to 2019 Forecast

| Upside Scenario | Downside Risk |
|---|---|
| Trade deal with China is reached early in year, removing uncertainty increasing global growth | Increased trade war with China |
| Greater growth in European markets | Messy Brexit, weakening Europe’s already tepid growth |
| Stronger productivity growth and less inflation | Continued volatility in the stock market |
| More accommodative monetary policy | Additional Federal shutdown |

# 2019 Debt Markets

## Commercial Banks

- Will be more active for most asset classes
  - Underwriting standards will loosen
  - Loan-to-Value targets will increase (DSCR will be limiting factor)
  - Spreads will tighten
- Regulatory roll back of Dodd-Frank could free up more capital for CRE, increasing competition. ("HVCRE" continue to be an issue for most lenders)

## Life Companies

- Very active in 2018, continues into 2019
  - Loan portfolios grew by 8.4%, nearly twice the growth rate of all mortgage debt
- Underwriting more conservative then Banks, tighter spreads
- Very active in Multi-family and Office sectors

Source: PWC, ULI; Emerging Trends in Real Estate 2019

# 2019 Debt Markets

- Freddie Mac / Fannie Mae
  - Experienced a 24% increase in loan production in 2018 over 2017
  - Additional capital available in 2019, which will drive down spreads
  - Uncertainty around privatization???
- Commercial Mortgage Backed Securities (“CMBS”)
  - Volume is trending down
  - Focus is on large single asset properties

Source: PWC, ULI; Emerging Trends in Real Estate 2019

# 2019 Equity Markets

- Transaction volume was up significantly in 2018
  - 14.8% YOY all transactions
  - 4.9% excluding entity level sales
  - Tremendous amount of “dry powder” sitting on sideline
- With exception of International investors, buyers are increasingly moving into secondary/tertiary markets
  - Continue to look for yield and **<u>upside</u>**
  - Not as “overbuilt” as some primary markets

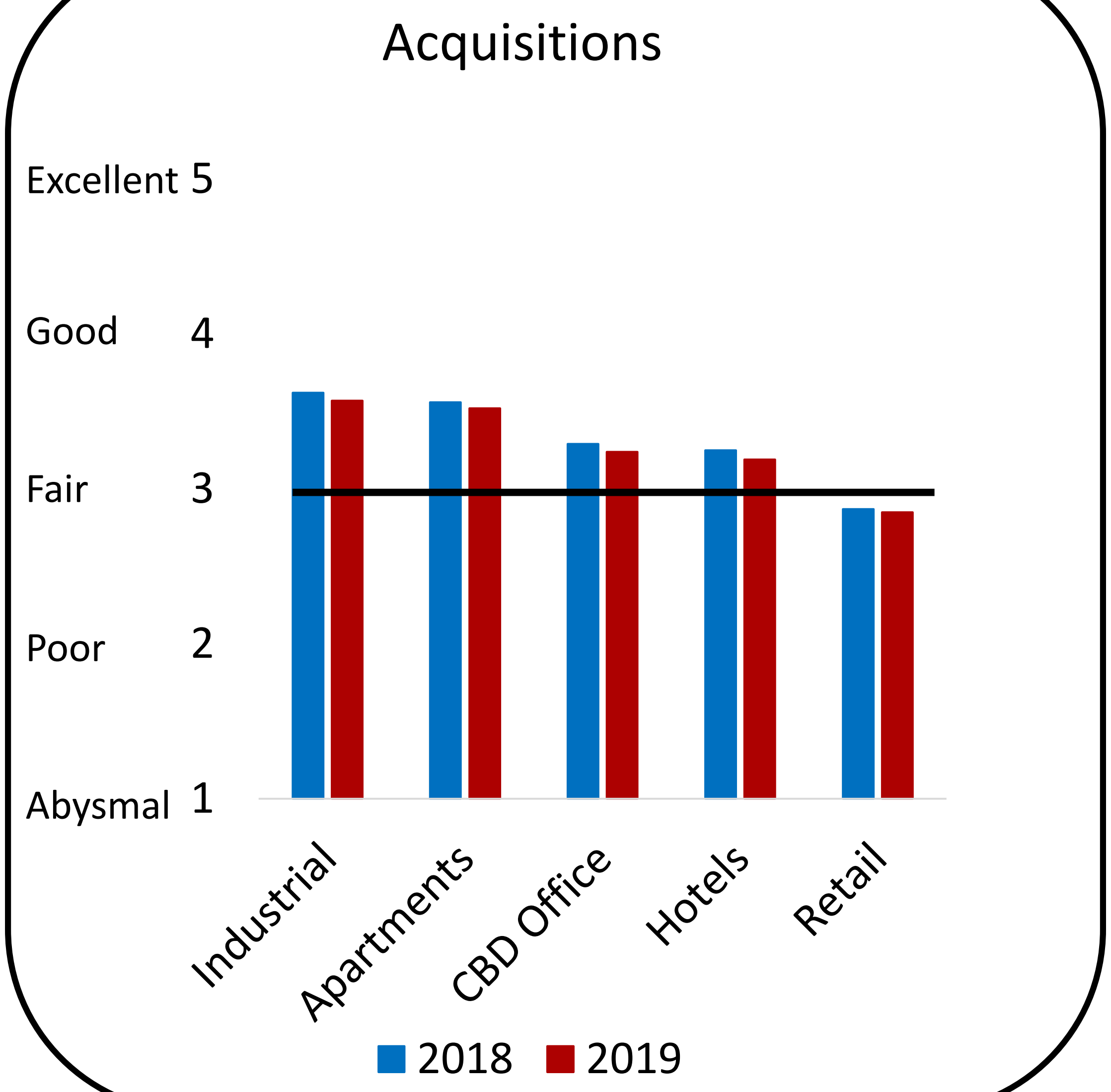
| Players | Net Activity 2Q17-2Q18 | 2019 Projected |
|---|---|---|
| Institutional /Equity Funds | Net sellers – all asset types except retail | ⟺ |
| REITS | Net sellers – all asset types except industrial | ⟺ |
| International | Net buyers – all asset types | ⟺ |
| Private Equity | Net sellers – all asset types except retail/hotel | ↑ |

