2021 Emerging Trends in Real Estate

Northeast Ohio

ULI Cleveland

Emerging Trends in Real Estate

2021

Content

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Emerging Trends Overview

ULI Cleveland Survey Process

Covid-19 has accelerated existing trends while upending entire industries. A public health crisis in origin, the ensuing lockdowns and restrictions have since turned into a financial crisis for certain sectors of real estate. Though many long-term effects have yet to clearly materialize, a few clues can help point readers of this report in the right direction.

The 2021 ULI Cleveland Emerging Trends Survey and Report was a year-long collaborative effort. Comprised of Focus Groups with leading Northeast Ohio real estate professionals, a corresponding survey, and a thorough analysis of publicly accessible data sources, report volunteers aim to capture the effects of a tumultuous year and calculate what one can expect going forward. Speaking with market experts via Zoom roundtables in Summer 2020, report staff observed a group that was still trying to figure out what those long-term effects of Covid-19 could be. Some spoke with cautious optimism while others wanted to wait for the dust to settle.

Figure: Role in Company of 2021 Survey Respondents

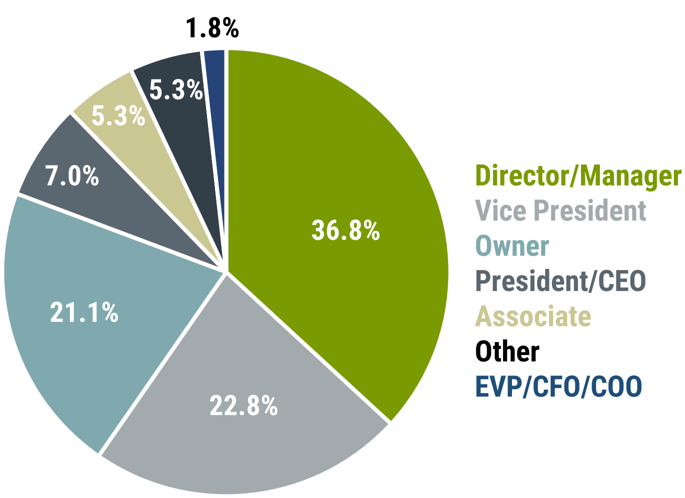


Figure: Top-5 Business Sectors of 2021 Survey Respondents

1. Professional Consulting/Service Firm (30%)
2. Private Developer (14%)
3. Other (12%)
4. Lender (11%)
5. Property Management (9%)

In the Fall, ULI Members were asked to complete a 15-minute survey, resulting in a total of 57 respondents. Those taking the survey generally held high-ranking positions in their companies and reflected major business sectors throughout commercial real estate (see charts). Professional development firms representing engineers, architects, and other contracts comprised the largest number of survey participants. Private developers, brokerage firms, and lenders also weighed in. It was ULI Cleveland's goal to keep responses both high-quality and from a variety of professional backgrounds.

The final component was corroborating ULI Member feedback with data from sources such as CBRE, the US Census Bureau, and news articles. Quantifying comments made during Summer and Fall sessions is important to telling the complete story and figuring out what markets will most likely experience in 2021. As always, trends are subject to change pending factors like government stimulus, adoption of certain technologies, or the vaccine rollout.

2021 Emerging Trends in Real Estate United States and Canada

Covid-19 Accelerates Change in Real Estate Industry:

Focus on Social Justice and Wellness Reign Supreme as Economic Uncertainty Remains

The 2021 ULI National report highlights how Covid-19 heightened the desirability of lower density areas for both residential and commercial real estate, with interest concentrated in the Sunbelt markets. Cost-conscious companies will gravitate toward cities that are business-friendly and low cost with large, growing workforces. Raleigh/Durham, N.C., for example, is nicknamed the "Bay Area of the East Coast," due to a surge in technology jobs and the area's reputation as an education mecca. Homebuyers will look to suburban locations with low taxes, affordable housing, auto-oriented transportation, and good job prospects. While growth in the suburbs has been a consistent trend since this report first predicted five years ago, greater family formation among millennials and flexible work from home policies are boosting this shift.

Social unrest and protests in cities across the country have also played a role in the reevaluation of presence in urban cores. 70% of [National Emerging Trends in Real Estate 2021 Report] respondents agree that the real estate industry can address and help end systemic racism—from promoting diversity, equity and inclusion within the sector to looking for ways to develop underserved communities. On a rating scale of social issues in real estate, income and racial inequality moved from little to moderate importance last year, to moderate to great importance.

"Times of great change always present significant opportunities," said W. Ed Walter, Global CEO of ULI. "In the near term, our suburbs will benefit from new growth spurred by shifting demographics and changes to living and working patterns resulting from the Covid-19 crisis.

Our cities will have the opportunity to respond by reimagining their public realm, building more resiliency, and reinventing assets, such as retail, that were already struggling before the pandemic. As an industry we have the opportunity to strengthen by truly embracing diversity and tackling the challenges faced by our communities."

"Now, more than ever, the real estate industry has the chance to take the lead in using planning and development skills and investment capital to reshape our work and lifestyle environments. These tools can be used to address societal issues of safety, green space and racial equity," says Byron Carlock, PwC Partner and U.S. Real Estate Practice Leader. "The gauntlet of responsibility is ours to embrace, and industry leaders see the opportunities and are responding with investment and leadership."

