2022 Emerging Trends in Real Estate

Metro Cleveland

ULI Cleveland

Emerging Trends in Real Estate
2022

Content

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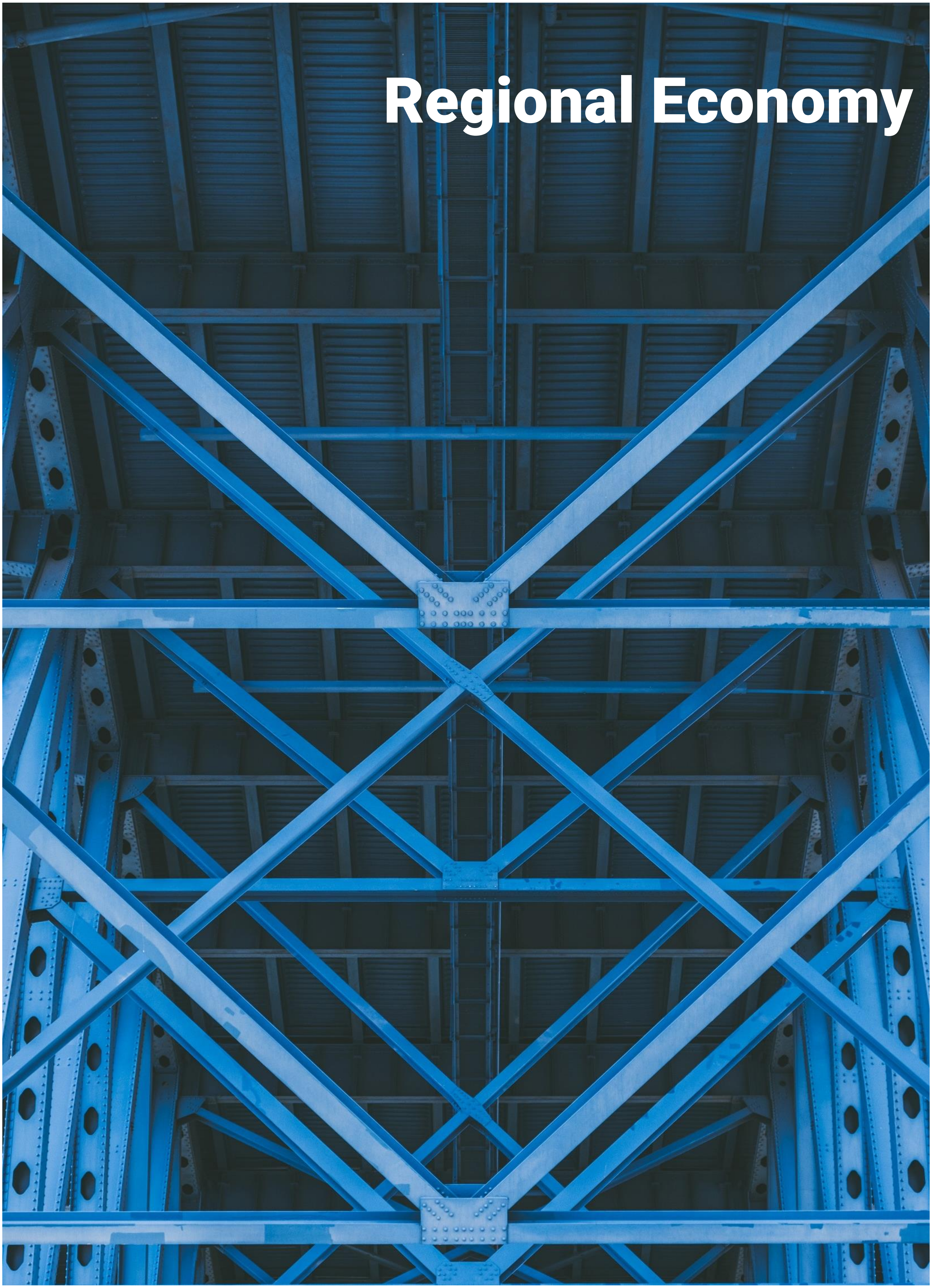
Regional Economy



Regional Economy

"The lack of net new job growth is something to focus on…but there are **some wonderful employers expanding**."

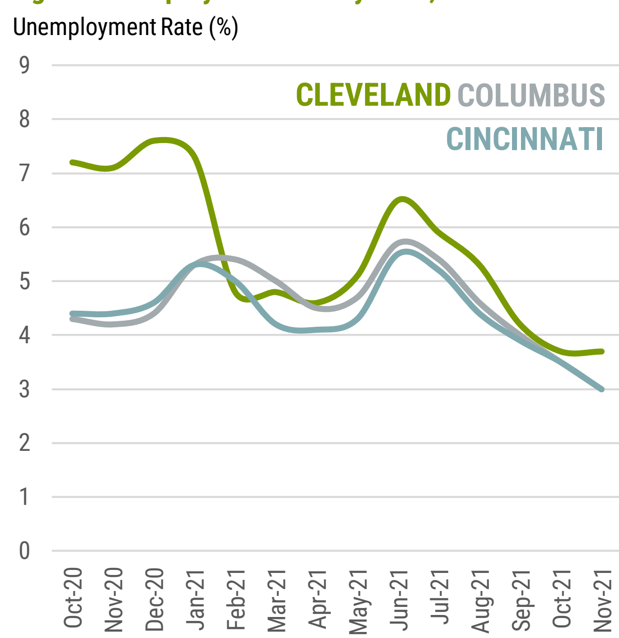
Supply chain woes and labor shortages impacted economies of all sizes in 2021. Cleveland, which has an oversized exposure to volatile industries like manufacturing, was impacted harder than other metro regions. Adding to this volatility is how the Covid pandemic is impacting the region's major healthcare employers. The postponement of elective surgeries due to a strained medical system reduces the companies' ability to perform more lucrative procedures. Between Q3 2020 and Q3 2021, the manufacturing and healthcare industries accounted for 75,000 jobs lost (see chart at bottom left). Though, the overall unemployment rate halved during that same period. However, the Cleveland Metropolitan Statistical Area (MSA) continues to underperform other major Ohio MSAs (see chart at bottom right).