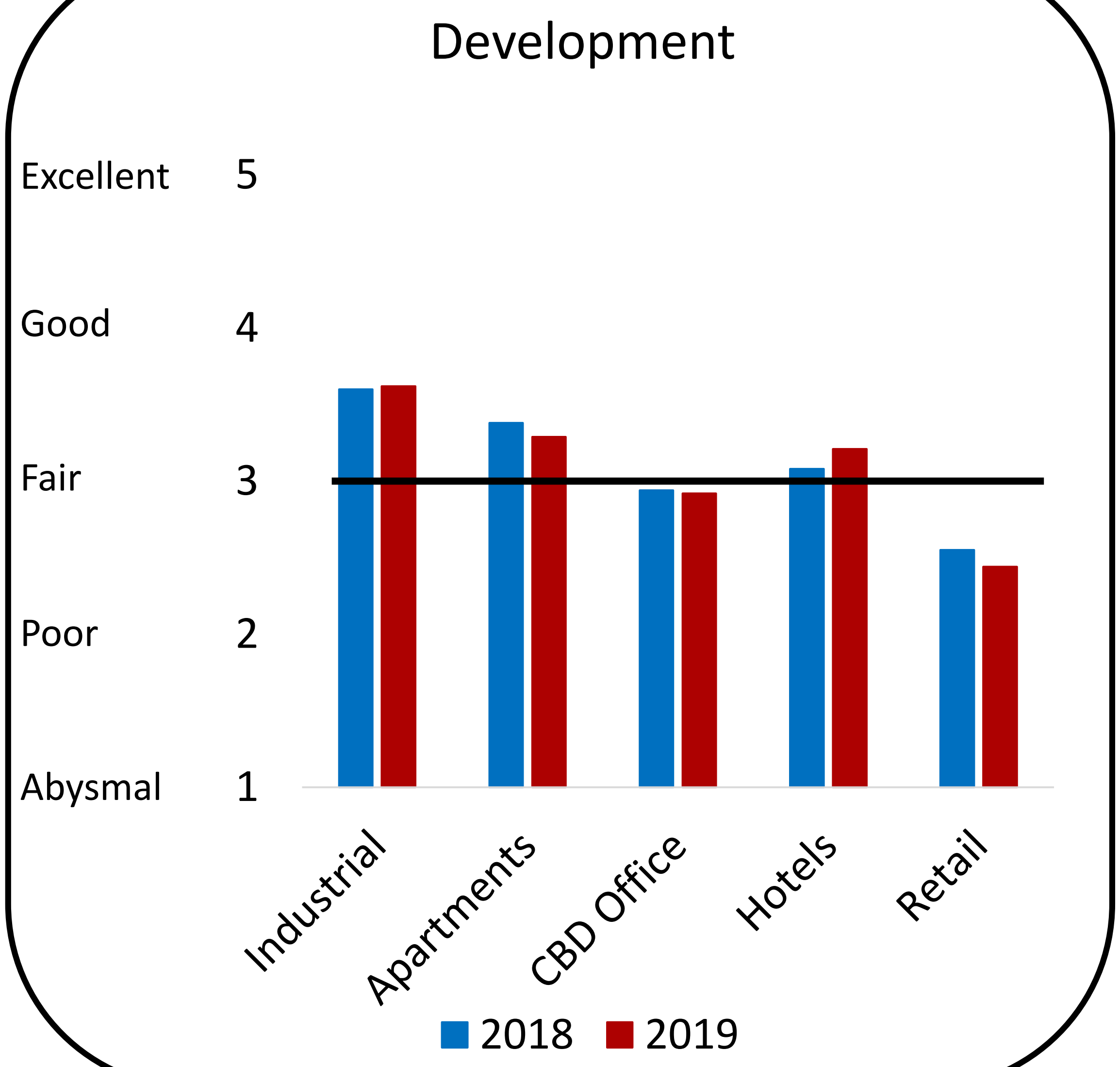
Source: PWC, ULI; Emerging Trends in Real Estate 2019

# 2019 Underwriting Criteria: Existing Core Assets

| | Max LTV | Vacancy | Cap Rate | Spread | 10-Year Treasury | All in Rate |
|---|---|---|---|---|---|---|
| Residential | 65-75% | 5-7% | 5.0-7.0% | 1.35-1.95% | 2.65% | 4.00-4.60% |
| Industrial | 65-75% | 5-10% | 5.5-8.0% | 1.50-1.80% | 2.65% | 4.15-4.45% |
| Office Suburban | 60-70% | 10-15% | 7.5-9.5% | 1.60-1.90% | 2.65% | 4.25-4.55% |
| Retail ("Anchored") | 65-75% | 7-10% | 6.0-7.5% | 1.50-1.90% | 2.65% | 4.15-4.55% |
| Hotel | 55-60% | 25-35% | 7.0-8.5% | 2.25-2.50% | 2.65% | 4.90-5.15% |

# National Sentiment for Acquisitions/Developments




Source: PWC, ULI; Emerging Trends in Real Estate 2019, CBRE 2019 U.S. Real Estate Market Outlook

# National Real Estate Overview: Cap Rate Summary

| | Range | 2018 Average | Change from 2017 | BPS |
|---|---|---|---|---|
| Apartments | 3.5 - 8.5% | 5.16% | ↓ | 16 bps |
| Industrial | 1.0 – 6.5% | 4.56% | ↓ | 50 bps |
| Limited Service Hotels | 7.5 – 11.0% | 9.15% | ↑ | 15 bps |
| CBD Office | 3.0 - 7.5% | 5.44% | ↑ | 29 bps |
| Suburban Office | 5.0 – 10.0% | 6.63% | ↓ | 9 bps |
| Neighborhood/Community Centers | 4.0 - 9.5% | 6.70% | ↓ | 32 bps |

- Cap rates should remain steady, downside risk due to increasing interest rates
- Market fundamentals solid in most sectors
- Equity is abundant, looking for “Core”, “Core Plus” and “Value Added Opportunities” in primary and secondary, and tertiary markets

