

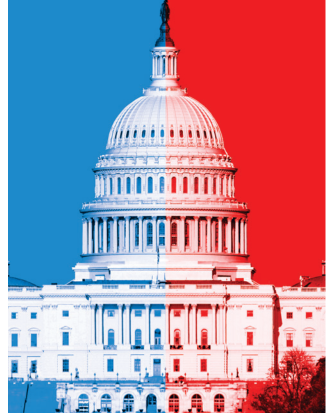


TOP TEN ISSUES AFFECTING REAL ESTATE®

The Counselors of Real Estate®





2021/2022

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1. Remote Work & Mobility
2. Technology Acceleration and Innovation
3. ESG at a Tipping Point
4. Logistics
5. Infrastructure: New Imperatives Emerge
6. Housing Supply and Affordability
7. Political Polarization
8. Economic Structural Change
9. Adaptive Reuse 2.0
10. Bifurcation of Capital Markets

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10. Bifurcation of Capital Markets

While we may not be experiencing the steep drops on our roller coaster ride since March of last year, the ride is far from over. When we look back at the last 15 months, what becomes clear is how different the market-changing event of COVID-19 was compared to prior market corrections. The debt capital markets have seen significant volatility, particularly in the public markets like commercial mortgage-backed securities, mortgage REITS, and agencies such as Freddie Mac and Fannie Mae. Swings in risk premium spreads have been on a roller coaster ride of their own. The number of non-current loans reverting to current and viable loans on income producing properties will be driven by performance and the impact of changes in e-commerce, travel, and office use and demand.

Mortgage REITs took a significant hit early in the pandemic, with some recent recovery driven by restructuring credit lines and paying down credit facilities that experienced margin calls. Debt funds issuing short-term transitional bridge and mezzanine loans have experienced stress, much of which came from financing costs. The market continues to be flush with debt capital liquidity, despite property type and market uncertainty. Looking out to the remainder of 2021 and into 2022, performance will dictate the amount of distress and losses, and risk management should dictate markets, property types, leverage, loan structure and pricing for mortgage debt. The next year should also tell us if commercial real estate debt was too rich and whether perceived risk underestimated where pricing should have been.

Private equity funds have raised significant capital to deploy over various real estate sectors, with $371.8 billion in dry powder available as of May 2021. With public, institutional, and private equity capital providing the market with a view of valuation and pricing, we still have not had an active transaction market. While transaction volume is slowly recovering, it's still well below pre-COVID levels. Price discovery continues to be limited, and buyers and sellers are holding their ground on the bid versus ask for assets that are still viewed with uncertainty as owners look to the vaccine and timing on a return to normal. The market has not seen the volume of expected distress sales, but there is plenty of capital ready to deploy.

9. Adaptive Reuse 2.0

Adaptive Reuse is not a new term or concept to the commercial real estate industry. It is an evolving property use expanding beyond the rejuvenation of single-property blight in urban areas to now a broader neighborhood application extending to the suburbs and secondary MSAs. Adaptive Reuse 2.0, what we call The Neighborhood Approach, is pivoting to address the challenge of what to do with hundreds of defunct suburban malls and thousands of empty Big-Box retail stores that are surrounded by desirable and affordable neighborhoods.

The trend from the preservation and enhancement of single, mostly historic assets in the core of our urban areas to a broader neighborhood approach is going to be accelerated in a post-pandemic environment as housing affordability pressures and remote work models disrupt the pre-COVID "experiential" urban city model. One need only look at the initial 2020 Census data and annual U-Haul Migration reports to see that our population and workforce are more remote and moving inland and to suburbia to find affordability and quality of life beyond the dense urban setting that was enabled out of necessity in response to the pandemic.

The neighborhood approach involves a re-examination of our suburban communities to reposition them for transformation before the opportunity for change passes them over, or worse, creates blight that will later need to be addressed at a much higher cost, especially in an era where so many retail, small business, and hospitality properties closed. Some communities are ahead of the curve for the change that lies ahead. Change such as driverless vehicles and a transportation evolution away from car-concentric infrastructure that is more walkable, driverless-car friendly, and utilizes less land for parking.

