COMMERCIAL PROPERTY EXECUTIVE™

MHN
MULTI-HOUSING NEWS

MID-YEAR 2016

The Innovation Issue

New Horizons

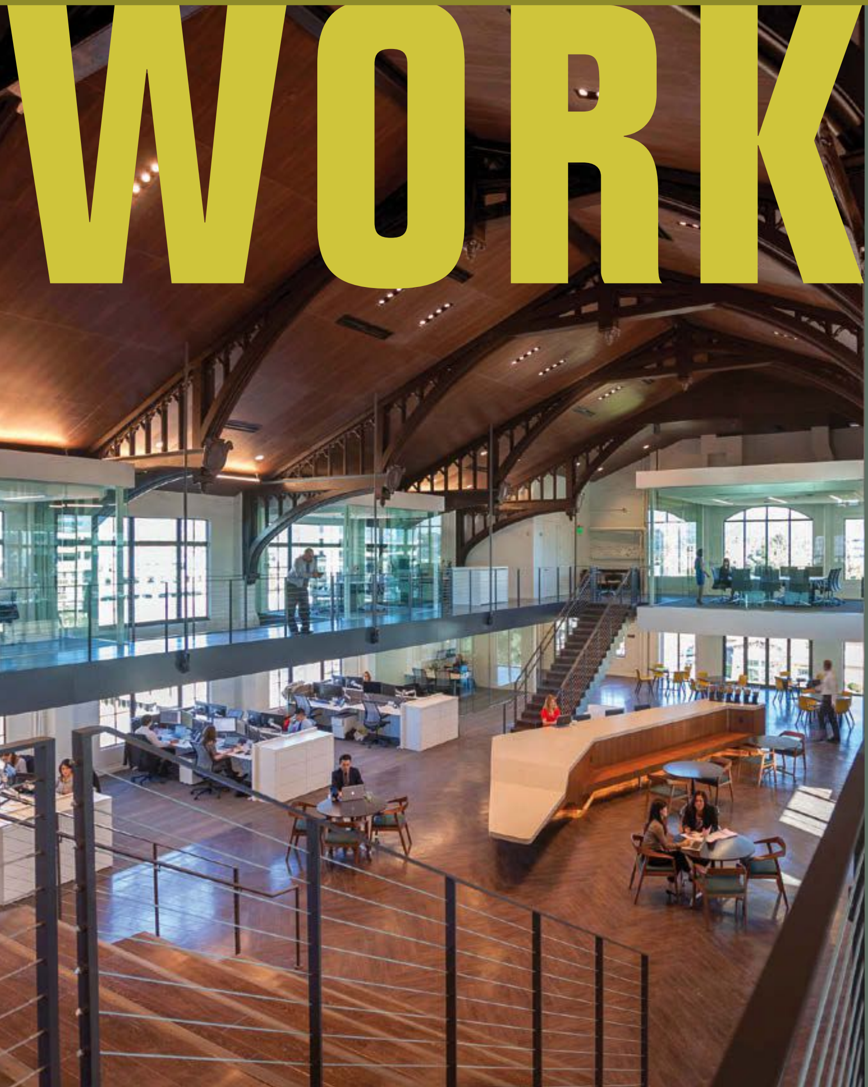
Futurists Roundtable: What's Next for Real Estate

Cutting-Edge Projects From Around the U.S.

Get Ready for Gen Z

LIVE

WORK



PLAY

The Next Big Challenge

The newest demographic groups may have very particular preferences, but technology, building materials and design innovations offer plenty of alternatives to stay on pace. A look at upcoming trends in how people live, work and play will help you determine how best to improve your properties.

LIVE

Americans are increasingly trading homeownership for rental units. While for many it's a lifestyle decision, that doesn't necessarily limit it to high-end renters. "The multifamily market today, and for the next 10 years, will continue to be strong, as we have become a 'GenerationALL' renting society. Homeownership rates are the lowest they have been in recorded history, and renting is up across all age groups as more people seek the convenience and flexibility of apartment living," explained Ella Shaw Neyland, president of Steadfast Apartment REIT.