Source : PWC Real Estate Investor Survey 3rd/4th Q2018

# Michael Lorelli

Sr. Vice President Commercial Asset Management
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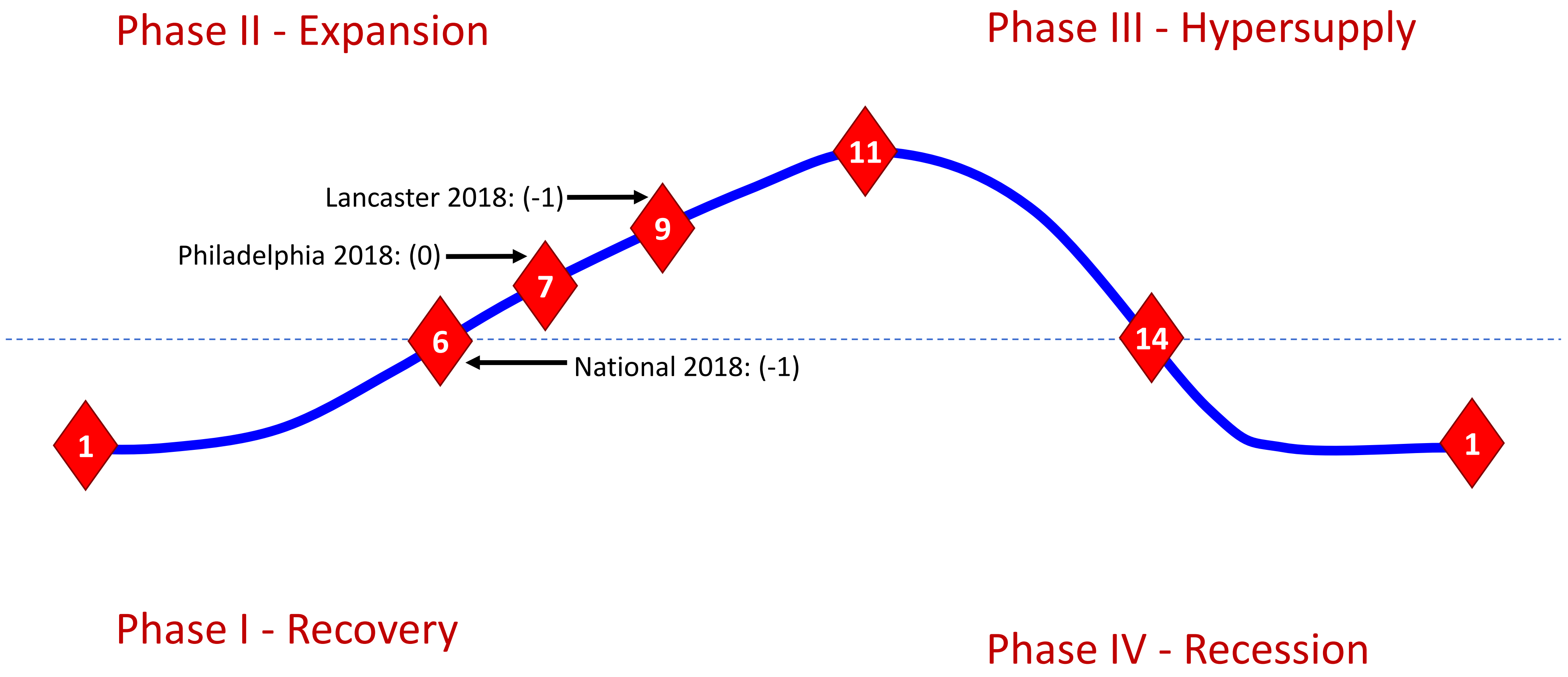
# Office Real Estate Cycle

*Third Quarter 2018*




Source: Black Creek Group Cycle Monitor – Real Estate Market Cycles
Lancaster: High Real Estate Group LLC

# Office: National Trends

- Rents grow 2.2% year over year
- Occupancy grew by .1%;  growth constrained by full employment
- Higher construction cost is impacting new development
- Design Trends:
  - Successful new projects have close proximity to food, entertainment, and housing
  - Shared office environments, or non-office (WIFI) is the fast growing segment
  - Companies looking at space as extension of their brand in attracting workers
  - 2019 outlook: rents +1.5%, occupancy flat

Source:  Black Creek Group *Cycle Monitor* – Real Estate Market Cycles; CBRE *Real Estate Market Outlook 2019;*  PWC, ULI; Emerging Trends in Real Estate 2019,  Jerry Sweeney, Brandywine Realty Trust