Despite the pandemic's impact, Cleveland's healthcare companies are continuing to invest in new projects. MetroHealth is wrapping up construction on a 11-story, 270-room hospital on

Figure: Change in No. of Jobs, Nov '20 thru Nov '21

Source: OH Bureau of Labor Market Information, Q1 2022

Figure: Unemployment Rate by MSA, Oct '20 thru Nov '21



Source: OH Bureau of Labor Market Information, Q1 2022

Market Data & Analysis

their campus in the Clark-Fulton neighborhood. In Q4 2021, the Cleveland Clinic opened a 22,000 sq. ft. biorepository center and, in partnership with the City of Cleveland, Fairmount Properties, Meijer, and the Fairfax Renaissance Development Corporation, broke ground on a multi-family property with ground-floor grocery in the Fairfax neighborhood. Both new development projects are being linked to the larger Cleveland Innovation District announced in early 2021. The Clinic, along with Case Western Reserve University, Cleveland State University, MetroHealth System, and University Hospitals, will double-down on their commitment to the region's biosciences sector with the help of $265 million in state incentives. Officials expect the District to generate 20,000 jobs over the next 10 years and create a $3 billion impact for the state of Ohio.

Northeast Ohio's industrial sector has a more complex near-term future. The region's overreliance on manufacturing has adversely impacted its recovery as supply chain issues and labor shortages persist. A recent analysis by Cleveland.com noted that the Cleveland MSA lacks large, shovel-ready sites that many companies require when making real estate decisions. Sales of two former Ford plants could help, but significant environmental clean-up will be needed before they can be reused.

Though not a distribution hub like Columbus, the Cleveland area continues to see warehouse and distribution properties developed to meet local demand as ecommerce continues to gain popularity. However, warehouses are not making up for jobs lost in manufacturing, especially regarding wages. The US Census Bureau estimates that over 30% of Cleveland residents live under the poverty line, nearly three times the state average. Median household incomes in the city ($32,053) are significantly below the median for Ohio ($58, 642) as well as Cincinnati ($46,260) and Columbus ($57,118). As noted in the chart below, the pandemic hit Cleveland harder than the other two major Ohio MSAs. Federal stimulus dollars, both at the individual level and the governmental level, should temporarily alleviate some financial strain but should not be looked at as a long-term solution.

It is worth noting that after 16 years, there has been a change in mayoral administrations. The Jackson administration saw the City of Cleveland through the 2008-2009 financial crisis in addition to the early (and most volatile) stages of the Covid-19 pandemic. Justin Bibb and his appointees have the tools of a once-bustling city but also the challenges of managing decline. There remains much to be seen of the post-pandemic world, but having a young, nimble administration may prove to contribute substantial systemic changes to the region's economic infrastructure.

Figure: Gross Domestic Product by Region, 2018 thru 2020

Region	Thousands of chained (2012) dollars			Year-over-Year Change	
	2018	2019	2020	2019	2020
Cleveland MSA	117,229,698	119,388,022	114,297,702	1.8%	-4.3%
Cincinnati MSA	130,650,848	135,463,017	130,578,434	3.7%	-3.6%
Columbus MSA	116,945,106	119,873,627	117,134,101	2.5%	-2.3%

Source: OH Bureau of Labor Market Information, Q1 2022

Construction Costs

"One of the biggest challenges is the **uncertainty of materials**—the scarcity of availability, and more importantly the skyrocket pricing."

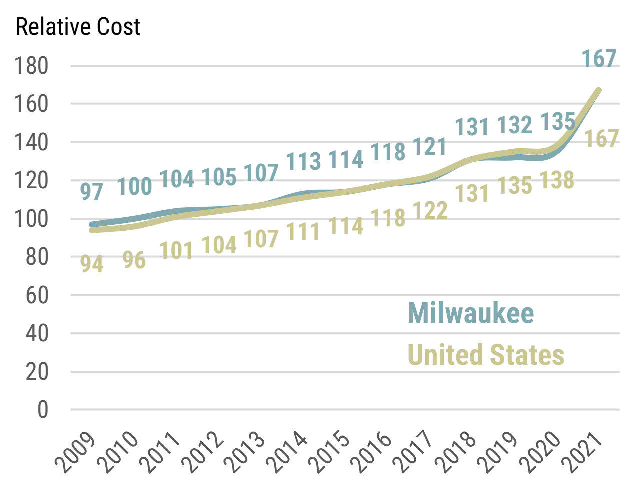
Construction costs are up in Northeast Ohio, as in every market across the US. Prices on construction materials, labor, and soft costs are expected to continue to rise in 2022.

The Mortenson Construction Cost Index is based on a survey of nonresidential construction over time, with a focus on major metro areas. Their data on Milwaukee may be relevant to the Cleveland area in relation to the US national average and other metro areas. This index shows a substantial rise in construction costs since Q3 of 2020, affecting all seven markets surveyed (Chicago, Denver, Milwaukee, Minneapolis, Phoenix, Portland and Seattle). Of interest, Milwaukee's index (162.5) is in the middle of the group as of Q32021, ahead of Chicago and Minneapolis, and only slightly below the national average (162.7). The Mortenson summary indicates high volatility in construction costs among all metro areas surveyed, due to supply chain and labor shortage issues, as well as overall inflation. In Milwaukee, construction costs increased 21.5% in the last 12 months, compared to 19.2% nationally. Material pricing changes parallel this increase, with some moderation in the rate of increase in the third quarter of 2021

The National Association of Homebuilders' research team analyzes lumber prices and adjusts for inflation. They calculate a composite cost from random lengths of lumber, and adjust to 1995 dollars. This analysis shows the 2020 real cost of soft lumber at $380, in 1995 dollars, well above the annual average of $325 prior to 2020. This is slightly higher than the previous peak of $377 in 1996.