The Counselors of Real Estate has identified Adaptive Reuse as a 2021 Top Ten Issue not just because of the number of projects completed and underway that now surpass even self-storage as a property type with more than 50,000 properties, but because it holds the promise of: 1) reconnecting our communities from what the Interstate Highway system divided from the 1950s to the 1980s; 2) preventing blight that developed in our dense urban cities from flowing to the suburbs and secondary MSAs; 3) restoring much needed greenspace to our neighborhoods and cities that can germinate interaction of diverse demographic groups; and 4) promoting good ESG and diversity, equity, and inclusion policies.

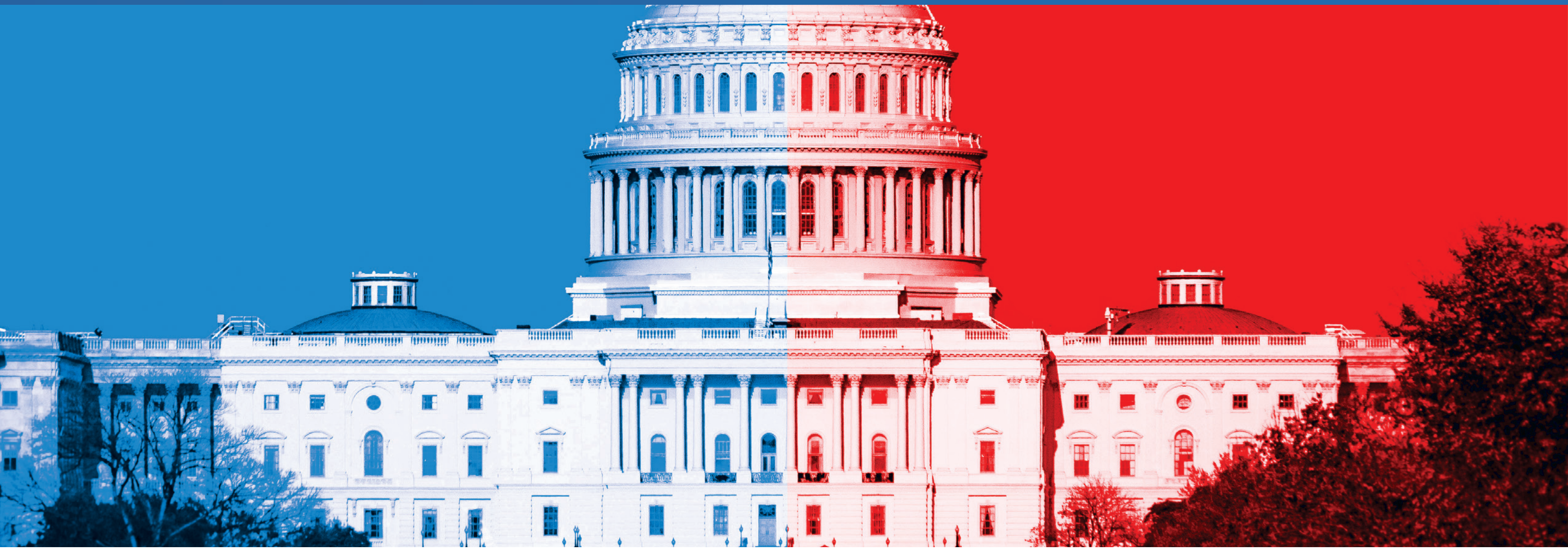
8. Economic Structural Change

How do we assess the real potential of the economy for sustainable growth? What numbers indicate a true trend—and therefore can be used for business planning purposes—and which are merely adjustments from the extraordinarily low bottom of the 2nd quarter of 2020? Which behavioral changes made by U.S. households during the pandemic will persist into mid-decade, and which will be happily set aside when things feel normal again?

No one knows, in all honesty, and that's the equivalent of indicator lights in the cockpit going out for budgeteers in Congress and for bankers, developers, investors, and other real estate professionals. At this point, it is safe to say that economic models are of limited use in providing numerical guidance. As such, the price of risk should be high. But it is not.