Trends Highlighted in the National Report include:

The Economy (and Real Estate Sector) Hang On:

Though real estate capital markets have settled, most anticipate overall real estate prices to fall 5-10% as income is curtailed for several years. Industrial properties, data centers and single-family homes are expected to rise in value, while retail and hospitality will see the largest decline. The long-term outlook in the real estate sector hinges on the country's ability to reign in Covid-19.

Exodus to the 'Burbs:

Covid-19 is accelerating suburban growth, especially in the Sunbelt markets. Appearing first in the 2020 report and now ranked second for 2021, Austin, TX has continued to see a surge in the suburban office and homebuilding sectors. With a greater emphasis on health and safety, the need for lower density environments and more space has only grown. Remote work and higher taxes in large cities due to declining tourism and business tax revenue are contributing to the shift away from an urban core.

Work from Home Changes Office Outlook:

The rapid shift to widespread remote work is considered the ultimate test of digital transformation in the workplace. Companies that invested in digital capabilities saw great success with work from home policies, and 94% of real estate professionals agree that companies will allow employees to work remotely at least part of the time in the future. As a result, some businesses will shrink their footprints as a cost savings measure. However, more than 60% of professionals agree that office tenants will look to expand spaces for new ways of collaboration and interaction while complying with social distancing measures.

The Essentials: Safety and Wellness:

82% of professionals agree that health and wellbeing will become a more important factor across all sectors of real estate. The industry will need to meet higher standards of cleanliness and safety to make tenants and customers feel safe and attract them back—particularly at hotels, office buildings, retail and restaurants. The new focus on personal safety will lead to new services and advanced technology that provide cleaner buildings, improved HVAC infrastructure, sensors, touchless entry and contact tracing apps.

Social Justice and Racial Equity Now:

The industry must do more to address social and racial inequity in the US. Nearly half (48%) of respondents disagree that real estate understands how past policies and practices have contributed to systemic racism. 70% agree that the real estate industry can address and help racial inequality. Existing job training and recruiting programs for minorities and underserved communities need to be supported and expanded. Real estate professionals are also evaluating efforts to invest and develop minority and low-income neighborhoods with an emphasis on housing and schools.

Stores Still Matter:

The next few years promise to be "retail's great transition period," as demand for large retailers and department stores dwindles in favor of discount stores, fast fashion and online retail. More than 80% of participants agreed that Covid-19 accelerated the shift in retail that likely would have occurred over the next few years. Expect to see a much smaller physical retail presence and vast amounts of vacant space with lower rents. Top brands will take advantage of lower prices to upgrade their locations, while malls will leverage empty space to improve their tenant roster or convert to distribution centers for online retailers.

Affordable Housing Remains a Major Issue:

Covid-19 has only accelerated the housing disparities in the US as many low-income workers experience unemployment and possible eviction. With state and local governments facing large revenue declines, experts agree that the federal government has the wherewithal to provide programs and resources to this problem, including expansion of the Low-Income Housing Tax Credit and Housing Choice vouchers.

The Great Fiscal Challenge:

Real estate taxes, generally the largest source of local government revenue, are likely to decline as hotels and shopping centers (and potentially offices) lose tenants and value. Long term revenue declines will affect all government services but could be particularly impactful on infrastructure investments, a critical need (not just for real estate) that this report highlighted for many years. An analysis by the National League of Cities predicts that 65% of cities will delay or cancel infrastructure projects due to Covid-19.

Regional Economy

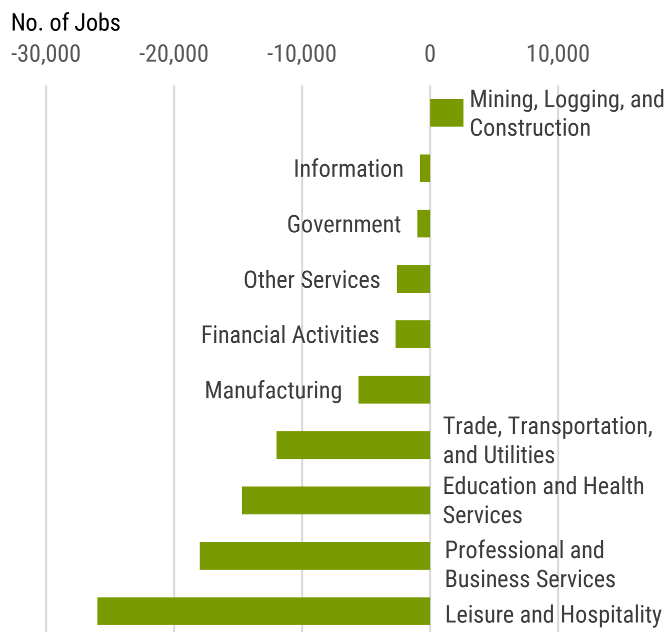
Regional Economy

“State and Federal programs will hopefully help Ohio be more competitive with manufacturing coming back from overseas.”

As with many sectors of the global economy, the Coronavirus pandemic exploited and sped up preexisting economic trends in Northeast Ohio. According to Cleveland State University (CSU), the job market was softening before government-mandated lockdowns were in place, setting the stage for an oversized impact on the region’s employment figures. Of the top 40 Metros in the United States, Cleveland’s job losses were fourth worst, performing better than only Boston, Las Vegas, and New York City, the latter of which was battered by the virus’ first wave. The area’s prominent health care sector was disrupted by the suspension of elective surgeries while sectors like Business and Professional Services saw over 10% of jobs eliminated (see lower left chart).