CBRE's Fit-Out guide for 2019-2020 notes labor shortages as a significant and continued pressure on construction costs across the country. The national average increase in labor costs is between 3 and 4% per year for 2019-2020. In addition to labor shortages, CBRE's report cites trade tariffs and wage increases as pressures driving rising construction costs.

Figure: Construction Cost Index (January 2009 = 100)



Source: Mortinson Construction Cost Index, Q1 2022

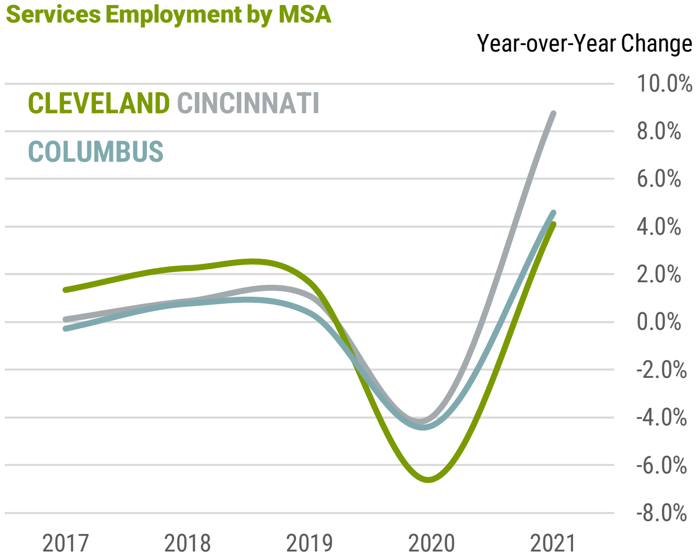
Property Sector Analyses

Office

"The office space is going to change but **nobody has finalized what that change will look like yet."**

Office continues to be the enigma of commercial real estate. Uncertainty remains about long-term employer behavior regarding remote work, but downsizing was occurring before the pandemic, and it will continue after. The Cleveland region's professional and business services sector took a substantial hit in 2020 but made notable gains over the next year, adding nearly 12,000 jobs since January 2021. However, the market has over 3,000 fewer jobs than at the end of 2019 (see chart to right). The sector also represents the boom-and-bust nature of Cleveland's economy when compared to other Ohio MSAs. Headwinds like this will continue to complicate the sector's recovery.

Figure: Historical Change in Professional & Business Services Employment by MSA



Source: OH Dept of Jobs and Family Services, Q1 2022

Participants in the ULI Cleveland *2022 Emerging Trends in Real Estate* focus groups were honest about their hesitancy to make any major prediction about the office sector. However, there was agreement that Cleveland has had success with converting defunct office space into multi-family and hospitality product. Look for this trend to continue, especially in the central business district where there are deliberate efforts to increase the residential population and lodging options.

The region's medical research sector also provides a reason for optimism. Though the real estate isn't developing quite as fast as in Columbus and Cincinnati, Cleveland still has the largest concentration of life sciences companies in Ohio. BioOhio, the only statewide membership organization for bioscience firms, says over 40% of participating organizations are in Northeast Ohio. Institutional leaders like Case Western Reserve University, the Cleveland Clinic, Cleveland State University, MetroHealth, and University Hospitals will collaborate on the Cleveland Innovation District, a major initiative launched in 2021. The $565 million plan will bring research jobs with the goal of creating a global pathogen center, resulting in a $3 billion economic impact.

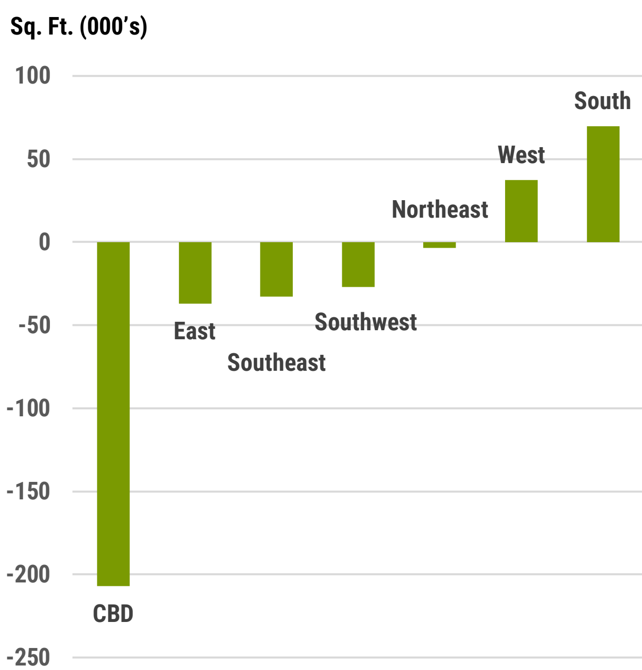
Market Data & Analysis

As of Q3 2021, the Cleveland office market had experienced five straight quarters of negative net absorption. Over 130,000 sq. ft. of office space came back on the market, with the central business district accounting for nearly 80% of the total (see chart below). Though the numbers are large, this is a trend seen across the country as companies look for the "next normal." Remote work will continue to impact absorption in the near-term and many unknowns remain.