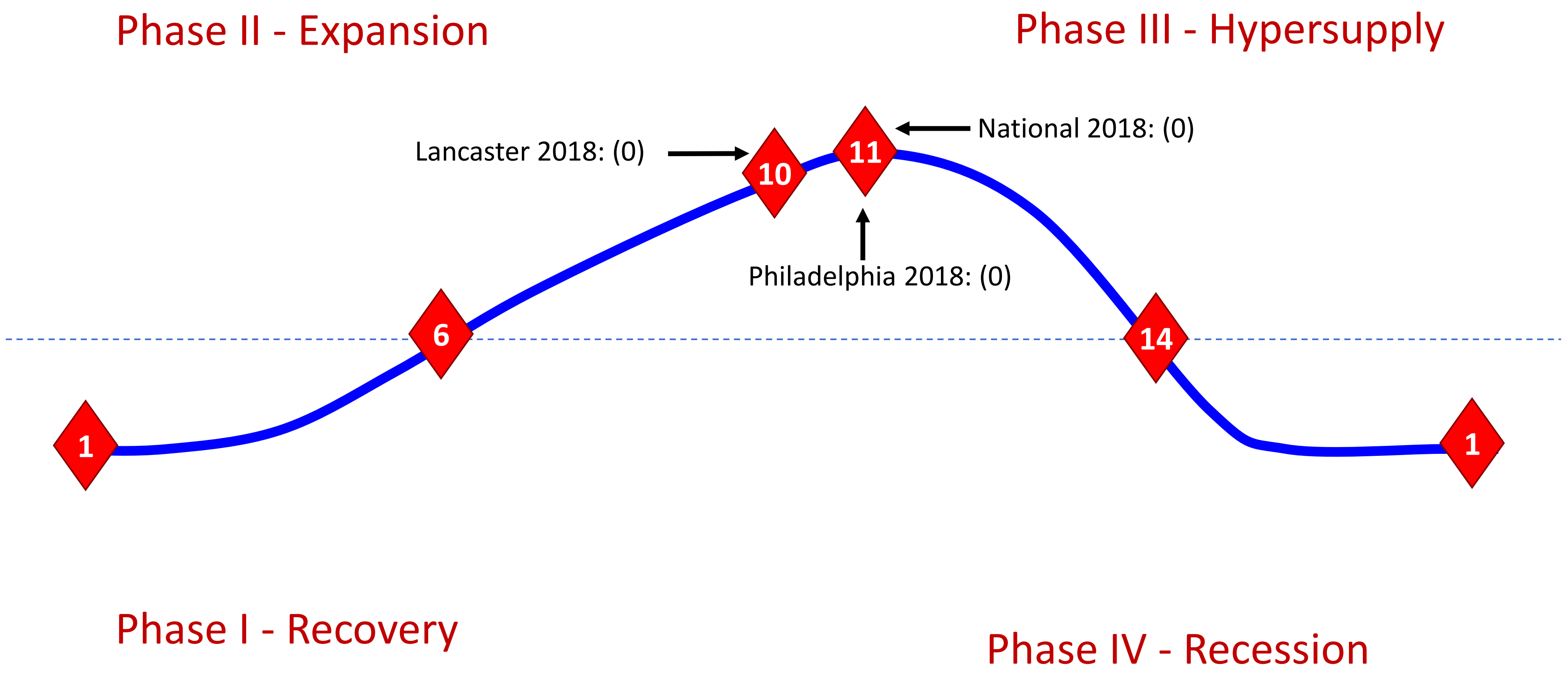
# Office: Lancaster

- Lancaster market sees first sizable expansion in two decades
- Four new projects near completion
  - 2301 Harrisburg Pike: 12,000 SF
  - Citygate Corporate Center: 60,000 SF
  - 101 North Queen: 50,000 SF
  - Lime Spring Penn State/Hershey: 80,000 SF
- Six new Class A projects are proposed totaling 147,744 SF
- Occupancy at an all time high of 94.1% for Class A
- Class A Lancaster market rental rates decreased -0.4% in 2018

Source: The Lancaster market statics are compiled by the High Real Estate Group LLC

# Industrial Real Estate Cycle

*Third Quarter 2018*




Source: Black Creek Group Cycle Monitor – Real Estate Market Cycles
Lancaster: High Real Estate Group LLC

# Industrial: National Trends

- Rents grew by 5.9% year over year
- Occupancy grew by .2% (95.7%)
  - Supply and demand are at equilibrium
- 35 straight quarters of positive absorption
- eCommerce and final mile continue as key drivers
- A new driver is the legalization of marijuana
- Users are demanding warehouse space where workforce is available
- 2019 outlook: rents +4.2%, occupancy flat

Source: Black Creek Group *Cycle Monitor* – Real Estate Market Cycles; CBRE *Real Estate Market Outlook 2019;* PWC, ULI; Emerging Trends in Real Estate 2019, Bill Hankowsky, Liberty Realty Trust

# Industrial: Lancaster

- Lancaster experienced an increase in occupancy and rates, new development in sight
- Two new projects completed or near completion
  - 201 Enterprise, Lititz: 80,000 SF
  - 1897 River Road, Bainbridge: 40,718 SF
- Six projects are proposed, totaling 572,700 SF
- Lancaster market rate increased 6.4%
- Lancaster market rate increased 17.5% for flex

Source: The Lancaster market statics are compiled by the High Real Estate Group, LLC

# Methodology For Market Research

- Research – Primary Research
  - Secondary sources (CoStar, MLS)
  - Owner occupied properties are excluded (e.g. Nordstrom and Urban Outfitters)
- Office – Institutional-grade, for lease (248 buildings, 5.5M SF)
  - Over 5,000 SF in size
  - City of Lancaster, Manheim, East Hempfield, and East Lampeter Townships
- Industrial – Institutional-grade, for lease (378 buildings, 22.3M SF)
  - Over 10,000 SF in size
  - Lancaster County

Source: The Lancaster market statics are compiled by the High Real Estate Group, Greg Cassel

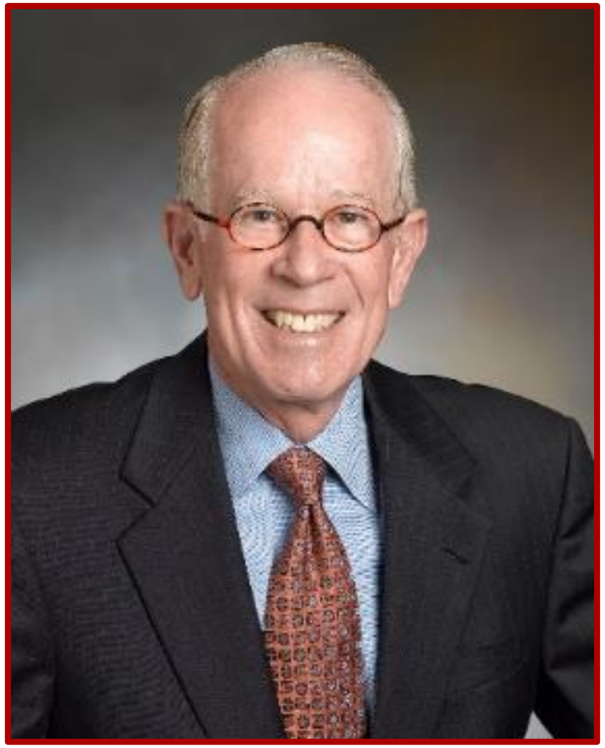
# Lancaster Market Comparison

| | | 2014 | 2015 | 2016 | 2017 | 2018 | 5-Year Average |
|---|---|---|---|---|---|---|---|
| Class "A" Office | Absorption | (12,320) | (10,447) | 87,988 | 75,273 | 203,039 | 68,706 |
| | Vacancy | 13.9% | 14.8% | 10.9% | 10.2% | 5.9% | |
| | Amount Constructed | 0 | 0 | 28,000 | 0 | 152,000 | 36,000 |
| | Available Supply | 257,044 | 267,491 | 207,503 | 132,230 | 81,191 | |
| "B/C" Office | Absorption | 6,753 | 86,396 | 59,167 | 36,732 | 136,537 | 65,117 |
| | Vacancy | 19.0% | 15.6% | 13.2% | 8.5% | 5.3% | |
| | Amount Constructed | 9,700 | 0 | 0 | 0 | 0 | 1,940 |
| | Available Supply | 506,090 | 419,694 | 360,527 | 323,795 | 187,258 | |
| Business Center | Absorption | 14,594 | 18,690 | 14,873 | 32,739 | (20,828) | 12,014 |
| | Vacancy | 14.2% | 12.6% | 11.2% | 13.2% | 15.8% | |
| | Amount Constructed | 0 | 0 | 0 | 0 | 0 | 0 |
| | Available Supply | 167,645 | 148,955 | 134,082 | 101,343 | 122,171 | |

