



2023 Emerging Trends in Real Estate

Metro Cleveland



Cleveland

Emerging Trends in Real Estate

2023

Content

Sponsors	Pg. 02
ULI Cleveland Leadership	Pg. 03
Regional Economic Summary	Pg. 04
Property Sector Analyses	
Office	Pg. 06
Industrial	Pg. 08
Retail	Pg. 10
Multi-Family	Pg. 12
Single Family	Pg. 13

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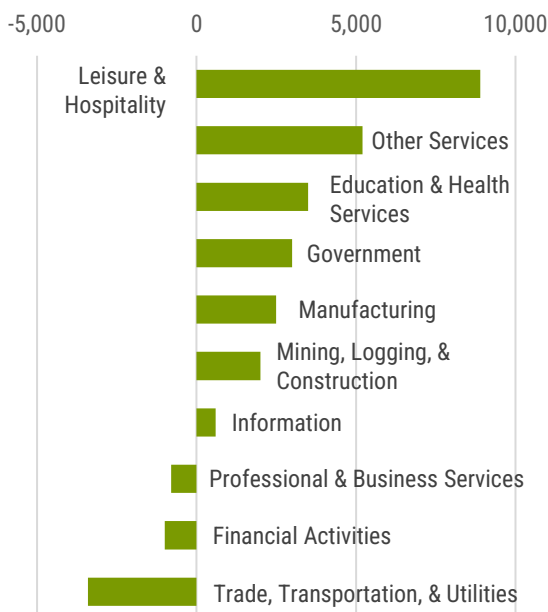
Regional Economy

Jack Newton

Many of Cleveland's major economic metrics were weak going into the pandemic. As the dust settles on the economic impact of Covid, we notice that it accelerated existing trends, which hit Cleveland especially hard. Though recovery is continuing throughout Northeast Ohio, the region still lags Cincinnati and Columbus on many fronts, most notably unemployment (see chart). As of November 2022, the Cleveland-Elyria MSA's unemployment was 4.2%, up from 3.5% in November 2021.

Figure: Change in No. of Jobs, Nov '21 thru Nov '22

No. of Jobs

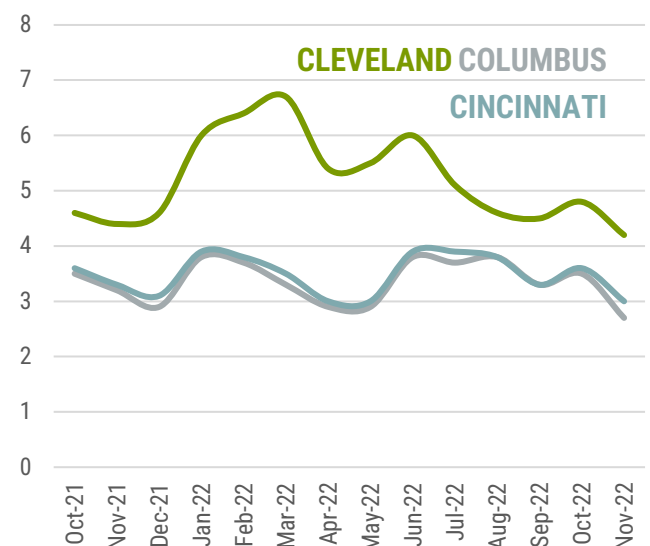


Source: OH Bureau of Labor Market Information, Q1 2023

Industry sectors that saw the largest year-over-year job gains were Leisure and Hospitality (8,900), Other Services (5,200)—which includes machine repair as well as civic/non-profit services—and Education and Health Services (3,500). The latter category speaks to the impact that the region's healthcare sector has. After several years of Covid-related turbulence, which often caused healthcare systems to postpone elective (and more lucrative) procedures, it appears that the industry is getting back to normal.

Figure: Unemployment Rate by MSA, Oct '21 thru Nov '22

Unemployment Rate (%)



Source: OH Bureau of Labor Market Information, Q1 2023

Regional Economy

The largest job losses were in Trade, Transportation, and Utilities (-3,400), Financial Activities (-1,000), and Professional and Business Services (-800). Contributing to the loss of jobs in Trade, Transportation, and Utilities was the subcategory of Retail Trade, which lost 2,900 jobs year-over-year. Continuing a worrying trend seen at the onset of the pandemic, Cleveland continues to lose office-using jobs, represented by the decreases in Financial Activities and Professional and Business Services, which include jobs in the insurance and real estate industry as well as management companies (see chart). Both Cincinnati and Columbus lost office-using jobs during 2022 as well, potentially signaling corporate decisions to prepare for a potential recession.