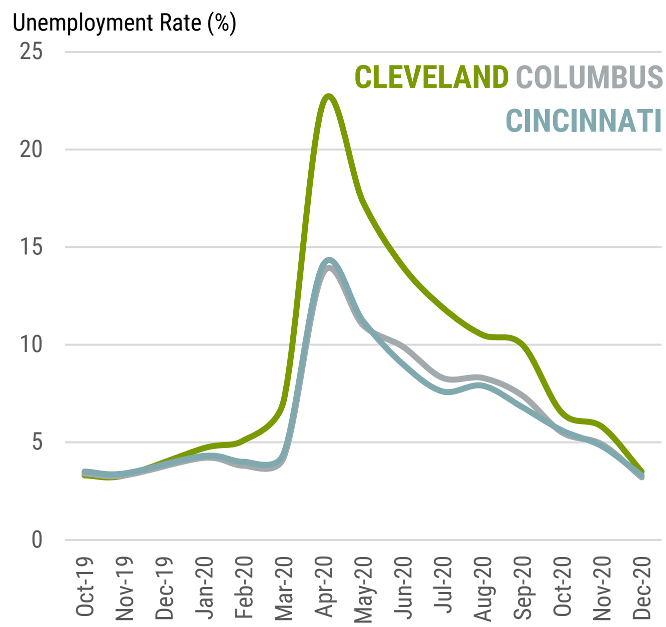
Of Ohio’s three major metropolitan areas, Cleveland experienced the largest increase in unemployment as a result of the pandemic (see lower right chart). Topping out at 22.4% in April 2020, the vulnerable job market saw a worrying spike compared to

Figure: Change in No. of Jobs, Nov ‘19 thru Nov ‘20



Source: OH Bureau of Labor Market Information, Q1 2021

Figure: Unemployment Rate by MSA, Oct ’19 thru Dec ‘20



Source: OH Bureau of Labor Market Information, Q1 2021

Market Data & Analysis

Columbus (13.7%) and Cincinnati (14.1%). Jobs have since returned to Northeast Ohio, dropping the unemployment rate to 5.8%.

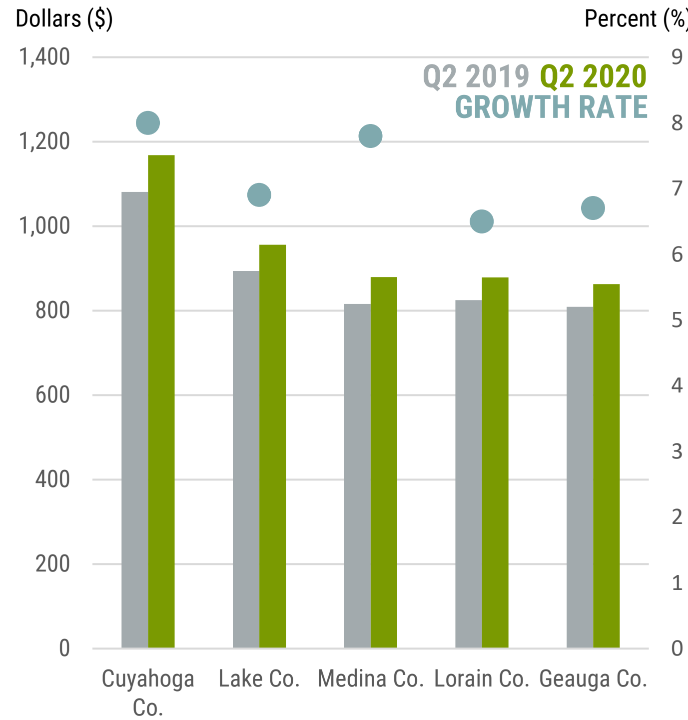
Incomes are up across the Cleveland Metropolitan Area (see chart to right). Between Q2 2019 and Q2 2020, weekly wages in Cuyahoga County were up 8% to $1,168, the largest growth rate in the MSA. Medina County posted the second highest rate (7.8%) as incomes there increased by $256 dollars per month.

Prior to the pandemic's effects, Cuyahoga County boasted the largest GDP in Ohio by total dollars. The five counties making up Cleveland-Elyria MSA had a total output of $118 million, with three of the counties (Cuyahoga, Lake, and Lorain) ranking in Ohio's top-15. This provides a cautious optimism for recovery.

Virtual work is providing flexibility unlike ever before, creating a new economic geography. Many in coastal cities have returned to smaller metros in the Midwest and Southeast to take advantage of lower costs of living and proximity to family. Northeast Ohio is likely to see a positive impact from this trend, albeit small-scale.

ULI's *2021 Emerging Trends in Real Estate United States and Canada* report rates Cleveland favorably for development prospects. The cost of doing business in Northeast Ohio is roughly 10% less expensive than the country's average. However, this contrasts local stories of material sourcing issues and higher labor costs. Construction costs are slightly down across the country—0.3% in Cleveland–which should help proformas. To build out an Office space in the region costs roughly $120 per sq. ft., half of that in New York City.

Figure: Weekly Wage Growth, Q2 2019 to Q2 2020



Source: Bureau of Labor Statistics, Q1 2021

The City of Cleveland, like many other major cities throughout the country, relies heavily on income taxes as a source of revenue. Roughly 65% of the money coming into the City are from workers salaries whose jobs are physically in Cleveland. While there existed enough reserves to shore up the 2020 budget shortfalls caused by the pandemic, future conversations about remote work and sharing of income taxes will undoubtedly be had.