# Lancaster Market Comparison

| | | 2014 | 2015 | 2016 | 2017 | 2018 | 5-Year Average |
|---|---|---|---|---|---|---|---|
| Industrial Space | Absorption | 549,424 | 223,333 | (232,207) | 552,062 | 109,123 | 240,347 |
| | Vacancy | 6.0% | 5.7% | 7.5% | 3.2% | 3.5% | |
| | Amount Constructed | 0 | 186,322 | 199,800 | 0 | 120,718 | 101,368 |
| | Available Supply | 916,024 | 879,013 | 1,311,020 | 758,958 | 770,553 | |
| Flex Space | Absorption | (2,345) | 77,172 | 23,125 | 21,899 | (9,339) | 18,160 |
| | Vacancy | 11.6% | 12.7% | 10.2% | 4.1% | 4.5% | |
| | Amount Constructed | 0 | 105,432 | 0 | 0 | 0 | 21,086 |
| | Available Supply | 89,696 | 117,956 | 94,831 | 72,932 | 82,271 | |

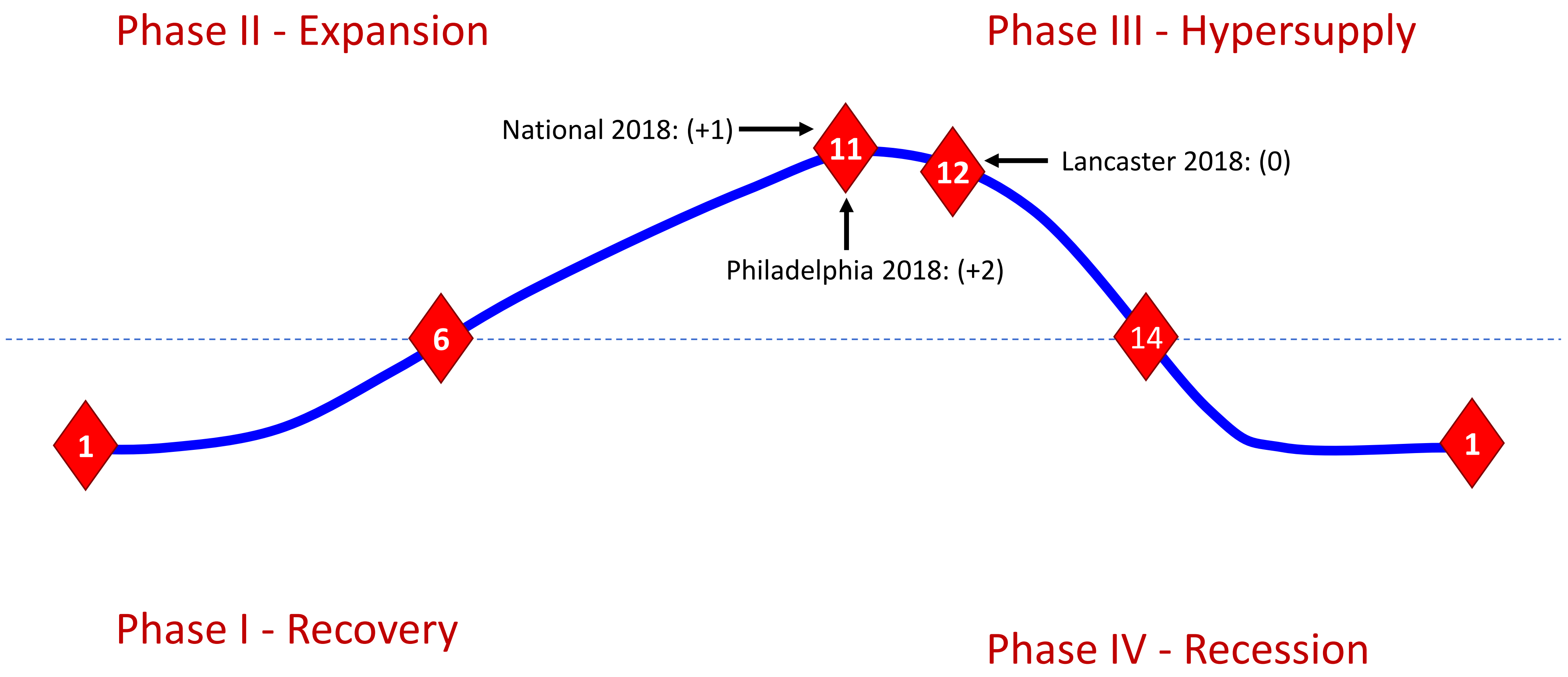
# Steve Evans



Sr. Vice President, Managing Director Retail Division
High Associates Ltd.

# Retail Real Estate Cycle

*Third Quarter 2018*




Source: Black Creek Group Cycle Monitor – Real Estate Market Cycles
Lancaster: High Real Estate Group LLC

# Retail

- Technology, is intensifying transformation of retail at a rapid pace
- Free delivery is not free
- The real story behind the headlines: retail is robust and diversifying
  - Adapting to consumer preferences and behavior
  - A tale of two cities: legacy malls and retailers vs. emerging new concepts and anchors
- Supply and demand: in balance in Lancaster?
  - New development: Yes
  - Obsolete retail assets: No, not yet, but it's coming and will take time
- It's a new paradigm with mixed-use, particularly redevelopment