Office Market

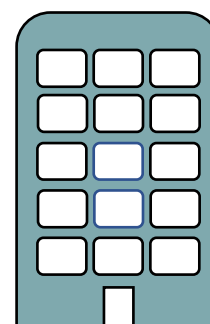
Vanessa DeLano

Office building conversions continue to be a major story in Cleveland's office sector and remain a priority for investors and property owners alike. The drive to use office space in multiple ways is only growing within several Cleveland submarkets. The improvements are attracting better workplace experiences as well as more traffic in downtown Cleveland. Cleveland is a national leader in office building conversions, as reported by CBRE Group, Inc. Much of this success is attributed to transforming office space into apartments, hotel and other uses. While the market's average conversion size is 177,150 sq. ft., one of the projects—45 Erieview in the newly minted Erieview Historic District—has a total of 493,000 sq. ft. being turned into 367 apartments with retail and office uses on the lower level. Office space conversions are not a fix all, but heavily impacts the amount of space being leased and the terms that come with it. Another planned office-to-mixed use conversion is the historic Union Trust Building, now named the Centennial. Located at 925 Euclid Ave, the building sits at 1.3M sq. ft. of space that will be converted into workforce housing, office, retail, a boutique hotel, and a museum.

Office space conversion is an important trend due to the impact working from home has had over the past three years. "Pre-pandemic: 70 to 80 percent of an

office was workstations for individuals whereas now we are seeing maybe 15 to 20 percent more amenities in the office," said a respondent in the *2023 North American Emerging Trends in Real Estate Report*. Despite this, companies like Sherwin-Williams (1M sq. ft.) and CrossCounty Mortgage (168,000 sq. ft.) are committed to their physical presence in downtown Cleveland. Now that companies have proven they can remain productive while being remote means less trips to the office for certain employees. Tech companies may never be back in the office full time, which means they will look to limit their footprint. This trend should continue throughout 2023 and beyond, and not solely in the tech sector.