Despite tenant right sizing, asking lease rates are in better shape than in ULI Cleveland's *2021 Emerging Trends in Real Estate* report. Downtown Cleveland saw average rents increase by $0.50 year-over-year to $20.42 per sq. ft. This is slightly higher than the top suburban market—the East submarket—which averages $20.23 per sq. ft. Rents in these two submarkets reflect the high level of demand. Nation-wide, suburban office has recovered faster than in the urban core and Cleveland is no exception.

The East experienced the highest leasing volume in the fall of last year, notching almost 90,000 sq. ft. of leases signed. Penske Logistics renewed over 70,000 sq. ft. at Two Chagrin Highlands in Beachwood. The South submarket along I-77 also experienced significant leasing volume, inking deals totaling roughly 65,000 sq. ft.

Figure: Q3 2021 Net Absorption by Submarket



Source: CBRE Research, Q1 2022

As expected, construction throughout the region has been muted. One notable exception is the activity taking place adjacent to Public Square where Sherwin-Williams will build its 36-story, 1 million sq. ft. office tower. The company also broke ground this year on a 600,000 sq. ft. research facility in Brecksville. News of Sherwin-Williams' renewed commitment to Cleveland was a positive note in an otherwise tumultuous market. With planned completion of the headquarters in 2024, the company will put its space at Landmark Office Towers back on the market.

While vacated office space presents challenges, it also creates adaptive reuse opportunities with which local developers have had past success. Downtown Cleveland remains desirable for residential and hospitality projects, which nicely utilize office floor plates. In September, the owners of Tower at Erieview announced plans to convert part of the building into a 210-room W Hotel in addition to 227 high-end apartments. The remaining 300,000 sq. ft. of office space will be updated in the process. Joining the Tower at Erieview are 75 Public Square where Cleveland Construction Co. and Millennia Companies converted the former office building into 114 apartment units, as well as Euclid Grand, which was rehabilitated into 200 units.

In summary, a lot remains to be seen in the nation's office market. Vacancies will continue to creep up as tenants reevaluate their needs. However, Cleveland's ability to convert defunct office space into other uses will prove useful as momentum in areas like the central business district continue into 2022.

Industrial

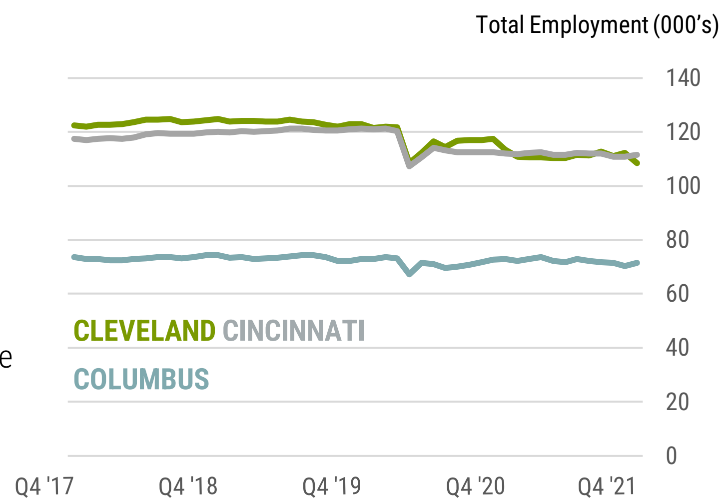
"We have a very tight market for manufacturing and distribution facilities, vacancies are very low. As a result, **we have an opportunity** to focus on these areas."

As highlighted in ULI Cleveland's *2021 Emerging Trends in Real Estate* report, ecommerce is the primary driver of Northeast Ohio's industrial activity in 2022. Markets are tight, leading to high rents and an increasing amount of construction activity. These conditions help explain why industrial may be the most successful property sector over the past year. However, much of this success is attributed to warehouse/distribution properties. Manufacturing in the United States continues to struggle, meaning challenges lie ahead for metro regions like Cleveland where manufacturing is a larger share of the economy. The metropolitan area lost nearly 5,000 manufacturing jobs between Q4 2020 and Q4 2021 (see chart to the right). However, former manufacturing sites are playing a pivotal role in developing new, modern distribution facilities.

Warehouses will provide critical infrastructure for the continued growth of ecommerce. Record levels of leasing activity demonstrate occupier demand space for distribution networks. Highland Park, a successful retail-to-industrial conversion in Garfield Heights, inked three of the largest leases in 2021. New tenants include companies Innoplast and Thermoprene, two light-industrial users specializing in traffic-centric products and materials manufacturing, respectively. The 63,000 sq. ft. lease was accompanied by a 58,000 sq. ft. transaction when Mpac Switchback agreed to occupy a former Walmart space where it will manufacture highly customized machinery and host its offices. A prime location allows tenants at Highland Park quick access to I-480 in order to meet consumer needs.

More muted is heavy manufacturing's recovery as supply chain disruptions and labor shortages create a challenging environment for the property subtype. CBRE notes that as of Q3 2021, Cleveland's manufacturing sector has seen over 93,000 sq. ft, of negative net absorption. Perhaps the most notable giveback of space was at 7005 Cochran Rd in