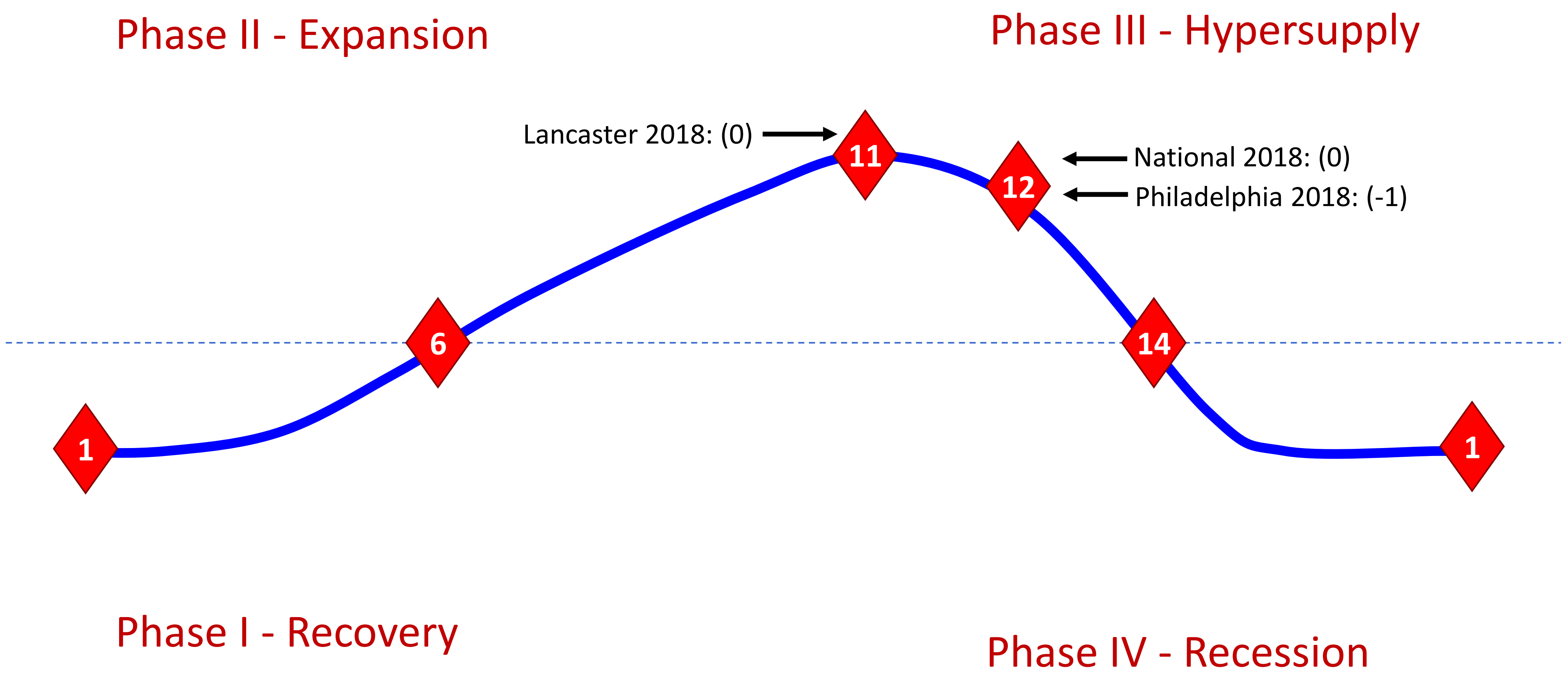
Source: Emerging Trends in Real Estate 2019/PWC-ULI

# Brad Mowbray

Sr. Vice President, Managing Director Residential Division
High Associates Ltd.

# Multi-Family Real Estate Cycle

*Third Quarter 2018*




Source: Black Creek Group Cycle Monitor – Real Estate Market Cycles
Lancaster: High Real Estate Group LLC

# Multi-Family: National Trends

- Anticipate steady multi-family demand at a national level
  - NMHC & NAA estimate 4.3 million new units needed by 2030 to keep up with demand
- Key demand drivers
  - Tax Cut and Jobs Act, decreases tax incentive for home ownership
  - Shift in household composition
  - Preference for flexibility
  - Affordability major issue, falling vacancy rates in Class B & C communities compounded with rising rents
- Supply constraints
  - Tariffs, rising labor costs & subcontractor availability is increasing construction costs
  - Cautious lenders, decreasing LTC
  - Local land use policy restrict density
- National vacancy rates estimated to increase 30 bps in 2019 after a stronger than anticipated 2018.

Source: PWC, ULI; Emerging Trends in Real Estate 2019, Berkadia

# Multi-Family: National Trends

- Tax Cuts and Jobs Act gives renters same federal income tax benefits as many homeowners
  - Single – increased from $6K to $12K
  - Married/Joint Filing – increased from $12K to $24K
  - $10,000 cap on local property tax deduction

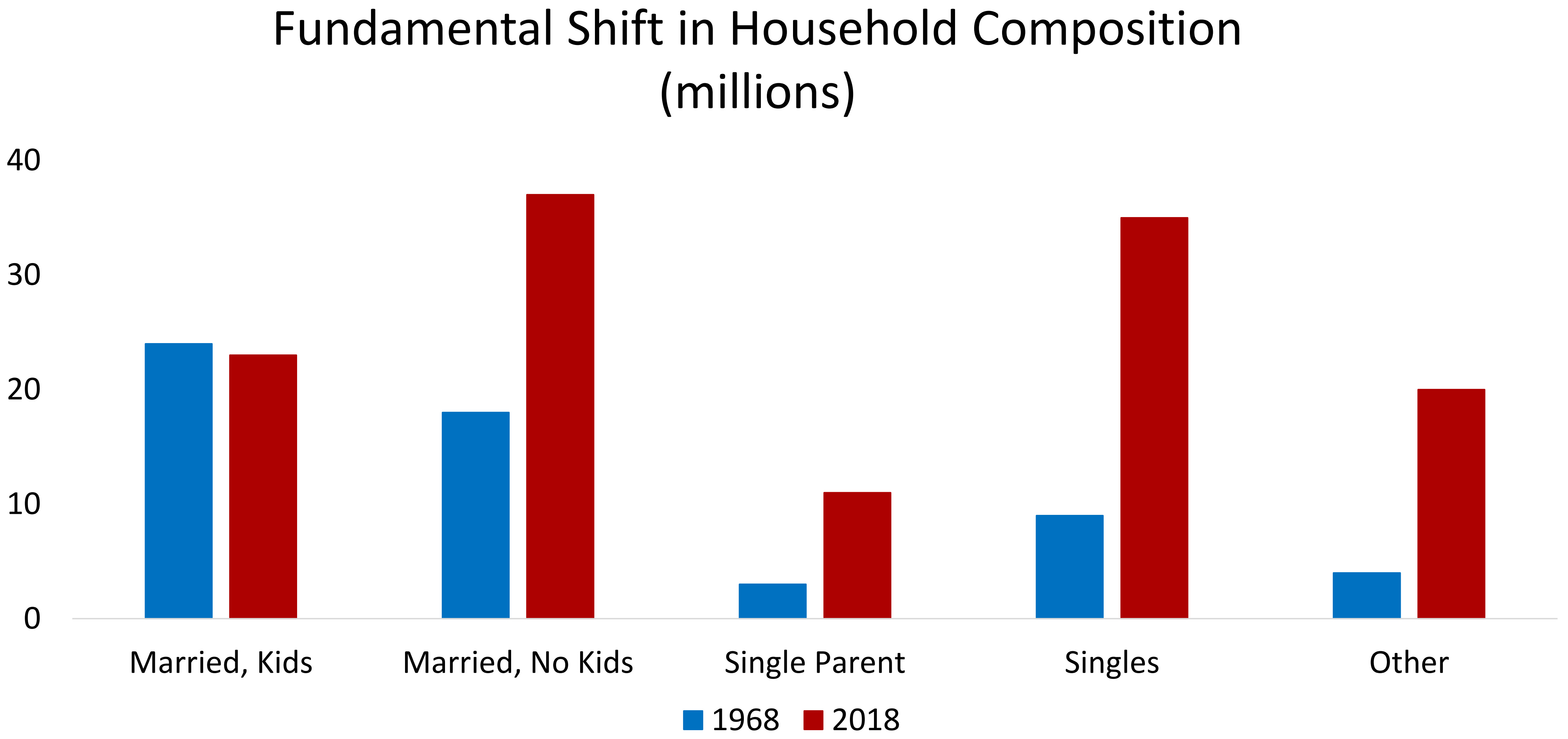
**Economic tax incentive to own declines with 2018 returns**