Figure: Return-to-Work Update, Nov 2022



58%

Share of Downtown Cleveland
Workforce Back in the Office

Source: Downtown Cleveland Alliance

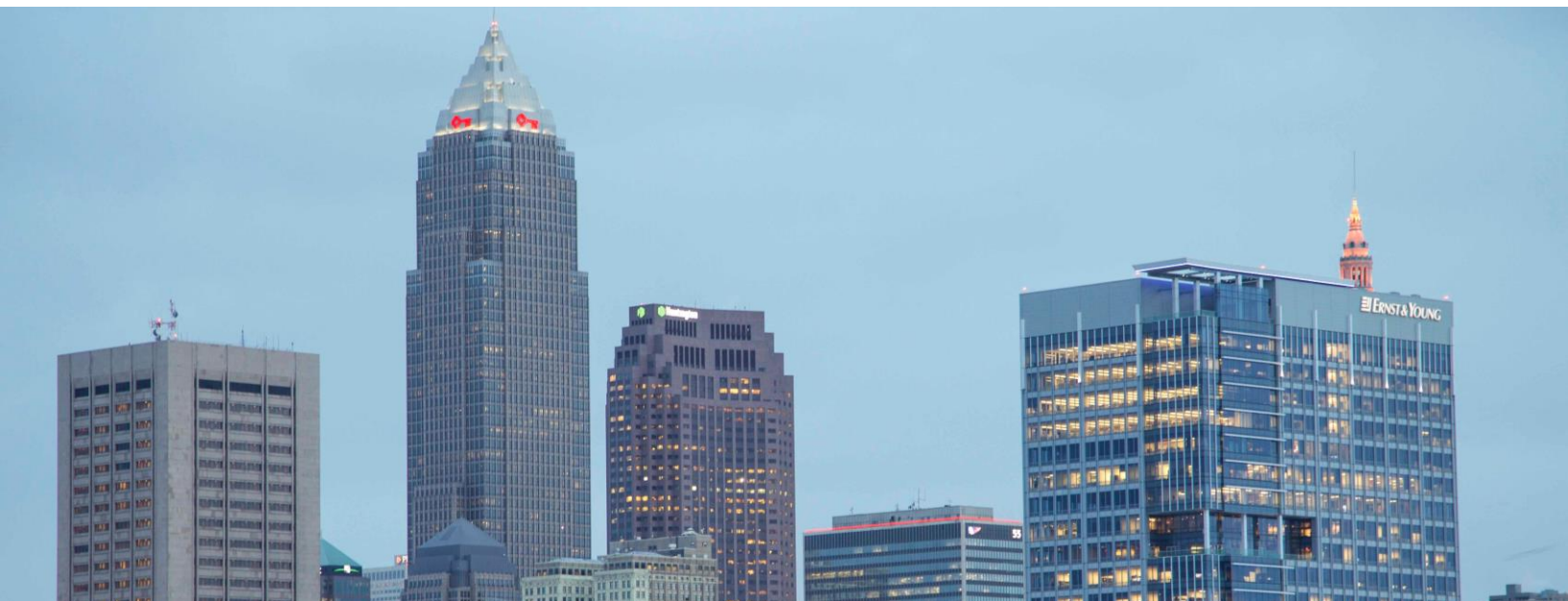
The rise of ESG (Environmental, Social, and Governance) within office decision-making is important for clients and investors to watch. ESG reporting is becoming more prevalent throughout commercial real estate. ESG preserves and creates value by minimizing energy use through more efficient construction materials. For example, retrofitting a former office building into multifamily units helps avoid emissions associated with new construction. Green properties are marketable to lenders, tenants, and buyers that seek lower energy costs. The Cleveland 2030 District, a non-profit organization, has a mission to “engage progressive property owners, professional partners, and community stakeholders to create a dramatically efficient built environment in Cleveland.” Cleveland is one of 15 cities supporting Architecture 2030’s Challenge, that calls for 50 percent reductions in energy and water consumption as well as reducing emissions in the office and operations using 50% less green house gas emissions by 2030. In fact, Cleveland was the second District of its kind founded after Seattle and grew out of a working group of Sustainable Cleveland four years ago.

Sustainable transportation is their next mission that has continued progress through traction.

Flexible lease terms with healthy work environments will continue throughout 2023. Hybrid working means less emissions from driving and more downtown living as buildings are converted to other uses, which will aid goals set by Cleveland 2030. Cleveland is ways away from reaching its net zero goals but chipping away little by little.

Incentives will also continue to impact the Office property sector. Property owners have taken advantage of incentives such as the Transformational Mixed-Use Development (TMUD) Tax Credit. The Centennial, mentioned earlier in this piece, received a \$40M allocation in Q2 2022. The project also utilized State Historic Tax Credit program (SB 225) and was awarded its allocation in 2015.

Overall, ESG and conversions, which can be synonymous, will help Cleveland transition into a “new normal” where flexibility and remote work will continue to impact the sector.



Industrial Market

James Jaworski

Cleveland's industrial sector continues to trend strong for another year, accounting for a significant amount of growth in the wider real estate sector. Although growth in certain areas is less pronounced than in cities like Cincinnati and Columbus, the industrial sector in Cleveland continues an upward trajectory that bodes well for the coming years.

Manufacturing, an important part of Cleveland's economy, has seen promising growth over the last year, following similar trends seen nationwide.

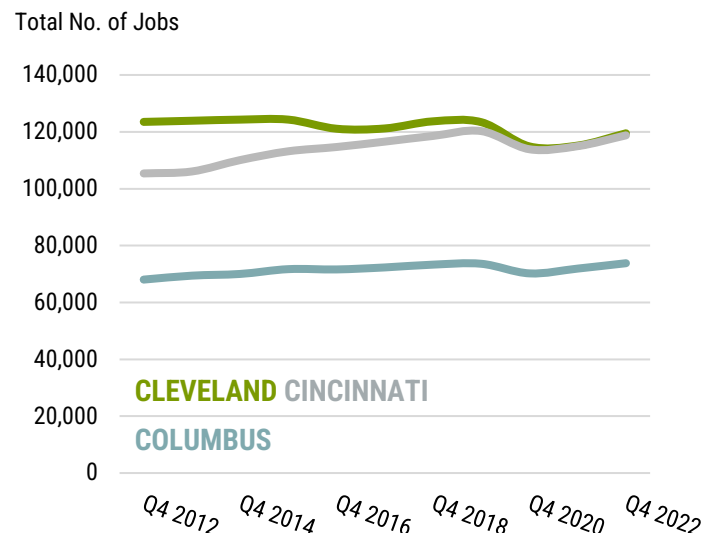
Manufacturing jobs in Cleveland increased by nearly 5,000 between Q4 2021 and Q4 2022 (see figure). While not in Cleveland, large projects around Columbus like Intel's new plant and the Honda EV factory are anticipated to draw more support manufacturing to the area, including in Cleveland. Radix, a manufacturer of high-temperature wire and cable, signed one of the largest leases on the market this year with their 120,000 sq. ft. manufacturing space in Glenwillow.