Figure: Historical Manufacturing Employment by MSA



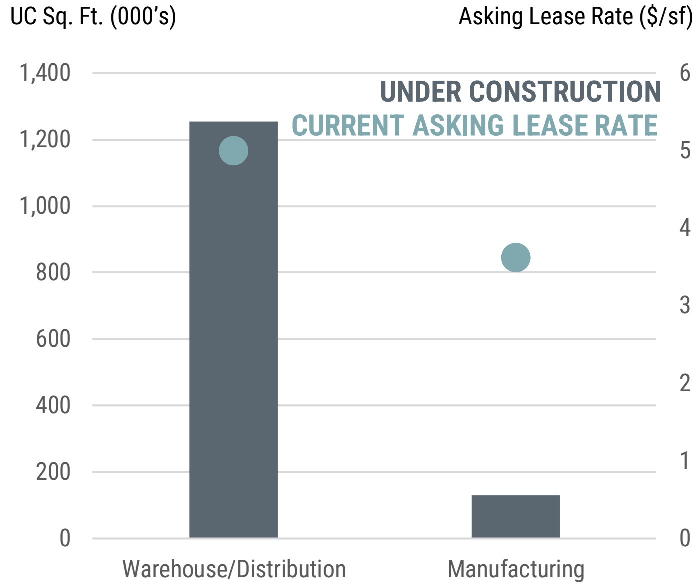
Source: OH Dept of Jobs and Family Services, Q1 2022

Glenwillow where TTI Flooring closed its facility. The maker of Dirt Devil will eliminate 56 jobs ranging from materials handlers to drivers in addition to senior staff. Economic decisions such as this explains the lack of new manufacturing space under construction (see chart to the right). As of Q3 2021, CBRE marked just 131,000 sq. ft. under construction throughout Northeast Ohio.

Asking lease rates have remained steady, even increasing for manufacturing properties despite a tumultuous year. In its Q3 2021 *Industrial Figures*, CBRE logs an average lease rate of $3.63 per sq. ft., a $0.09 increase from Q2 2021. This increase may be explained by the tight market where only 3.2% of existing manufacturing space is vacant. Warehouse and distribution properties average $5.00 per sq. ft. and had a vacancy rate of 5.3% as of October 2021. Cleveland's asking lease rate for warehouse properties built in the last 20 years—known in CBRE reports as *modern bulk*– averages $5.97 per sq. ft., which is notably higher than both the Columbus ($4.30) and Cincinnati ($4.19) markets.

While Northeast Ohio is not as centrally located as other major Ohio cities to the south, demand from ecommerce growth is driving construction around the region. Notable new projects include Gateway Commerce Center in Streetsboro, a 434,000 sq. ft. speculative development completed by Geis Companies and Westminster Capital in summer 2021. Geauga County saw a major expansion of Great Lakes Cheese Co.'s headquarters in Troy Township, adding nearly 290,000 sq. ft. to their manufacturing and distribution operations. The company cited proximity to Interstate 90 and the Ohio Turnpike as reasons for investing in their current space. Construction completions as of Q3 2021 left the market with roughly 1.4 million sq. ft. under construction, nearly triple the amount at this time last year.

Figure: Asking Lease Rates & New Construction



Source: CBRE *Industrial MarketView*, Q3 2021

Sales activity picked up in 2021 with major acquisitions throughout the Cleveland Metro area. A partnership consisting of Weston, Inc., DiGeronimo Cos., and Indianapolis-based Scannell Properties purchased two former-Ford properties in Cuyahoga County. In May, the trio purchased the 200-acre Cleveland Engine Plant No. 2 for $31.5 million, later announcing that it will be redeveloped into the Forward Innovation Center. The development will consist of more than 3 million sq. ft. of modern industrial space. Ford also sold its 111-acre plant in Walton Hills to the investor group. Plans for the site will be similar to Cornerstone Business Park in Twinsburg where Weston, Inc. and Scannell Properties built distribution facilities leased by Amazon, FedEx, and Lowe's.

Looking forward, ecommerce growth and supply chain disruptions will continue the momentum into 2022. The Cleveland market is finding new opportunities in existing vacant properties and local groups are gaining experience in large-scale industrial redevelopment. Relatively high lease rates for modern bulk make these opportunities attractive, generating historic levels of speculative development.

Retail

"Projects that have a retail component do get **scrutinized a lot more from a lenders perspective**."

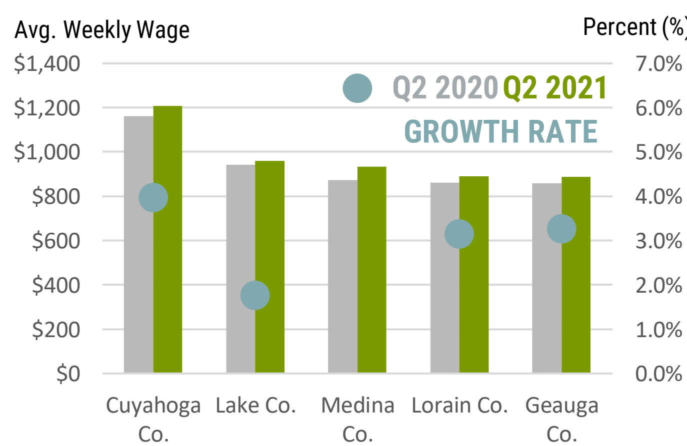
With the worst of pandemic lockdowns now behind us, the Northeast Ohio retail market has shown signs of steady recovery. Retail vacancy peaked in 2020 at 5.2% as the economic impact of the pandemic and recession weighed on tenants causing a plethora of bankruptcies and store closures. However, the economic environment has proven challenging for new supply. New construction of retail assets in Northeast Ohio was already limited prior to the pandemic. While a record 1.3 million square feet were delivered to market in 2019, just 450,000 SF was delivered in the following two years. A local developer and ULI survey participant explained that over the past year, projects with a retail component have faced more scrutiny from lenders and equity partners, who have been less willing to sign up more deals and more conservative with their underwriting assumptions. The largest new construction project in the market currently is the delivery of 159,000 square foot Meijer's in Brunswick.