Figure: GDP by County, 2016 thru 2019

County	Thousands of chained (2012) dollars				Rank in state	Percent change			Rank in state
	2016	2017	2018	2019	2019	2017	2018	2019	2019
Cuyahoga	83,020,201	84,385,012	86,762,595	87,921,020	1	1.6	2.8	1.3	43
Lake	9,894,855	9,811,846	10,077,505	10,266,470	11	-0.8	2.7	1.9	33
Lorain	9,264,642	9,195,992	9,339,435	9,390,379	12	-0.7	1.6	0.5	55
Medina	6,417,786	6,571,017	6,736,604	6,802,952	18	2.4	2.5	1.0	48
Geauga	3,634,004	3,654,111	3,742,179	3,797,778	32	0.6	2.4	1.5	41

Source: Bureau of Economic Analysis, Q1 2021

Property Sector Analyses

Office

“Companies are going to take a really hard look at **how much space** they actually need."

With trends like remote work and public health affecting the region’s office sector, many Northeast Ohio real estate professionals are delaying big decisions. "All of us in our professions want certainty and plan on certainty,” said one ULI Cleveland Focus Group member, “and I think we’re going to need to remain flexible.” Tenants are delaying investments until the picture becomes clearer, especially surrounding how best to integrate employees back into the office.

In response to this, decision makers will seek to maximize existing space or even shrink their square footage. Creatively—and safely–distributing workers throughout the office will build on flexible office space trends. They will have to think more carefully about how employees move throughout the office or how to best regulate air quality. Public health will become a more frequent factor in how to use space efficiently.

Survey respondents agree that Cleveland’s office market cycle is in the stages of either early or advanced decline. Companies invested in their virtual infrastructure and have discovered that employees do not always need to be in the office. "There's certainly been a quantum leap in the acceptability of people working remotely,“ said a Focus Group participant. Because of this, expect a slow-down in office construction in the near-term. This trend is being seen around the country, but rather acutely in Cleveland.

Cleveland has a 27,000-job deficit in traditional office-using jobs like Financial Services, Information, and Professional & Business Services compared to November 2019. So as expected, available equity capital will most likely pull back in response to local and national real estate trends. Almost 80% of survey respondents expect there to be some level of decline in available equity for office product. Like national markets, much of this comes from hesitancy as fundamentals return to normal.

One subsector that bucks this trend is Medical Office, in which respondents have much more confidence. Over 60% believe Medical Office is either in growth or peak market cycle stages. The Cleveland Clinic is one of the top hospitals in the world, and National Focus Group participants in that market noted that “health care tech is growing in Cleveland.” The region performed well in CBRE’s 2019 *U.S. Life Science Clusters: Markets Positioned for the Century of Biology*. Notably, Cleveland logged more biologists, biochemists, biophysicists, and chemists than any other Ohio market. With the pandemic and corresponding vaccine highlighting the importance of biology in a global world, expect this type of office space to continue to outperform the broader market.

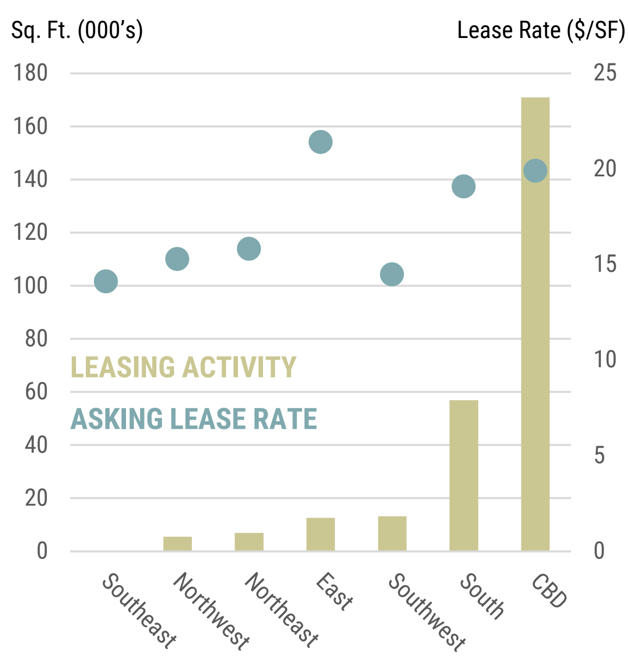
Market Data & Analysis

Subleases placed roughly 200,000 sq. ft. back on the market in Q3 2020. Since real estate tends to be a lagging indicator for the larger economy, this reflects Cleveland's significant office-using job losses in Q2 2020. The suburban market accounted for 83% of the square-footage given back, most of which occurred in the Southwest submarket. Companies will continue to evaluate the amount of space they actually need to remain productive going forward.

Large tenants stayed committed to downtown Cleveland long-term (see figure below) despite the pandemic's negative impact on neighborhood amenities. CBRE reports that over the last three quarters, the Central Business District has either led leasing activity or finished as a close second place. A prime example is Sherwin-Williams moving forward with the construction of a 1 million sq. ft. headquarters between Public Square and the Warehouse District. Renewals remain consistent, though lease terms may be shorter to allow flexibility.

Asking lease rates performed stably despite the rise in sublease activity. Hovering between $19.50 and $20 per-square-foot since Q4 2018, space in the downtown Cleveland is the most expensive of all submarkets. Driven primarily by the "flight to quality" trend, CBD Class A office rents have steadily increased during that same period. At 21% vacant, Class B office space may continue to struggle with future corporate downsizing. Sherwin-Williams currently occupies over 500,000 sq. ft. in various downtown office buildings prior to the construction of its new headquarters.