Despite these strong moves, Cleveland's emphasis on manufacturing in the industrial sector could be a reason for its partial lag relative to the rest of the country. Not to be deterred, however, Cleveland continues to invest in its manufacturing sector. A shining example of the effort to revitalize manufacturing in Cleveland, the Manufacturing Advocacy and Growth Network—or MAGNET—completed its new headquarters on Cleveland's east

side; a 53,000 sq. ft. facility at the former site of the Margaret Ireland Elementary School in the Hough neighborhood. MAGNET, a nonprofit focused on growing and supporting Northeast Ohio's manufacturing sector, says that its new facility will create 30,000 jobs and grow the local economy by \$40 billion by 2032.

Warehouse spaces and distribution centers continue to make a strong showing in the overall market, with 1.4 million sq. ft. of speculative space being added over the course of 2022. Large speculative projects like the Turnpike Commerce Center and Westfield Commerce

Figure: Historical Manufacturing Employment by MSA



Source: OH Dept of Jobs and Family Services, Q1 2023

Center will add an anticipated 2.8 million sq. ft. in the near future. Orlando Baking Company finished their 156,000 sq. ft. cold storage facility along Cleveland's Opportunity Corridor in late 2022. All-in-all, the industrial sector saw over 5.3 million sq. ft. over the course of the year. Cleveland has seen less investment in ecommerce and logistics hubs recently than other similar cities, but these new and in-development facilities could perhaps indicate a turning point for the city.

Following national trends, vacancy rates sat at record lows for much of 2022, finishing the year around 3.5% and increasing mostly only due to completion of speculative projects. Unsurprisingly, rent growth has also hovered around record numbers of about 8.7%. While still unusually high, this percentage falls noticeably lower than the double-digit percentages seen in Cincinnati and Columbus.

While supply chain issues and economic uncertainty may stunt some growth in the Land, the overall prospects look good entering into 2023.



Retail Market

Nora Walsh

As the world continues to recover and move forward from the pandemic, the retail sector in Northeast Ohio has shown signs of recovery and stabilization in various ways. According to the ULI America's 2023 Emerging Trends in Real Estate report, the head of advisory services for one real estate firm indicated that there has been a reset for the retail sector and companies that survived up to this point have a strong future ahead of them. This reset has been evidenced by a decrease in retail vacancy from 5.2% in 2020 to 4.6% in Q3 2022 as the sector continues to stabilize with grocery-anchored retail centers leading the charge. Through the pandemic many retailers struggled. The retailers that ultimately failed that had primarily located space were soon filled by discount retailers, grocers and restaurants due to location being a key factor in demand. In addition, an abundance of previous retail space has been re-purposed for e-commerce use as online shopping continues to trend positive. Although demand remains strong, which keeps vacancy low, the supply of new quality product in the retail sector is not keeping up with demand. Since Q2 2022, only 320,000 SF of retail space was delivered with a large percentage being the new Meijer store in Brunswick. Additionally, there is only 290,000 SF spread across 29 properties currently under construction, which are also most grocery retailers.

As stated earlier, many large, unused retail spaces are

being repurposed for e-commerce purposes as online shopping continues to show strength. However, Northeast Ohio is seeing the national phenomenon of "clicks to bricks" where native online retailers are moving into physical spaces and providing compelling shopping experiences for customers. This phenomenon has been seen with Warby Parker opening in Crocker Park in 2021, Brilliant Earth opening at Pinecrest in 2022, and Made Cleveland, a local native online brand opening in Coventry in 2022. Made Cleveland, which features local artists work originally started as an online-only brand, then did a temporary holiday pop-up shop which led them to opening their first brick-and-mortar location. The founder of Made Cleveland indicated it was important to create a dynamic shopping experience that included both online and in-person experiences which appears will be a trend that we will continue to see.