Developers have been more willing to reposition existing assets for new purposes. Big box retailers such as Kmart exiting the market created large vacancies. A previous Kmart location in Cleveland's West Park neighborhood was filled by Burlington, Ross Dress for Less, and Big Lots and Starbucks and ALDI are expected to open at the site in 2022. Detroit-based Bedrock has set out to revive Downtown's Tower City into a marketplace for shopping, entertainment, and dining. Much of the lease-up push was driven prior to NBA All Star Weekend, during which a revitalized Tower City was on display for event goers and visitors.

As the economy continued to recover in 2021, demand for retail space in the market slowly rebounded. The first half of 2021 started slowly, and rents barely increased. Activity picked up in the second half of the year, and by the end of 2021, the retail market absorption was once again yielding positive metrics. As supply of retail spaces remains relatively constant and the economy continues to recover, rents are likely to continue to increase over 2022. However, incomes in the region remain below inflation, slowing the sector's recovery (see chart below).

Sales in the market picked up significantly in 2021, totaling over $600 million, which is near record level for Northeast Ohio. Four of the top 10 deals of 2021 were large shopping centers. The largest retail deal was the purchase of Westgate Shopping Center in Fairview Park by R.H. Johnson Co. of Kansas City. Grocery-anchored shopping centers accounted for many of the top sales as investors sought out more stable streams of income. A top sale in this sector was the $38.8 million acquisition of three properties in Cedar Center South shopping center in University Heights by First National Realty Partners. Sales pricing did not change much over the last year.

Figure: Weekly Wage Growth, Q2 2020 to Q2 2021



Source: Bureau of Labor Statistics, Q1 2022

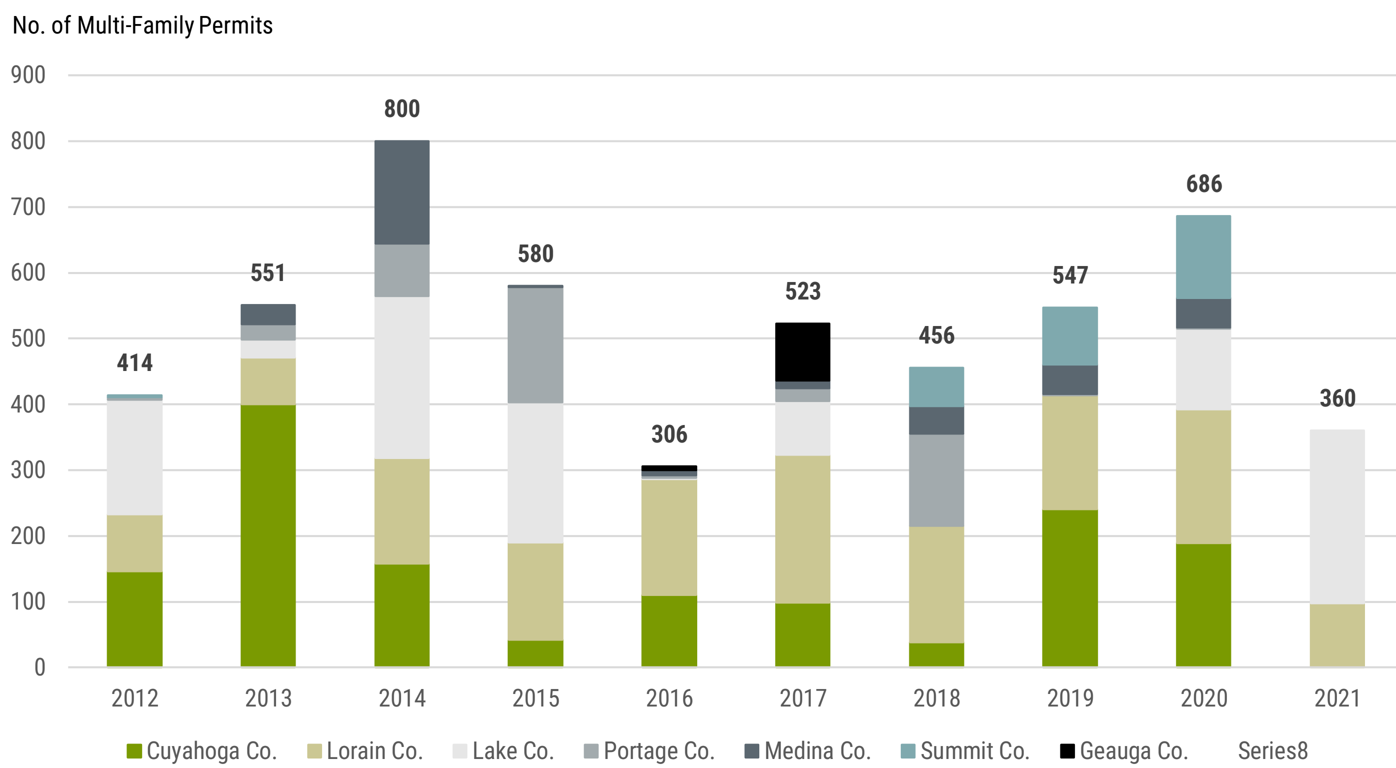
Multi-Family Residential

"We're just scratching the surface in terms of what we can do with Downtown residential development and population growth."

Multi-family permits are less clear in pattern over time, due to the low overall quantity of units developed in the region. The "lump-wise" nature of delivery of multiple units at once in any specific county in a given year, while other years that county may have few new projects coming online, makes for a highly varied permit data graph.

Since 2010, counties with peak awarding of building permits, by unit count, include Summit and Cuyahoga counties (more than 400 units). All counties have demonstrated at least one smaller peak (100 units or more) from 2010 to 2020. Medina's building permits have slowed since 2014. There is no overall indication of building permit trend changes since the pandemic, except for Lake County, which appears to have a surge in multi-family units since 2019.