| HOMEOWNER | | | RENTER | | |
|---|---|---|---|---|---|
| Home Value | $ 400,000 | | USE $80,000 FOR … | | |
| Equity | 80,000 | 20% | vacations, life experiences, education, | | |
| Debt | 320,000 | 80% | investments, savings, charitable giving, | | |
| | | | entrepreneurship, etc. | | |
| Annual Interest | 15,200 | 4.75% | | | |
| Taxes | 8,000 | 20 mils | | | |
| Insurance | 1,000 | | | | |
| Itemized Deduction | $ 24,200 | | Standard Deduction | $ | 24,000 |
| Monthly payment | $ 2,420 | | Monthly payment | $ | 2,100 |

NOTE: This is not intended to be tax advice, see your individual tax advisor for further guidance as it relates to your situation.

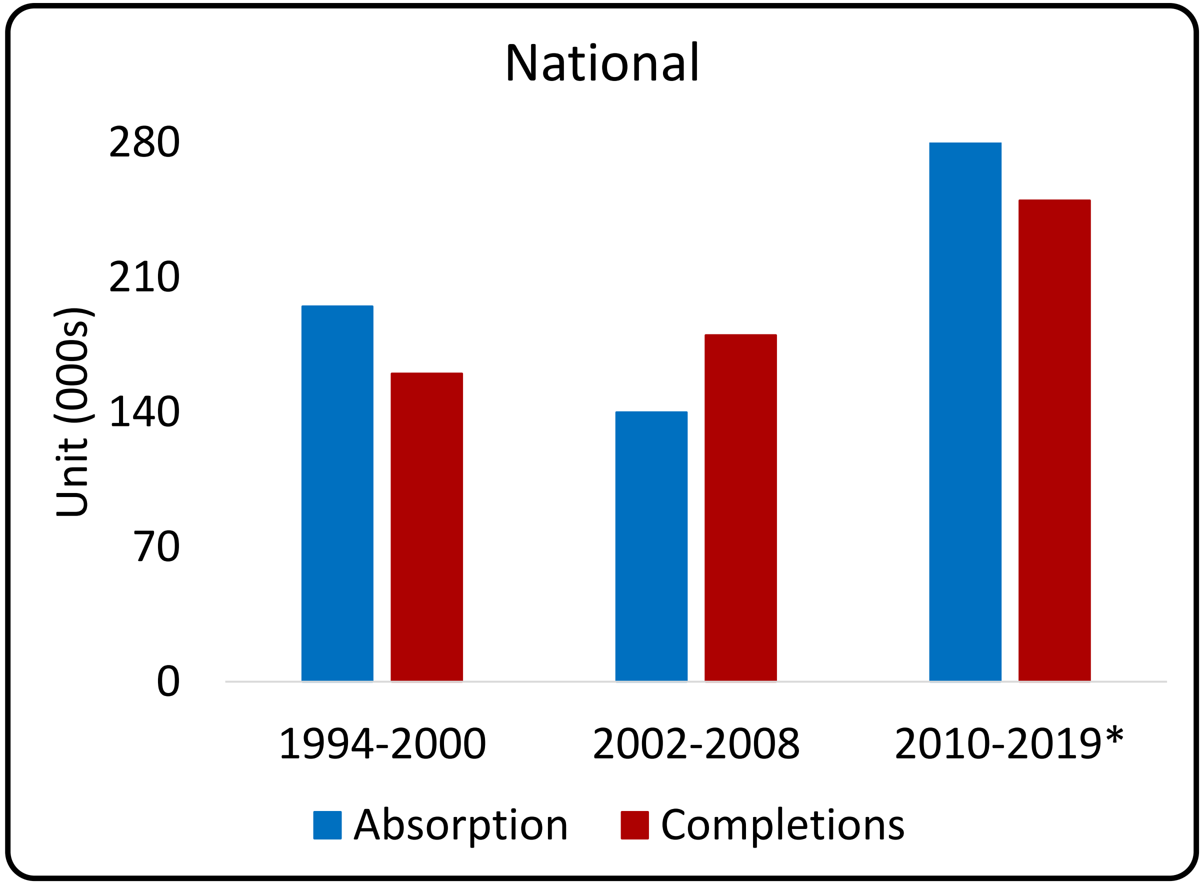
Source: High Real Estate Group LLC

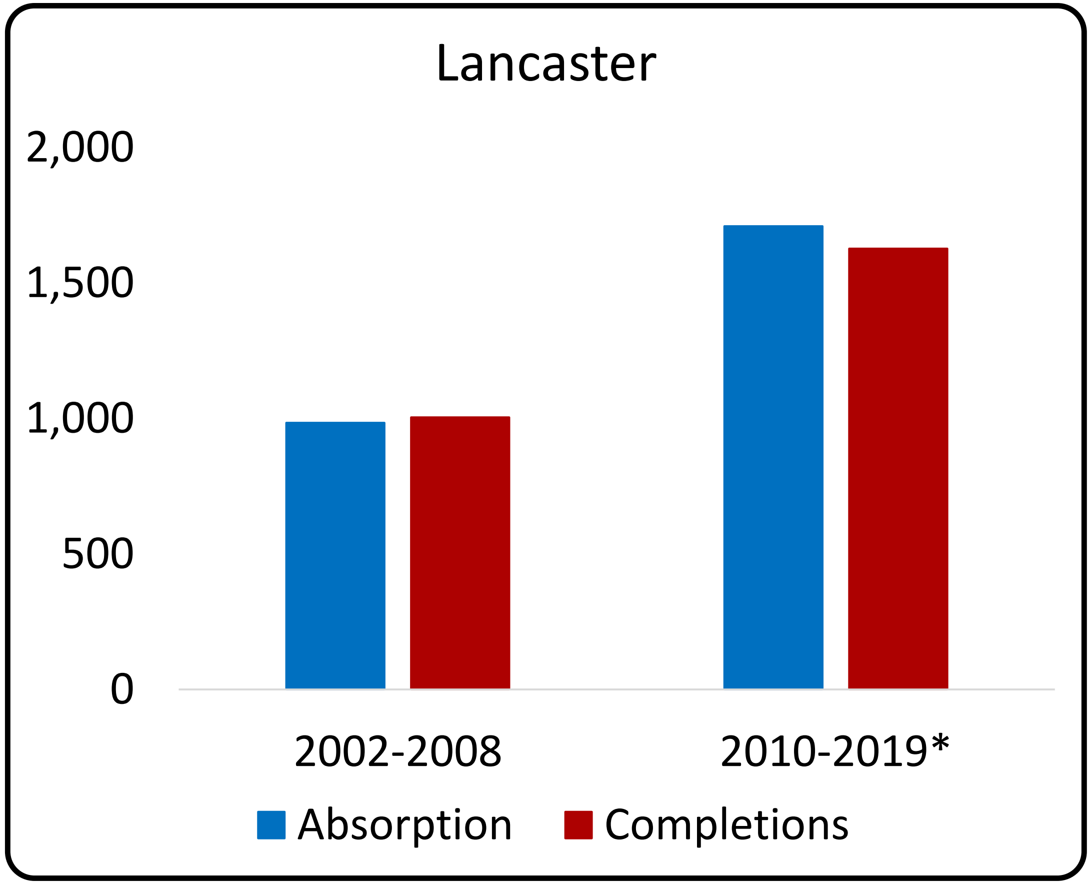
# Multi-Family Real Estate




Source: NMHC, NAA

## Average Annual Absorption Has Kept Up With Supply




*Forecast

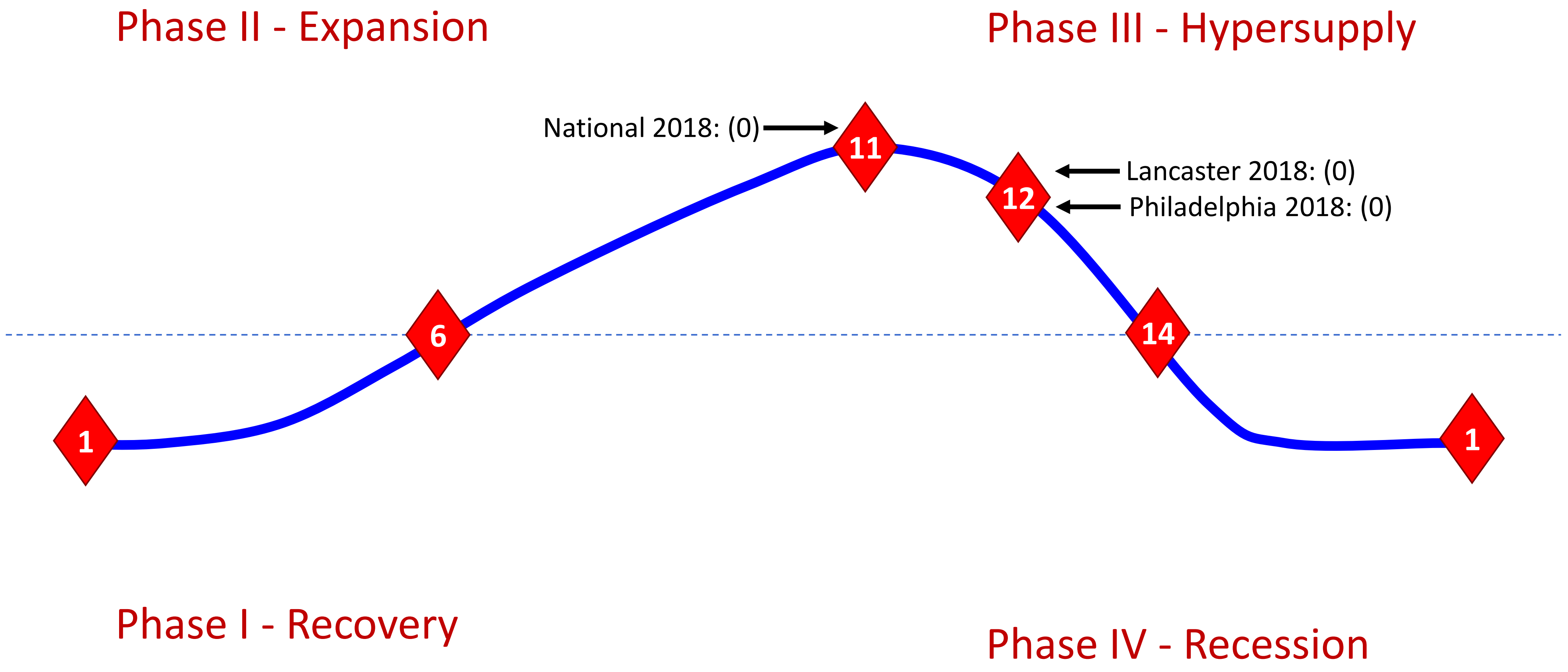
Source: IPA Research Services, RealPage, Inc., NMHC

# Russ Urban

President
High Hotels Ltd.

# Premium Select Service Hotel Real Estate Cycle

*Third Quarter 2018*




Source: Black Creek Group Cycle Monitor – Real Estate Market Cycles
Lancaster: High Real Estate Group LLC

# Hotel: National Trends

- Record 2018 Demand