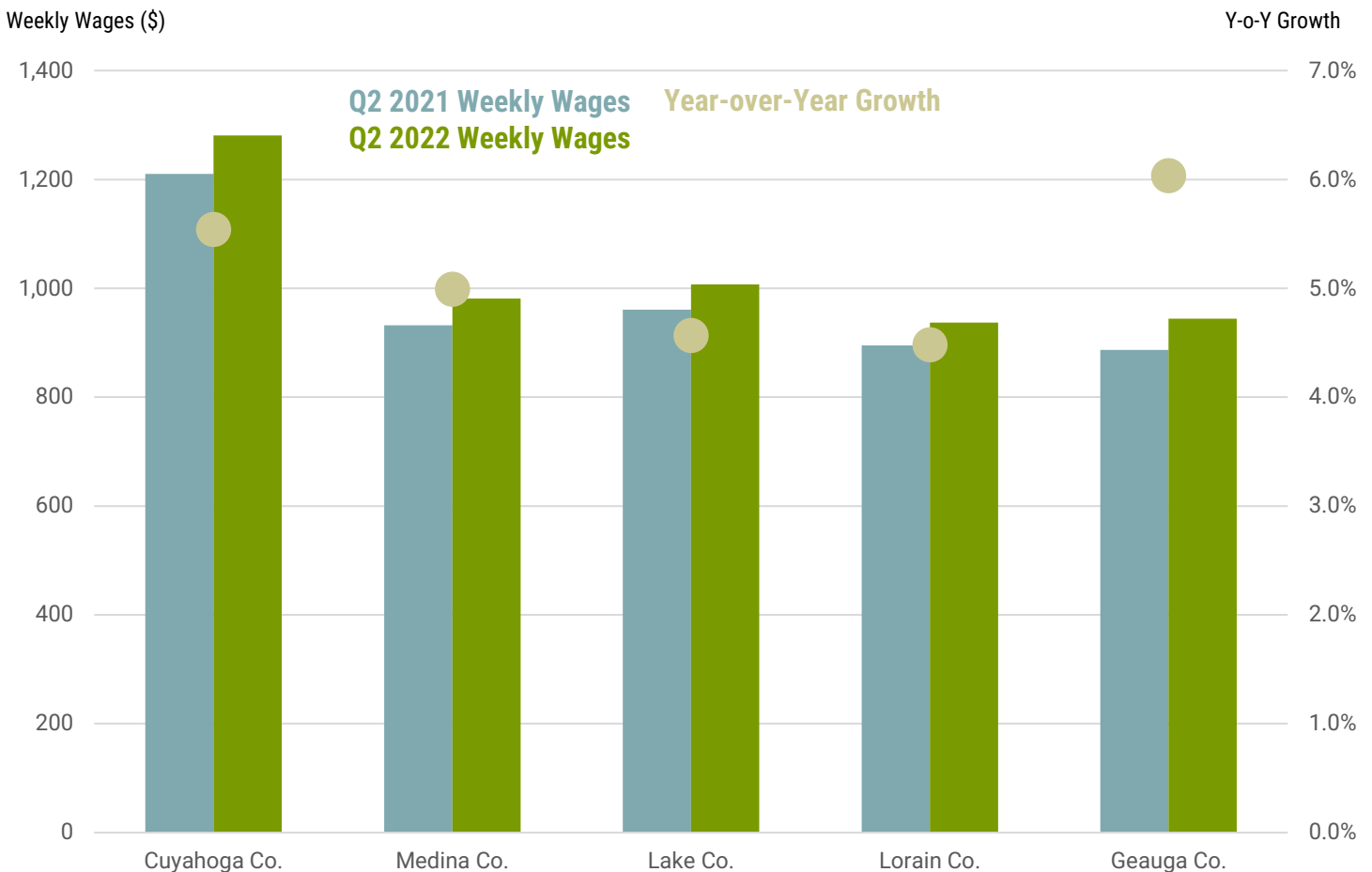
Another exciting endeavor for the retail sector comes with Detroit-based Bedrock's recent unveiling of their master plan to re-develop the Cuyahoga riverfront. Within this master plan is the overarching plan to revitalize Tower City Center as a "hub for shopping, pop-up retail experiences, dining, and entertainment". With this revitalization has come the addition of many new leases and expansions including Infinite Boutique, Unscript'd Boutique and

360 Clothing Studio. As they continue to materialize their master plan, the hope is to continue signing on new retailers in Tower City.