Figure: Multi-Family Permits by County and Annual Total, 2012-2021



Source: MLS Now, Q1 2022

Single-Family Residential

"Permits for alterations and repairs are **concentrated on the West Side of Cleveland**."

As more of the millennial generation reaches the age of 32, which was the median age of first-time homebuyers in the US in 2018, we are seeing an uptick in purchase of new homes in the suburbs and exurbs surrounding Cleveland. New home construction is still far below its peak in 2004 but has been steadily rising year-over-year in Northeast Ohio since 2011. While not the main impetus for this trend, the pandemic has contributed to it, as demand for new construction has grown steadily.

Prices of new single-family homes have surged due to increased labor and supplies costs fueled by the pandemic, but housing prices in general have risen substantially. Redfin reports that the price of single-family home sales in the Cleveland market have risen 14% year-over-year as of December 2021. In July of 2021, Crain's reported home sales in the region were up 11.8% from 2020. The year-to-date sales were up 9.7% from the same period in 2020.

According to data from MLS Now, total home sales in the seven-county area grew 3.9% from 2020 to 2021, while the average sale price rose 10.7% from $230,016 to $254,561 (see table below).

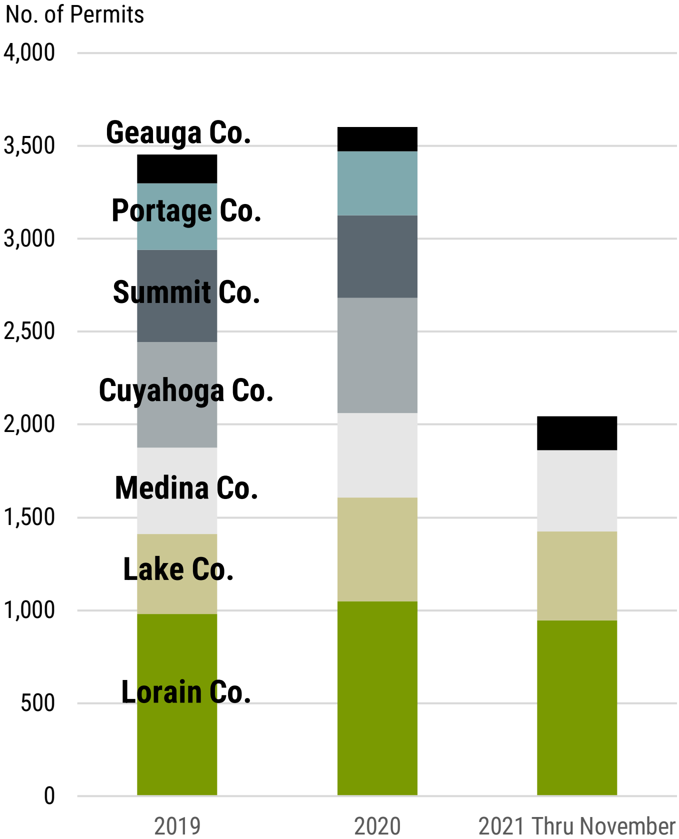
Building permit data for the seven Northeast Ohio counties shows steadily expanding new single family unit development since a low in 2011. In February of 2021, Crain's reported that the number of new

Figure: Change in Average No. of Homes Sold & Average Sale Price by County

County	All Homes Sold, 2021	Change from 2020	Average Sale Price, 2021	Change from 2020
Cuyahoga	17,945	7.6%	$ 224,214	12.6%
Geauga	1,124	-3.6%	$ 358,888	9.8%
Lake	3,996	5.2%	$ 218,935	12.7%
Lorain	4,505	1.0%	$ 228,782	10.1%
Medina	2,449	-5.1%	$ 298,134	11.6%
Portage	1,757	-2.3%	$ 241,917	10.0%
Summit	8,057	2.4%	$ 211,060	8.2%
Total	**39,833**	**3.9%**	**$ 254,561**	**10.7%**

Source: MLS Now, Q1 2022

Figure: New Single-Family Permits by County, 2019-Nov 2021



Source: MLS Now, Q1 2022

single-family homes had risen 7.8% in the past year, with continued increases expected in 2021.

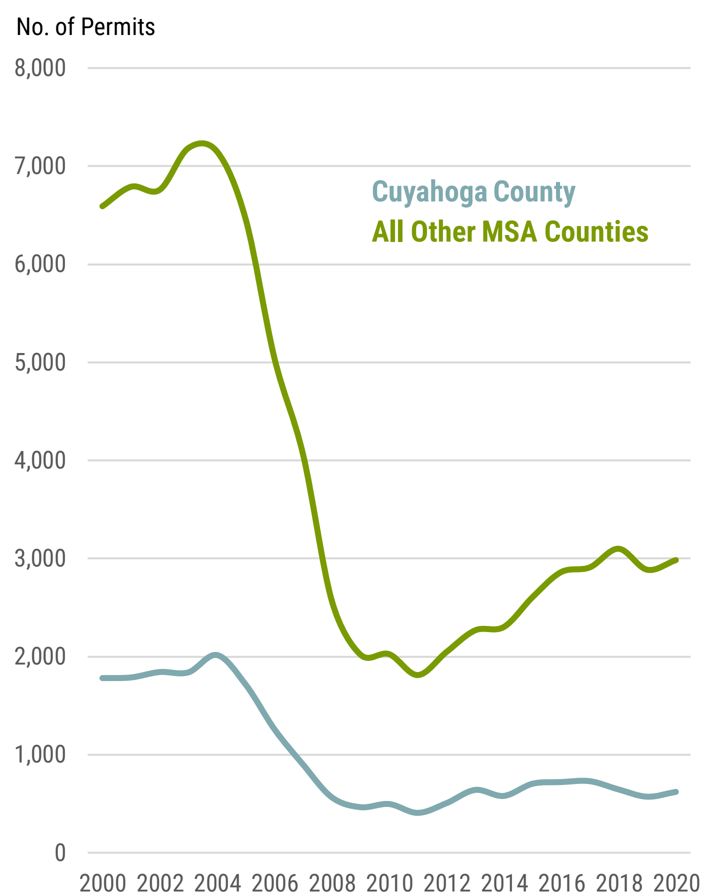
In particular, more single-family building permits have been awarded in Lorain County than in any other county, with a significant expansion since 2017. Lake County has also demonstrated expansion in permits, especially 2019 to 2020. Permits in Summit and Medina counties have decreased since 2017, while other counties have held steady. Considered together, suburban county single family development continues to outpace single family development in Cuyahoga County. Among suburban counties taken together, there does not appear to be a significant rise in permits since the pandemic began; Cuyahoga County appears to also be holding steady during that period (see graphs above and right).