But for those on the more moderate portion of the rental spectrum, finding a rental alternative is not so easy. That's because many developers continue to focus on building high-end properties. Roughly 82 percent of all new construction in the last year has been luxury product, and rents are higher in most markets than they were in the previous peak, before the last recession, according to Greg Campbell, senior managing director of acquisitions & dispositions at TruAmerica. The trend is expected to manifest itself through 2016, as well. In fact, more than 300,000 units are expected to be delivered this year, with deliveries still slanted toward the high-end segment, according to the July Yardi Matrix Monthly Rent Survey.

"People's incomes in the low and middle (sectors) have not really gone up that much, so their ability to afford an increasingly higher rent burden has become more difficult," noted Charles Werhane, president & CEO of Enterprise Community Partners. Yet in the 12 months ending in June, rents for lower-priced Renter-by-Necessity properties rose 70 basis points more than those for higher-priced Lifestyle properties, Yardi Matrix reported, and the difference was even more pronounced in Denver, San Francisco, San Diego, Orange County and Houston. In Denver, growth in Renter-by-Necessity rents was double that of Lifestyle rents.

According to Werhane, there are about 31 affordable apartments for every 800 people seeking

(Continued on page 10)

From home to work to retail centers, properties are increasingly emphasizing technology, flexibility and interaction. Situated in the Allston Green District of Boston, ECO (*top left)* caters to young urban professionals. CBRE's Glendale, Calif., office *(far left)* features an open floor plan. Yoga is just one non-store offering at Liberty Center *(left),* which will ultimately include 50 percent non-retail uses.

Images of ECO by Warren Jagger; CBRE Glendale by RMA Photography Inc.; Liberty Center by Todd Joyce

LIVE

housing, and the gap widens every year. "Even with an uptick in completions, we are still years away from overcoming the 650,000-unit deficit created from seven years of lackluster completions attributable to the Great Recession," said Neyland.

Expect more pressure as more Millennials seek to rent their own apartments. "Roughly one-third of the 75 million Millennials are still living at home," Neyland pointed out, noting that that could translate to a demand of more than one million new renter households annually over the next decade.

Chasing product

Developers' abililty to relieve the moderate-income imbalance is curtailed by low increases in wages, which are limiting profitability. Financing is also an issue, since banks have significantly cut back their lending levels for construction, with debt available for new developments disappearing in many markets. There are also fewer and fewer equity sources for new projects.

Meanwhile, prices for existing Class A product continue to soar. In most markets across the U.S., listing prices are past the previous peak of 2006-2008, before the housing crisis hit, Campbell said. In Boston, for example, the median home price increased by roughly 27 percent from 2009 to 2015, when it surpassed $412,000, according to Yardi Matrix. With average income in the mid-$70,000 range, mortgages have become so tough to afford that Boston Mayor Marty Walsh implemented "Boston 2030" to incentivize developers to build middle-income housing, while Gov. Charlie Baker announced a statewide allocation of $1.1 billion to affordable and workforce housing.

More investors are now focusing on Class B properties with value-add potential. "Steadfast was an early adopter of the 'middle-income, Middle America' investment strategy, but after six years near the top of the investment prospect list, competition for deals has increased significantly," Neyland said. Foreign investors are joining the new competition, as many shift from commercial properties to multifamily in search of better yield and refocus on lower-priced Class B product rather than Class A properties. Multifamily communities that can be renovated, repositioned and marketed as more affordable for renters are now more appealing.

Commonly, these assets are not located in downtown areas. "We like those areas, too, because we don't see large development pipelines where we're buying. We're buying … a little more suburban—maybe not way out in the suburbs, but something between downtown and the suburbs. We're seeing high occupancies, high demand. We're typically looking for properties, on average, from the 1980s and newer, through 2005," observed Campbell.

Prellwitz Chilinski Associates designed The Mount Vernon Co.'s ECO apartment building to address Boston's need for mid-market housing and the Allston Green District's focus on sustainability.

All in all, it seems that the imbalance between supply and demand is here to stay. "I think it will slow down for 2017, 2018, maybe 2019, and then it will ramp back up again because the current new products being delivered in the next two or three years will be completely absorbed, and then suddenly there will be demand for more, and then they'll probably overbuild for two or three years again," Campbell said. With economic factors likely to continue putting pressure on rents, in turn making it hard for developers to add affordable product to the rental supply, he predicted development won't catch up with demand before 2030.