Throughout 2022, as the economy has continued to recover from the pandemic, demand for retail space has been significant. Compared to 2021's slow rent growth, rents have grown 5.1% throughout 2022. This growth typically occurs with accelerated leasing activity and when there is an increase in retail sales. It is expected that in the next few quarters, rents will continue to grow in the retail market with the highest rents at \$21.45/SF for mall retail space currently. However, the inconsequential increase in average weekly income from Q2 2021 to Q2 2022 in the region, has hindered the sector's recovery (see chart below).

Over the past 12 months, Northeast Ohio has seen over \$704 million in retail space sales, with grocery-anchored retail topping the charts in number of deals as investors look for more stable income streams. One of these major deals included the sale of Medwick Marketplace, a shopping center in Medina that is anchored by a Marc's grocery store which sold for \$14.45MM in May 2022. Sales pricing increased 6% in 2022 with cap rates slightly compressing in the later quarters of the year.

Figure: Weekly Wages and Y-o-Y Growth by County, Q2 2021 – Q2 2022



Source: Bureau of Labor Statistics, Q1 2023

Multi-Family Residential Market

Joseph Spinuzza

Changes to Cleveland’s economy has led to a shift in the supply and demand in Cleveland’s multi-family apartment rental sector. As Cleveland continues to see a decline in manufacturing jobs, the healthcare industry has been growing due to a variety of large investments from local hospitals with help from the City of Cleveland. This investment in healthcare services has brought well-paying jobs that has changed where Clevelanders want to live and how they want to live. As Cleveland continues to see growth of well-paying jobs, there will continue to be demand for high-end living.

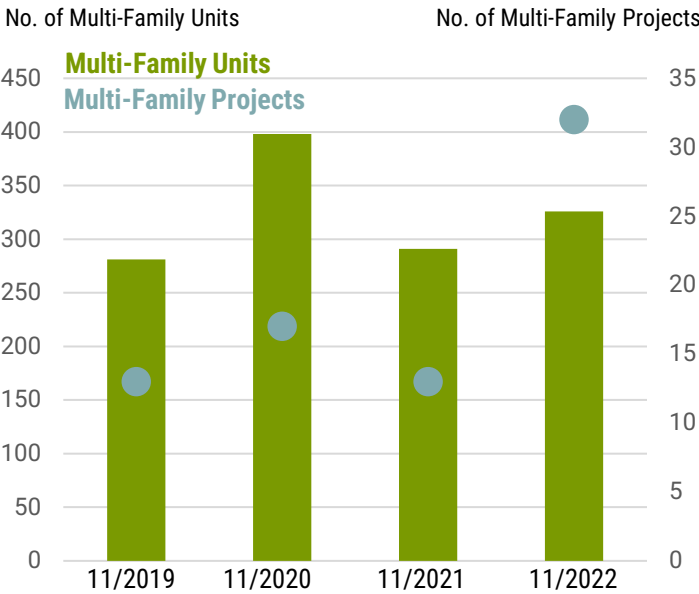
Downtown Cleveland, specifically, has the highest share of demand in the market that is responsible for ongoing revitalization and development in the area. About 1,700

units are underway in 2022 alone, representing about 13% of the existing inventory in the Downtown market.

Notably, Cleveland has done an excellent job of converting existing office space into apartments, hotels and other uses. Since 2016, at least 16 conversions have been completed with 8 more currently in development. Conversion projects account for more than 6,000,000 square feet of space, mostly in the Downtown area. Pending projects include the Rockefeller Building, Tower City, the Agora Theater and the former headquarters of the United Church of Christ. Conversion projects have become increasingly important as cities grapple with how to maintain a vibrant urban center as many employees continue to work from home.