Real estate certainly knows how debilitated property demand is. According to CBRE, office net absorption in the first quarter of 2021 was negative 34.8 million square feet, and vacancy rose even more steeply than in the worst year of the Great Recession. With more than 111 million square feet still in the construction pipeline, office owners are braced for more bad news later this year and into 2022. Retail real estate was hammered long before COVID-19 arrived, as the sector has been 'overstored' throughout the 21st century and was threatened by e-commerce even prior to the population being required to shelter in place in 2020. A May 2021 analysis by PricewaterhouseCoopers pegs U.S. hotel occupancy at 61.8 percent, up from the 2020 and 2021 lows but still below any year from 2013 to 2019. Likewise, hotel revenues are expected to stay at pre-2015 levels into next year.

Even though real estate investors may reasonably expect an uptick in demand in the coming year, the ability to anticipate when occupancy and rent will rise frustrates underwriting. And cap rates ranging, on average, from 5% for apartments to 6.6% for offices are keeping pricing rich compared with the risk inherent in that underwriting uncertainty. We are observing many investors increasing their focus on property management aimed at retaining tenants and defending cash flow, while selectively seeking 'value-add' properties amenable to active asset management. The thinking is "focus on what you can control" during this period where macro-level uncertainty is the governing headwind at the policy level in terms of the structural problems in this economy.



7. Political Polarization

There seems to be nothing new about America's political polarization. And it is not our intent to pick sides in this divided polity. Doing so only exacerbates the division. We want, first of all, to reflect on the pragmatic harm that the division is inflicting on our society, our economy, and on the real estate industry which is our professional field. Political friction is holding back America's economic productivity. We are squandering resources as we try to address problems that arise from the partisan divide, rather than problems confronting us as common issues.

Pre-COVID, real estate was feeling the pinch. The National Association of Home Builders has stressed how the broken immigration system has hamstrung the production of housing, delaying deliveries and driving up prices. Building service workers are calling for an immigration approach facilitating immigrants' full participation in the economy as an immediate priority. Many forms of real estate, including hotels, restaurants, personal service retailing, and medical offices, have high levels of immigrant workers in their occupancy profile.

So it is that we consider the present tribalism of American politics as a top issue for real estate now and in the foreseeable future. It hinders our productivity and therefore the nation's economic strength. And the real estate industry's well-being is a function of our economic growth. Partisanship has been distilled into more extreme positions within Washington by the vagaries of primaries, gerrymandering, and the propensity of incumbents to stick to the status quo. In fact, Congress is more divided on many issues than is the American public as a whole.

We acknowledge that there is legitimately a diverse range of political ideology in America. But there must also be a kind of Venn Diagram in which the political positions can acknowledge an area of overlap, common ground that is apparent when those outside the Beltway are queried. Even though the red and blue map represents truly differing perspectives and priorities, the nation is decidedly less polarized than are its elected representatives. The economy and the real estate industry would be far healthier, as would American society, if the pattern of party-line voting in the halls of Congress could be transcended in favor of something very traditional: the defining of politics as the art of compromise.

6. Housing Supply and Affordability

In this era of political polarization, there are three things that most can agree on vis-à-vis housing: 1) there is a tremendous need for affordable housing; 2) there continues to be a sentiment of a "Not in My Back Yard" mentality; and 3) there's an ongoing supply deficit of market-rate housing.

Decades of underinvestment and underbuilding have created a shortage of housing in America that is more dire than previously expected and will require a concerted, long-term nationwide commitment to overcome.

According to the National Association of Realtors®, the state of America's housing inventory is dire, with a chronic shortage of affordable and available homes needed to support the nation's population. A severe lack of new construction and prolonged underinvestment have led to an acute shortage of available housing to the detriment of the economy and certain segments of the public. The scale of underbuilding and the existing demand-supply gap is enormous and will require a major national commitment to build more housing of all types.

Growth in America's housing inventory has slowed significantly since the turn of the century, particularly over the past decade. This trend affects every region of the country, creating an "underbuilding gap" of 5.5 to 6.8 million housing units since 2001.