- Current economic expansion vs. last expansion:
  - Slower supply growth
  - Higher demand growth
  - Lower ADR growth - a paradox
- Low unemployment rate is yielding difficult recruiting and high turnover
- Select service hotels dominate
- Big brands continue to flourish: Hilton, IHG, Choice, Marriott
- Margins are tightening as costs are growing faster than REVPAR largely due to:
  - Increasing fees from OTAs (ie Hotels.com) and Brand programs
  - Labor

Source: STR, CBRE, High Hotels Ltd.

# Hotel: Lancaster

- Record 2018 Demand
  - Up 5.4% from 2017
  - Tourism is the primary driver
- New Supply is rampant
  - Current hotel supply is 7,741 rooms, growing to 8,851 by 2023
  - New supply includes 11 new hotels, a conversion and an expansion by end of 2020
  - 719 rooms being added in 2019 alone, the largest annual supply increase ever
- Hourly labor market is very tight
- Average rate growth will be muted
- Acute supply/demand imbalance exists for the coming years
  - 4-5 year absorption expected
  - Some replacement of older hotels

Source: STR, CBRE, High Hotels Ltd.


Q&A
PHARMACY
Wegmans
MARKET Café
Wine & Beer

# Thank You!

- Presentation will be available at www.highassociates.com
- Thank you for coming!