The Cleveland area outside of Downtown has seen an interesting trend of mixed-use properties such as the Van Aken District in Shaker Heights as well as Pinecrest in Orange Village. These properties provide a mix of residential areas in the middle of restaurants, retail, co-working space and entertainment districts where residents and guests can enjoy a modern urban environment while still being in the suburbs. Multi-Use properties such as Van Aken and Pinecrest promote a vibrant lifestyle that many of the young professionals are looking for when they move to cities such as Cleveland.

Figure: Multi-Family Units and Projects by Annual Total, 2019-2022



Source: US Census Bureau, Q1 2023

Single Family Residential Market

Jack Newton

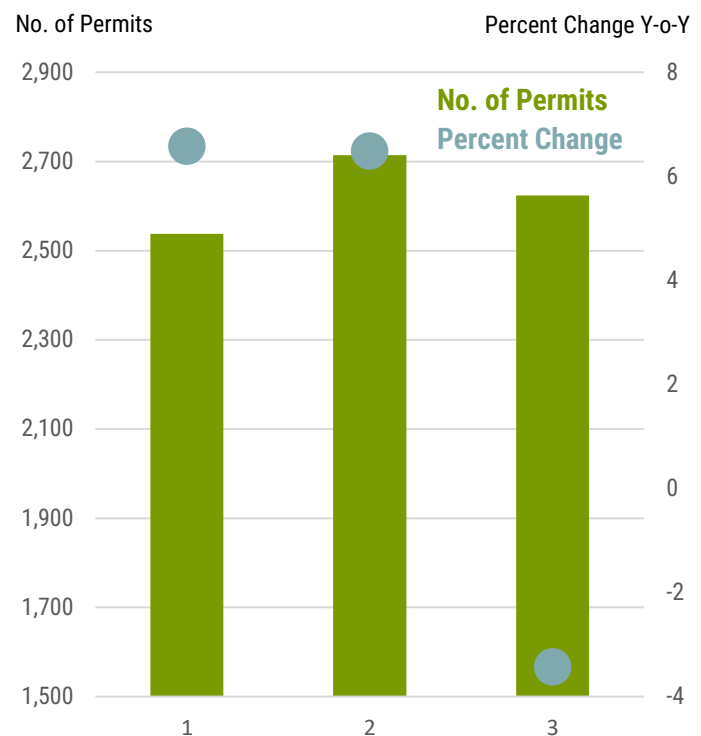
Housing affordability in Northeast Ohio—like in most markets across the country—is at the forefront of most minds. Wage gains throughout 2022 were noteworthy, especially for those in the lower quarter of the income bracket, but housing demand and prices far outstripped those gains. As of Q4 2022, home prices in Cleveland were up 10% year-over-year, averaging \$111,995 according to Zillow Research. These prices lag Cincinnati and Columbus, whose home values average \$232,884 and \$242,726, respectively.

Despite dramatic increases, Cleveland's home prices still offer a more achievable path towards homeownership for first time buyers. Zillow Research named Cleveland as one of the top-10 markets for first time homebuyers with the region coming in at no. 5. On average, a typical mortgage payment in Cleveland is 30% of a buyer's income as opposed to 31% for rent. Within the City of Cleveland, Ohio City (\$246,377) and Tremont (\$262,416) boast the highest average home value. Both neighborhoods saw roughly 7% increases in home values between Q4 2021 and Q4 2022.

According to Redfin, a national residential real estate brokerage firm that estimates in migration and outmigration patterns of major markets, most people interested in moving to Cleveland during Q4 2022 were from Detroit, Los Angeles, and San Francisco. The top

three outmigration destinations were Cape Coral (FL), Sarasota (FL), and Columbia (SC). See chart on next page for a visual. Outmigration to Sunbelt states is a trend seen in most Midwestern and Northeastern markets and should come as no surprise if you've spent a winter in Northeast Ohio. Of all Clevelanders who searched for homes using Redfin, 79% were looking within the Cleveland metropolitan area.

Figure: No. of Single-Family Permits & Percent Change, '19-'22



Source: MLS Now, Q1 2023

Inbound Migration

- Detroit, MI
- Los Angeles, CA
- San Francisco, CA
- Washington, DC
- New York, NY

Outbound Migration

- Cape Coral, FL
- Sarasota, FL
- Myrtle Beach, SC
- Knoxville, TN
- Tampa, FL





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