The Counselors of Real Estate agrees that lawmakers must work to expand access to resources, remove barriers to and incentivize new development, and make housing construction an integral part of a national infrastructure strategy. We are seeing a number of legislative initiatives at the local and national levels to defeat NIMBYism, as well as an infusion of affordable housing financing. Taken together, the light at the end of the tunnel looks much more like the bright sunshine of hope that we are finally moving towards the end of affordable housing discrimination than the headlight of an oncoming train.

5. Infrastructure: New Imperatives Emerge

The COVID-19 pandemic, climate change, and heightened societal interest in social and economic equity have redefined infrastructure imperatives beyond the significant ongoing necessity for improved roads, bridges, airports, ports, mass transit, and other traditional infrastructure needs.

The latest bipartisan draft proposal on Capitol Hill would allocate $110 billion in new spending to bridges and roads, $65 billion to expanding access to broadband, and $48.5 billion to public transit, among other priorities. Extended over an eight-year timeline, the plan would apportion a total of $1.2 trillion.

While our infrastructure focus in this year's Top Ten is on some new infrastructure imperatives, the need for enhanced investment in all areas of infrastructure remains high if we are going to maintain a strong economic competitive position. The American Society of Civil Engineers gives U.S. infrastructure a score of C-, classifying it as "poor" and "at risk," while the World Economic Forum's Global Competitiveness Report ranks the U.S. 13th in the world.

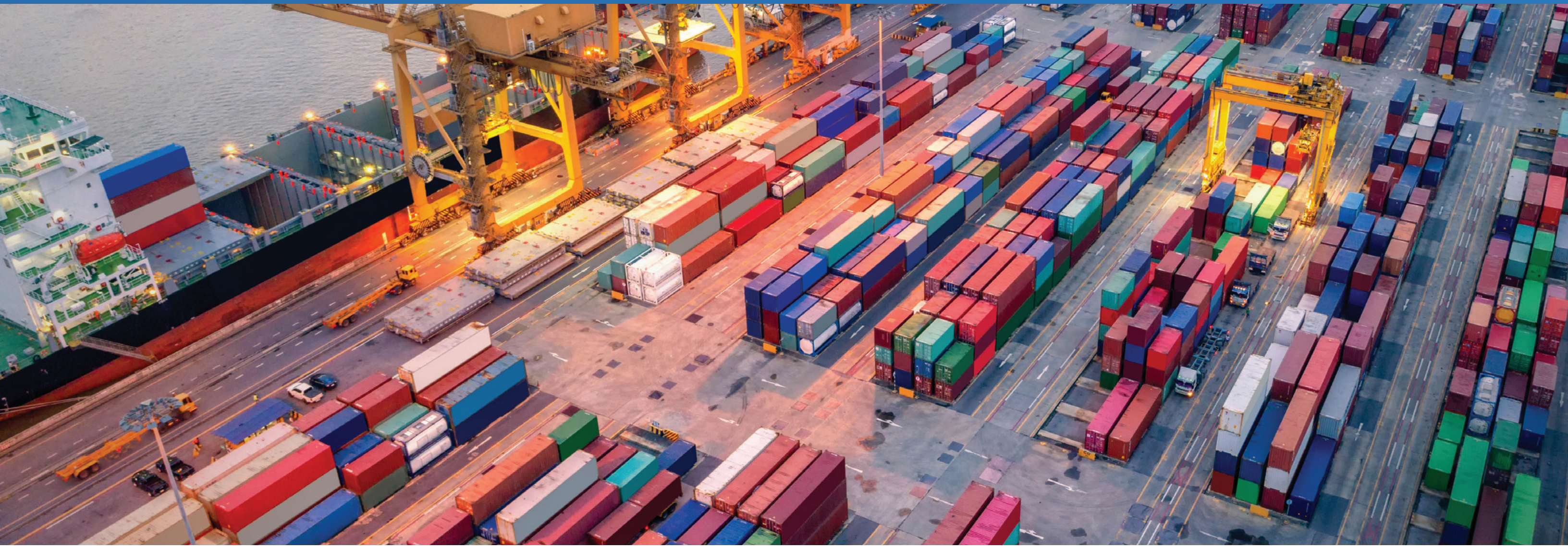
The Civil Engineers also estimates the U.S. infrastructure funding gap in 2021 to be $2.6 trillion, up 24% from 2017. Not only is public safety at risk from failed water systems, roads, dams, and other shortfalls, but the McKinsey Global Institute estimated that fully closing the physical infrastructure gap could translate into 1.2%, or 1.5 million, more jobs across the economy. The U.S. spends only 2.3% of GDP on infrastructure, while European countries spend 5% on average and China spends about 8%.