Figure: Q3 2020 Leasing Activity and Asking Rate by Submarket



Source: CBRE Research, Q1 2021

However, the continued removal of Class B and C office space via conversion will help bolster CBD metrics. In August 2020, the Tower at Erieview received $5 million in historic tax credits that will help convert 20 of the building's 40 floors into a hotel, removing a 380,000 sq. ft. of Class B space from the market. The newly designated Erieview Historic District contains several other Class B office buildings that currently sit vacant or are underoccupied.

Though the suburbs experienced a tough quarter, long-term metrics remain healthy. Vacancy in the popular East submarket, home of the Chagrin and Lander Corridors, sits at just 10.5%— roughly half the rate of the CBD. Lease rates in the East submarket are above $21 per sq. ft., putting it on par with Class A asking rates in downtown Cleveland. Rent growth remained modest overall, but subleasing trends could impact asking rates.

Construction and deliveries in Cleveland's office market slowed, perhaps contributing to lease rate stability. Notable projects under development include the Avian at Thunderbird, a 20,000 sq. ft. warehouse-turned-office project on Scranton Peninsula, as well as Swagelok's new $30 million, 130,000 sq. ft. headquarters in Solon. The latter project expects to add 400 new jobs and $87 million over the next 10 years. Like markets around the country, Cleveland's office developers will most likely wait to assess long-term, pandemic-related trends.

Industrial

"Manufacturing consolidation is being seen now, however, there is a **strong push for warehouse and distribution.**"

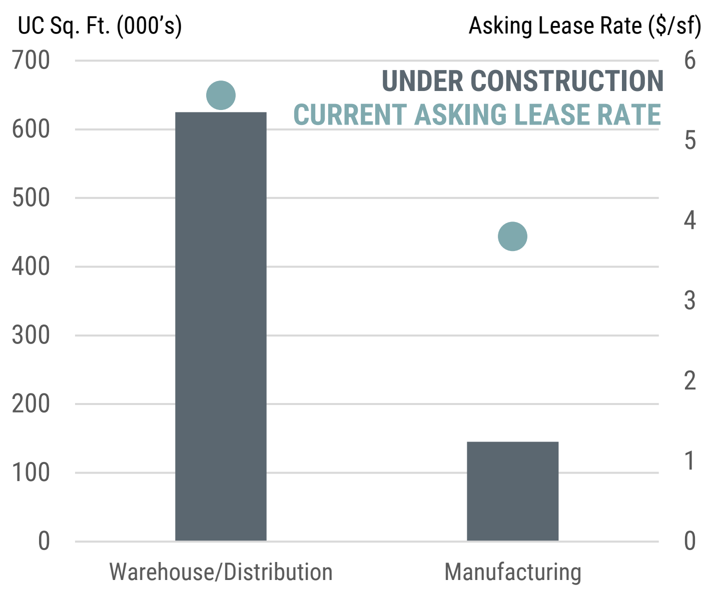
The replacement of vacant malls with Amazon fulfillment centers was poetic. It also dictated the impact that ecommerce will have on the sector's short- and long-term impact. Overall growth of online sales most likely saw its peak in 2020, according to CBRE's *U.S. Outlook 2021*, but demand will continue to strengthen. "The ability to have money to do spec is good," noted a Focus group participant, "and the State is putting up cash to do that [through the Ohio Site Inventory Program]." OSIP offers grants and low-interest loans to support speculative real estate projects. Supply chain disruptions have demonstrated the value of onshoring as much manufacturing and storage as possible. Companies should begin to reinvest in the sector and strong public support will help the region remain competitive.

Warehouses will also benefit from supply chain uncertainty. Stockpiling extra materials picked up during the US-China tariff-related trade disputes and this trend will continue as supply chain redundancy is established. Survey respondents overwhelmingly agree that Northeast Ohio's industrial sector is poised to grow throughout 2021. They expect capital to find its way to local projects, citing Covid-19 as a having a direct impact on this trend.

Cleveland's submarkets all offer 'Fair' to 'Excellent' prospects, according to survey respondents. Leading the way is the Southeastern Cuyahoga County near the cities of Solon, Twinsburg, and Macedonia. CBRE's Q3 2020 *Industrial MarketView* reflects this as well, citing the Southeast submarket's strong performance during the pandemic.

Construction in the region remains modest. CBRE reports that roughly 800,000 sq. ft. are being developed across the region, with 80% being bulk warehouse space (see chart below). Activity near the North Randall Amazon fulfillment center shows the strength of both freeway proximity and the "Amazon Effect."