New Home Source lists 60 communities of new construction homes within 25 miles of Cleveland. A handful of builders with multiple communities around the region account for most of the development.

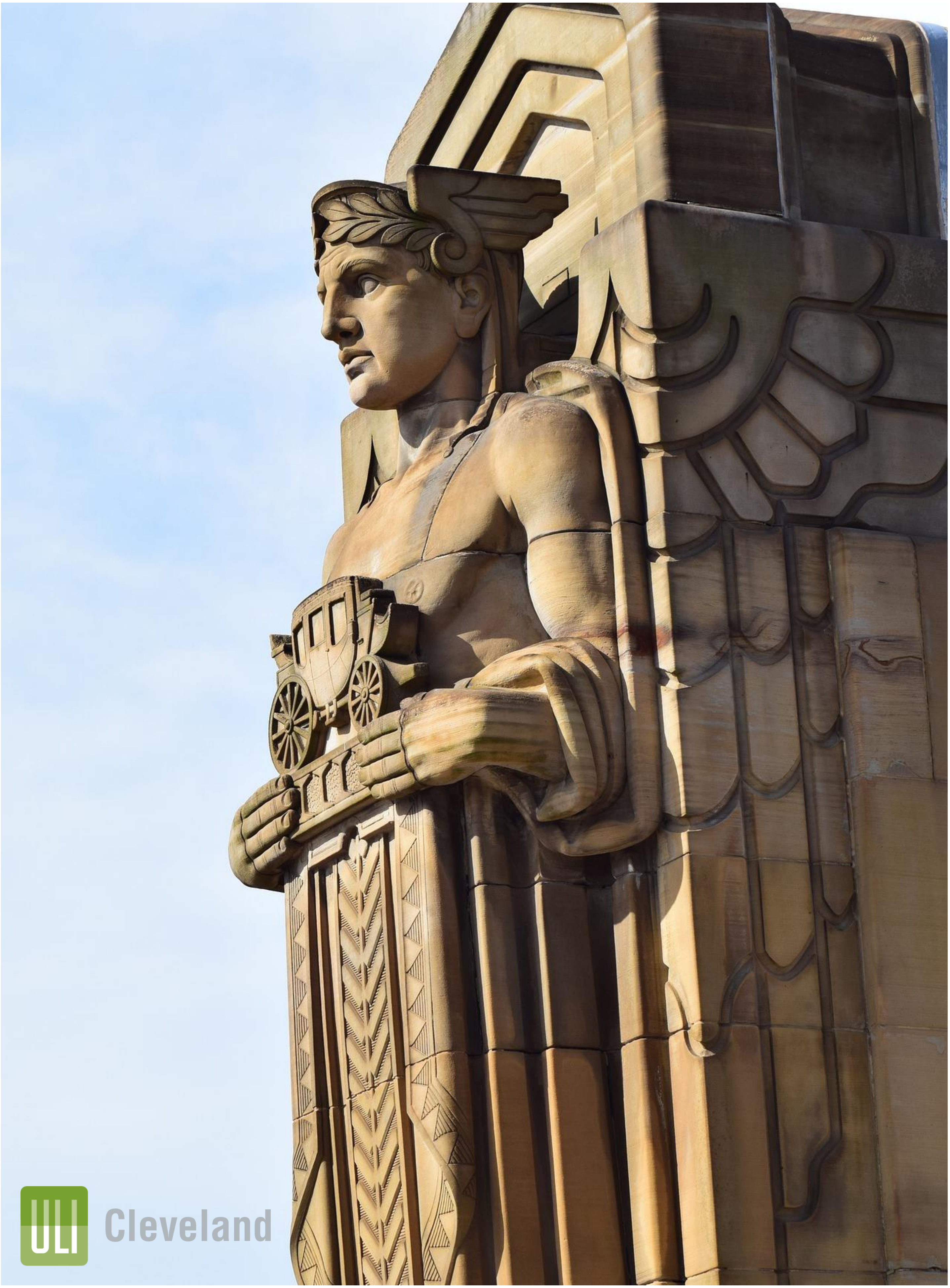
Examples of single-family developments include:

- The Preserve at Parkside, Brecksville, Parkview Custom Homes, $800,000 and up
- Edgerton Commons, Broadview Heights, Petros Homes, $500,000 and up
- Prell Retreat, Broadview Heights, Drees Homes, $500,000 and up
- Ledges of Avery Walden, Strongsville, Pulte Homes, mid $300's and up
- River Run Landing, Elyria, Ryan Homes, mid $200's and up
- Aspire at Auld Farms, Akron, K. Hovnanian Homes, low $200's and up

Figure: Single-Family Permits Issued since 2000



Source: MLS Now, Q1 2022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