Even as the pandemic eases, enhanced broadband access is necessary to provide substantial flexibility to respond to not only an increasingly virtual society, but also more effectively to future pandemics, natural disasters, and other events.

The increase in last mile deliveries to homes and businesses has also required the creation of massive delivery systems, changed inventory storage and distribution requirements, and put significant demands on information systems. Automation, optimization, supply chain strategy, and transparency are seen as vital infrastructure areas in which to invest.

As electrification and renewables increase, significant new infrastructure investment is needed in the electric grid. Additionally, buildings, which consume about 40% of total energy use, and water systems, which can represent 30% to 40% of a municipality's energy bill, need to be made more energy efficient.

Cities and neighborhoods that work to encourage electromobility will be prime investment locations as tenants and their employees move to electric modes of transit. Cities and neighborhoods that adopt electric buses, rail and other forms of mass transit will be cleaner, quieter, and less polluted. Buildings located near charging hubs or that provide charging opportunities will be rewarded. And real estate owners who get out in front of these changes will reduce their costs of adaptation and profit handsomely.



4. Logistics

The Counselors has identified logistics as a 2021 Top Ten Issue because it is at the epicenter of what makes our economy function. Whether it's a port, rail line, pipeline—such as the now infamous Colonial gas pipeline—manufacturing facility, warehouse, farm, ranch, or grocery store, all these real estate assets are a critical segment in the supply-chain funnel that is logistics. How logistics is functioning impacts the utilization of commercial real estate. Redundancy and the ability to process disruption are two key elements required to support the fast-moving, high-volume requirements of modern-day logistics in the "shop-online-and-deliver-to-me" era in which we find ourselves.

Logistics post-COVID-19 will disrupt commercial real estate models for years to come. Disruption in commercial real estate capital allocation—with more funding to industrial property and less to retail—can be expected. There will be less dependency on physical stores and more on modern eCommerce warehouses that will be increasingly automated with less reliance on labor. And expect disruption in pricing as cap rates are going lower for industrial. As the Monmouth MREIC and EQC REIT merger highlights, the 4%-5% cap rates once reserved for the Los Angeles/Long Beach and Inland Empire markets now apply to the "Golden Triangle" encompassing portions of the Great Lakes, the Southwest and the Southeast. Whether business-to-business commerce or business-to-consumer, commercial real estate is the field on which it all plays out.

3. ESG at a Tipping Point

Environmental, social, and governance initiatives have, indeed, reached a tipping point. In a 2019 McKinsey survey, 57% of CEO respondents said they believe ESG programs create long-term value, and 83% say they expect ESG to contribute more shareholder value.

In 2020, ESG funds more than doubled net new money intakes, capturing $51.1 billion. The growth in recent years is fueled by multiple drivers, including consumer shifts, regulatory requirements, trillions of dollars of wealth transferring to Generation Z and Millennials committed to philanthropic living, a blurring of work and societal expectations, and a full sprint to attract and retain top talent. PwC's 24th Annual Global CEO Survey found that 30% of CEOs are concerned how climate change will threaten their organization's growth—up from 24% last year—a growing aspect of the ESG puzzle. Investor and market demand for ESG in real estate spans the globe with the key questions being what is material, where are we vulnerable, and which strategies will cost-effectively mitigate risks.