Figure: Asking Lease Rates & New Construction



Source: CBRE *Industrial MarketView*, Q3 2020

Market Data & Analysis

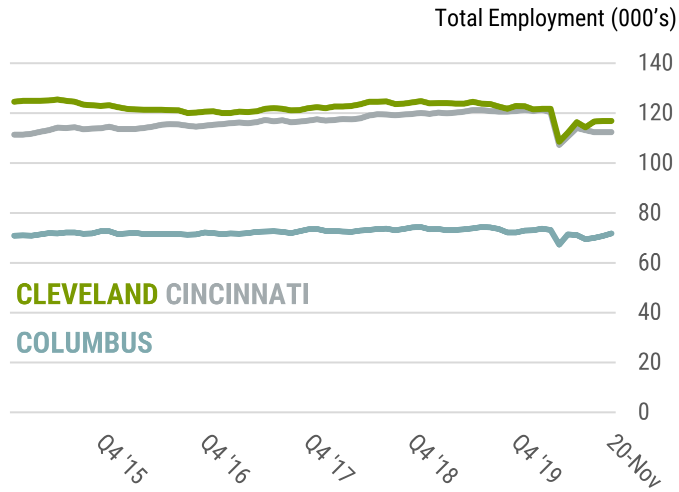
Cleveland's Industrial market is a tale of two property subtypes: Manufacturing and Warehouse/Distribution, the latter of which had a much stronger performance in 2020. In response to increased ecommerce, Warehouse/Distribution properties absorbed nearly 375,000 sq ft. in Q3 2020 according to CBRE's *Industrial MarketView*. Meanwhile, Manufacturing properties placed 150,000 sq. ft. back on the market, bringing the total through September to 431,267 sq. ft. of negative net absorption.

Four of the top-5 transactions noted by CBRE were new leases, and all top transactions were in distribution facilities. The Southeast submarket, which contains the important I-271 & I-480 junction, vastly outperformed all other submarkets, accounting for the only positive net absorption in the region. This explains why the submarket boasts the largest inventory, low vacancy, and favorable asking lease rates.

Lease rates for Cleveland's industrial market remain competitive nationally ($4.81), though slightly higher than regional peers Columbus and Cincinnati. Cleveland's warehouses tend to be older, with only 13 million sq. ft. (of 134 million) built after 1999. However, lease rates for this property subtype ($6.23) are well above the market average, which has led to a spate of construction in the area.

At the end of Q3 2020, 624,000 sq. ft. of modern (i.e. 100,000 sq. ft. footprints and 24 ft. clear heights) Warehouse/Distribution were under construction. This will grow regional inventory by 4%, helping to ease the high asking lease rates. One of the projects, the 300,000 sq. ft., $20 million Sapphire Corporate Center in Middleburg Heights, is expected to deliver in January 2021. This property will take advantage of proximity to, and direct visibility from I-71. 20801 Miles Rd. in North Randall will also bring 300,000 sq. ft. of distribution space to Northeast Ohio near the Amazon Fulfillment center.

Figure: Historical Manufacturing Employment by MSA



Source: OH Dept of Jobs and Family Services, Q1 2021

Construction activity in manufacturing, a sector hit by tariff-related supply disruption and the global pandemic, remains low. Manufacturing employment in Cleveland experienced a steep decline between March 2020 and April 2020, shedding 13,000 jobs as the lockdowns set in (see chart above). As of November 2020, the sector had regained roughly half of the jobs lost, posting stronger gains than Cincinnati, Ohio's other manufacturing-heavy market. Of Cleveland's 990,000 jobs, 12% are manufacturing, which is in-line with the overall share of manufacturing employment in the state of Ohio. However, this is a drastically larger share than Columbus where only 6% of jobs are in manufacturing.

Both Vacancy and Availability rates in Cleveland are some of the lowest among CBRE's 11 Midwestern markets. However, the market also has the least amount of space under construction, possibly explaining the low availability. The Southwest submarket 6.9% availability is higher than the market average, reflecting the 480,000 sq. ft. of new space under construction in the area. Consumer spending, driven by a new federal stimulus and greater vaccine distribution will continue to drive new warehouse space in the near- and medium-term.

Retail

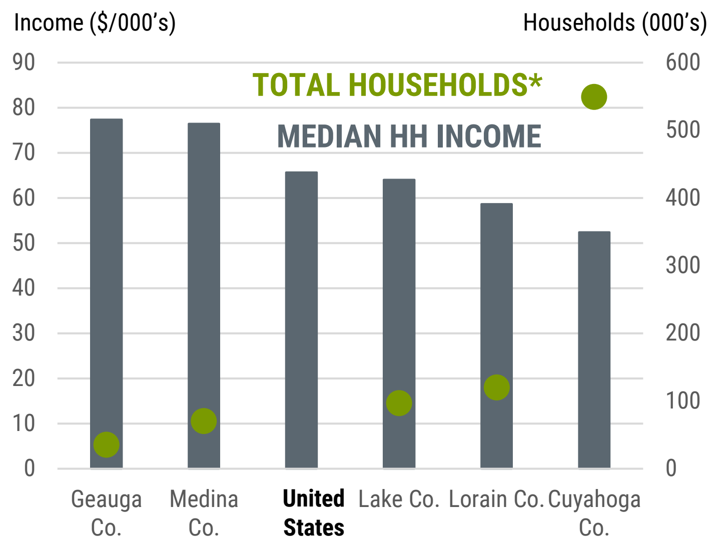
"Cleveland already had a glut of retail and restaurant space, so recovery is going to be even harder."

Cleveland's retail properties, like those around the country, are in a state of transition. The pandemic has accelerated trends of winners and losers in this sector, with numerous retailers declaring bankruptcy. One of the last remaining Northeast Ohio JC Penney locations at the Shoppes at Parma will close soon, adding to a growing list of closures seen in other regional malls. Expect this to continue into 2021 as structurally declining categories like department stores and apparel chains feel the brunt of the transition.

Lower rents could give way to more resilient—and sometimes unique–retail concepts as second-generation prime space will be available across the region. This also includes further conversion of vacant malls into industrial sites focusing on distribution. In April 2020, Cleveland.com reported that the City View Center could be rebranded into a business park like several other sites in Northeast Ohio. Success of projects like the Randall Park Mall's conversion into an Amazon fulfillment center bring optimism to a sector that needs some forward momentum.

Brick-and-mortar locations are adjusting to an environment with continually changing restrictions. "Restaurants and other retailers are working hard to break even," stated a ULI Cleveland Focus Group participant. During warmer months, patios served as way to increase dining capacity; winter could prove a significant test for the market.

Figure: Median HH Income & Total HH by County, 2019



Source: United States Census Bureau, Q1 2021

Though growing, Cuyahoga County's median household income ($52,000) is just 79% of the national median. While surrounding counties fair a bit better (see chart), but those counties with higher median incomes also have significantly less households making that amount of money. With low growth and a recovering economy, consumer spending in the region could be down. However, revived Federal Stimulus dollars could provide a cushion for the sector later in 2021.

*Note: Total US Households not included due to relevancy of comparison being made.

Market Data & Analysis

Retail in Northeast Ohio was not immune to the expediting of trends that already existed. According to CBRE, the sector shed over 330,000 sq. ft. of occupancy during the first half of 2020. Properties across the region tell two different stories: one about Power Centers—defined by CBRE as a property collection of category-dominant anchors and only a few small tenants ranging from 250,000 to 500,000 sq. ft.— and big-box stores like Meijer and Menards, which have opened multiple locations in the area over the past several years.

Declining demand has been prevalent throughout the country as major retailers such as JC Penney and J Crew declare bankruptcy and actively reduce space. As with most other real estate trends, Covid has merely sped up existing changes. Brick and mortar locations will remain relevant to omni-channel retail strategies, the centers around Northeast Ohio could become a situation of "haves" and "have nots."

Creating unique mixes of retail has seen success. For instance, Cuyahoga Community College renewed its 25,000 sq. ft. lease in a ground floor retail space at the May, a newly opened adaptive reuse multifamily project on Public Square. The Hospitality Management Center of Excellence activates a storefront and provides students an opportunity to learn in one of downtown Cleveland's entertainment districts.

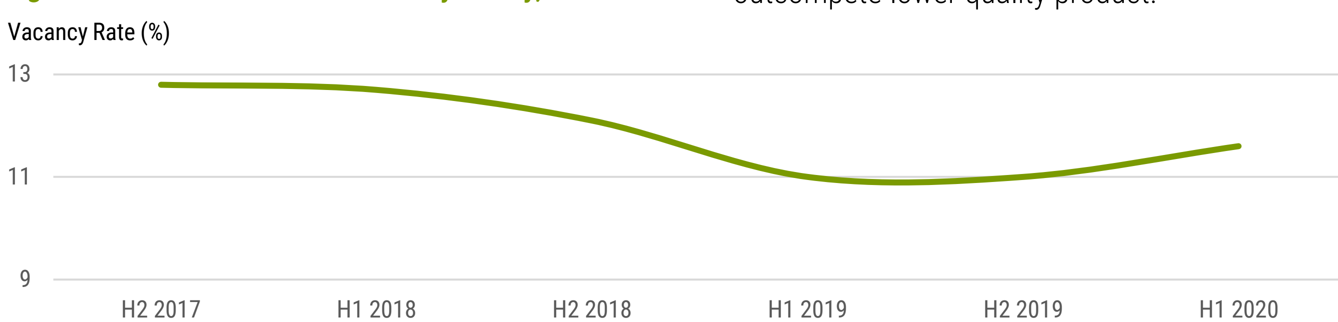
Covid restrictions, such as capacity limitations, and cold weather will continue to burden retailers into 2021. Those that were able to adapt to either a curbside pickup or deliver model will be more successful through the winter and early spring. With the potential for more federal stimulus money, retailers and food service could benefit from consumers with extra spending money.

Despite a slight increase in vacancy during the first half of 2020 (see chart below), there are reasons to be optimistic regarding new construction. In October 2020, Beachwood's City Council voted to expand its community reinvestment area, which includes Beachwood Place mall. A potential expansion has been discussed in the past. Leasing in downtown Cleveland should remain strong as vaccine distribution picks up and amenities like Playhouse Square reopen.

The long-term outlook for Cleveland Retail is complex. On one hand, mean household income for Cuyahoga County sits just north of $52,000, which is 20% less than the mean of the United States. Additionally, population decline undoubtedly reduces demand for lower quality retail centers. As seen over the past several years, defunct retail properties can be converted to other uses such as ecommerce facilities.

Retail is heavily tied to income and employment, which Cleveland has struggled with over the past few decades. As with other aspects of the national economy, area retail will have a K-shaped recovery as properties like Crocker Park and other newer spaces outcompete lower quality product.

Figure: Median HH Income & Total HH by County, 2019



Source: CBRE, H1 2020

Multifamily

"Until we get the occupancies up in these new downtown multifamily buildings…**it will be really touch-and-go**."

Northeast Ohio's multifamily performed well during the pandemic compared to other property sectors. Nationally, and outward migration to the suburbs caused those submarkets to fare better than their urban counterparts. Long-term, CBRE's *U.S. Outlook 2021* predicts that due to cost per sq. ft. and an abundance of spacious units, downtown residents will continue to be tempted to move. One ULI Cleveland Young Leader and downtown resident noted that the loss of neighborhood amenities has been challenging. Because of this, they are eyeing a move to just outside the city center.

However, there is reason for optimism in urban multifamily. Announcements like those of Rocket Mortgage, which is reportedly eyeing hundreds of new jobs in the Central Business District, keeps the submarket competitive in the long-term. Playhouse Square and Cleveland's sports teams will be back in full force as the vaccine is widely distributed. Investments from the region's corporations should give confidence to newly completed or underway projects.