Transformative, enterprise-wide ESG programs in all sectors of real estate can be one of the best ways to reduce carbon emissions, accrete value, and demonstrate reputational value.

The demand for progress towards ESG initiatives is encouraging capital markets and financiers to deploy an increasing diversity of financial products to support these goals. At the same time, workforce development, Diversity, Equity, and Inclusion initiatives, and recognition of the importance of health and wellness in commercial real estate are setting new expectations for building operations and how to engage stakeholders and the communities in which real estate owners and users invest.

Globally, government stimulus funds had reached $15 trillion and counting by early May, according to Reuters, some of which is being directed to ESG programs. This further confirms that ESG has reached a tipping point, and now the expertise, creativity, and innovation that the real estate and finance industries are well known for need to be applied to assessing risk and deploying strategies to mitigate those risks while creating value for investors, occupants, and the capital markets that serve them.

2. Technology Acceleration and Innovation

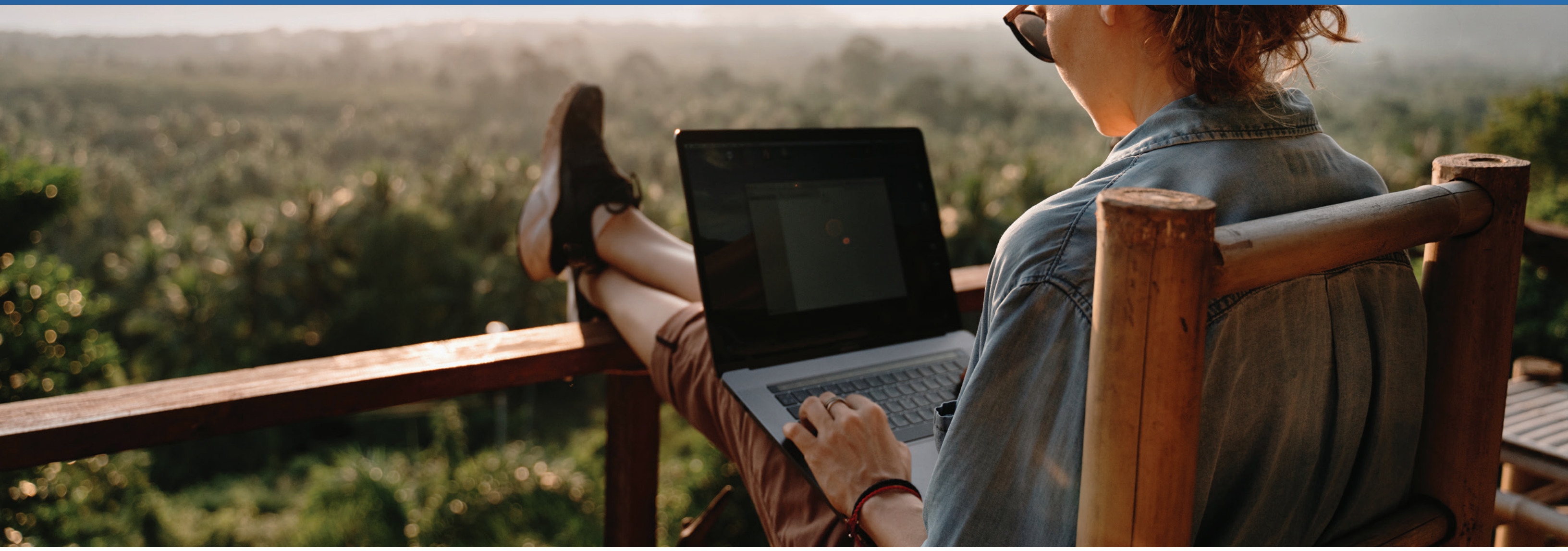
Technology once again makes our Top Ten list but under different conditions and with more short-term implications. Constant themes like artificial intelligence, machine learning, the Internet of Things, and cybersecurity remain part of the landscape. They have moved from "new" to "how we do things now." This year the news is not about new tech, but about our acceptance of it. Lockdown-driven changes in our work, in the economy, in social structures, and in our personal behavior have pushed our reluctance aside. The acceleration and adoption of technology during the pandemic has impacted everything, and real estate is no exception.

The question remains: what will stick? Real estate is long-lived and capital intensive. Lasting impact requires the creation of value. Mere response to a pandemic-driven anomaly is insufficient to make permanent shifts. Value creation will be driven by three things: risk management, generating trust, and increasing utilization.

The pandemic was a stress test, revealing vulnerabilities, appetites, and new and increased risks. We have been awakened to some familiar but nascent areas of importance, namely cybersecurity, supply chain logistics, and price instability. None of these are new concepts, but in a span of months if not weeks in some cases, we saw high profile hacks, shortages of resources like microchips, lumber and labor, and rising prices across the board.

The accelerated upgrade of connectivity, security, and hosted processes mean utilization is being maximized and any place is now a potential workplace. This creates new pools of vacancy and pools of availability enabled by technology.

Pandemic-driven uncertainty is fading as we are now off the diving board and in the water. When we stop panicking, decision drivers change—from survival-based questions to those driven by optimization, by inflection points, and by moments where change can happen. Lease expirations, construction projects, mergers, and dispositions will all include an aspect of tech-based pandemic response. Let's get used to it.



1. Remote Work & Mobility

COVID-19's disruption significantly impacted human behavior in how and where space is used. Now with an escalating return to "business as normal" and workers beginning to return to offices—32% on average as of June 18th—commercial properties nevertheless may need to be repositioned for changes in demand. One of the greatest lessons learned during COVID is the benefit of more flexible, easily adaptable, and sharable spaces.

It is clear that remote working, the acceleration of internet retail, and the demand for larger and more natural spaces and other pandemic-era behaviors will remain, at least at some level, which will impact land uses and locales. We learn as an industry that flexibility and adaptability are paramount goals in real estate markets that desire resiliency when confronted by local and global disruptions. As the recent rapid growth in virtual accessibility has made the world smaller, we will soon learn the resultant changes in the movement of people and the impact on the spaces they use. One immediate effect of returning to the office is the residual benefit for restaurants, coffee shops, dry cleaners, and other retailers—and thus for their landlords as well.

Further, after years of apparent but variant trends towards urbanization, the pandemic universally caused a movement away from urban cores, particularly for those with higher incomes who could afford to move and for lower-income individuals seeking lower costs of living. Most of these relocations remained within their original region—84%—and, while some are returning, it is unknown as to the permanence of these movements or whether they represent a true urban exodus.

Time will tell as to which population migration and space use behaviors will endure, as all real estate sectors will be watching closely and poised to react. Property owners and managers should be flexible in order to accommodate these demand-driven changes in the desired use and location of space. It is for these reasons, The Counselors of Real Estate believes Remote Work & Mobility merits the number one spot on the 2021-22 Top Ten Issues Affecting Real Estate.

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The Counselors of Real Estate® is a highly selective, global organization of commercial property professionals from leading real estate, financial, law, valuation, and business advisory firms, as well as real property experts in academia and government. Membership is selective and extended by invitation, although commercial real estate practitioners with 10 years of proven experience may apply. An invitation to membership means access to a knowledge network of high-level professionals with an esprit de corps unparalleled among real estate groups. Experienced, innovative, and credentialed problem solvers, Counselors practice in 20 countries and offer expertise in more than 50 real estate disciplines across all asset types and classes. The CRE® credential opens the door to a unique, intimate culture grounded in trust, shared values, and exceptional peer expertise. Only 1,000 individuals have earned the CRE® designation in North America, Europe, and Asia.

Thought leadership is a widely recognized core competency of Counselors of Real Estate. Among thousands of assignments large and small, Counselors have resolved the dispute between the developer of the World Trade Center and its insurers post-September 11, 2001, introduced the theory of property valuation to the country of Turkey, led the privatization of U.S. Army Housing, developed a multi-billion-dollar, 10-year master plan for Philadelphia Public Schools, introduced the concept of parking garages to China, valued both the Grand Canyon and Yale University, and created and endowed the MIT Center for Real Estate.