The region's relatively strong performance during 2020 is reflective of a larger Midwestern trend. As apartment markets in coastal cities were heavily impacted by the prevalence of remote work, more affordable areas of the country maintained steady rent growth. Cleveland's more recent additions to the suburban submarkets have performed well. All 103 apartments in Upstairs at Van Aken are leased, prompting the developers to weigh a new set of apartment towers. Dubbed "Phase II," the 17- and 16-story buildings could house up to 225 units. Targeted investments in submarkets outside of the CBD could take advantage of the "urbanization" of suburbs as seen with the Van Aken District.

Multifamily throughout the country is also being impacted by the aging of Millennials and historically low interest rates. After helping to fuel urban renaissances, many in this generation are seeking more space to start a family and access to quality schools. While Generation Z is as urban-minded as Millennials, the cohort is smaller. In 2019, Millennials and Generation Z made up 22% and 20.3% of the US population, respectively, a difference of nearly 6 million. Baby Boomers will continue to consider urban living, especially as in-home aging care becomes more affordable.

"Our units are at a higher price point and our typical clients are downsizing empty nesters," noted a Young Leader Focus Group attendee, "and we have not had any issues with collection." The participant also noted that they acquired more sites during the summer, representing the resiliency seen so far by multifamily.

Market Data & Analysis

Like markets around the country, Cleveland's multifamily sector has performed relatively well during the pandemic. Government stimulus money, eviction moratoriums, and remote work allowed apartment dwellers to pay rent throughout the summer.

Downtown Cleveland remains the most active submarket, accounting for a lion's share of new construction and deliveries. As of Q3 2020, over 20% of units under construction were in the submarket (see chart below). Projects like the Lumen, the Beacon, and the May have placed hundreds of units on market, offering more residential options than ever before. This caused vacancy in the submarket to increase 6% between Q2 2019 and Q2 2020 to 7.4%. However, apartments built between 2015 and 2019 are 96% occupied, according to the Downtown Cleveland Alliance. Major corporate announcements (see Office section) and an impending vaccine should reinforce confidence in the neighborhood.

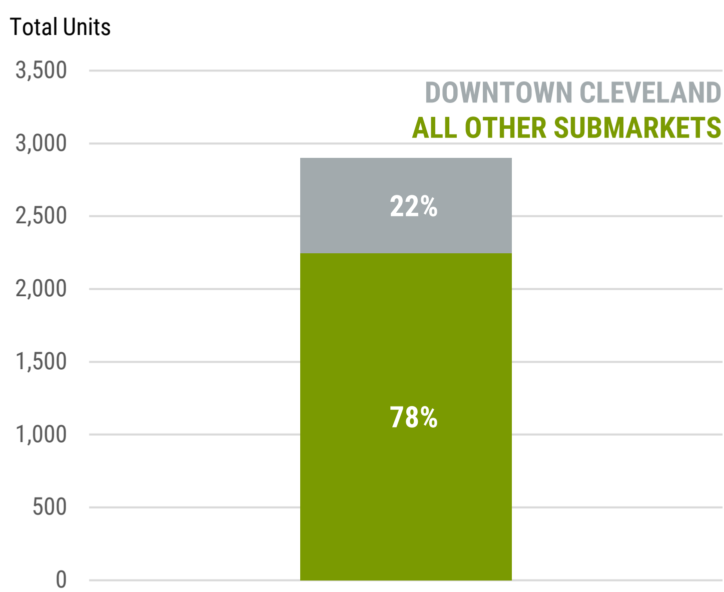
The old moniker of "retail follows rooftops" will bode well for investors as downtown Cleveland's population grows. As of mid-2020, almost 19,000 people called the neighborhood home, well within reach of the 20,000-target set by the Downtown Cleveland Alliance. Over 1,200 units are under construction and more than 500 are in the planning pipeline. 2017 remains the most active year for deliveries in the urban core.

Development remains steady in other submarkets as well. The Ascent, which is bringing 261 apartments to the Top of the Hill development in Cleveland Heights, will offer modern amenities and quick access to the Cleveland Clinic. Near West Side multifamily projects like INTRO, Waterford Bluffs, and the Quarter Phase II in Ohio City will continue to add density to the West 25th St and Detroit Ave corridors. Projects like these explain the increase in neighborhood rents, which surpassed $1,600/month in Summer 2020 according to Yardi Matrix. Development as a share of inventory is 1.6%, far below 4.1% seen in Columbus and Cincinnati.

Rent growth in Cleveland remained steady overall, reflecting a larger Midwestern trend identified by CBRE's Q3 2020 *U.S. Multifamily Housing Figures* report. Rents in coastal markets plunged, resulting in negative figures for both quarter-over-quarter as well as year-over-year growth. In contrast, Cleveland's rent grew by 0.9% Q-o-Q and 1.5% Y-o-Y, beating out other large Midwestern markets like Minneapolis and Chicago.

Downtown multifamily rents increased faster than their suburban counterparts during Q2 2020. Between February and June, apartments in the urban core were asking 4.9% more than the summer of 2019, possibly reflecting the higher quality product being placed on the market. In the suburbs, rents increased by 2.8% year-over-year, which is consistent with neighborhoods in other major Ohio metros. However, expect concessions to stay consistent or increase due to the competitive apartment market.

Figure: Share of Multifamily Construction



Source: Yardi Matrix, Fall 2020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