—Alexandra Pacurar

WORK

More offices across the United States are getting makeovers today as landlords seek to entice or retain tenants. Office space is shrinking, but employees may not notice it because they have flexible work areas and lots of amped-up amenities to keep them happy and productive.

"People don't want to sit at their desk all day," said Brian Harnetiaux, senior vice president of asset management at McCarthy Cook & Co., which co-owns a three-building, 800,000-square-foot office campus in Costa Mesa, Calif., with PGIM Real Estate. The owners are planning a multi-million-dollar renovation of the 1980s complex, to be rebranded MET at Costa Mesa.

Vacancy rates across the U.S. continued to decline to an average of 12.6 percent in the first quarter, according to Colliers International; absorption remained positive, and Class A asking rents were up in both the CBDs and suburban markets. But development remains constrained, and many property owners and managers, like McCarthy Cook and PGIM, are renovating and repositioning existing space.

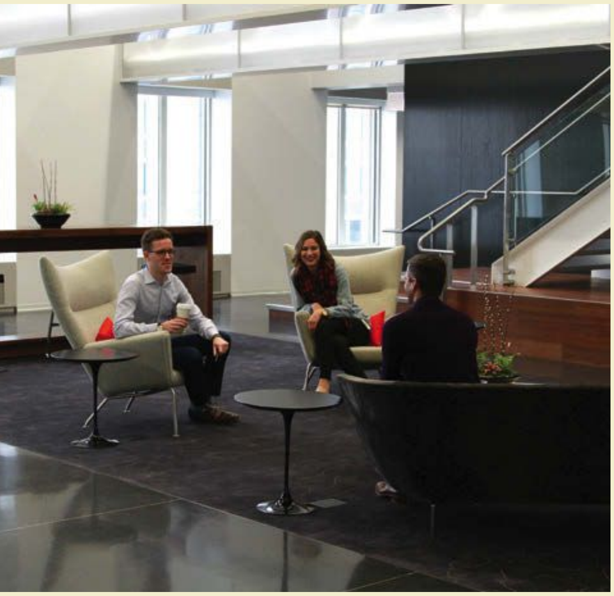
Both CBRE and JLL were early to revise their offices to provide openness and flexibility. CBRE's Glendale, Calif., office *(above)* illustrates its Workplace 360 initiative, which allows employees to work seamlessly throughout the space. JLL is currently renovating its headquarters in Chicago's Aon Center *(below)* to feature a two-story reception space, a café area with semi-private booths and other elements that make it easy to transition between team and individual work.

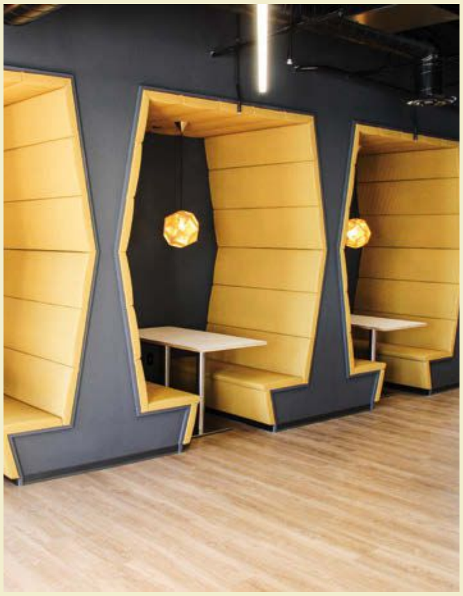
One of the biggest trends is bringing the outdoors inside. Many buildings have floor-to-ceiling glass windows and glass block walls inside the office for more natural light. Harnetiaux said that in the Costa Mesa property they replaced the ground-floor windows with sliding doors. Outside, they created a gaming area and a one-mile fitness loop, plus water and electric hook-ups for food trucks. Inside, a café draws from a community garden.

"It creates a different environment. Millennials, especially, like that work-life balance," said Harnetiaux, who is on top of national trends as chair elect of BOMA International.

Tiffany English, a principal at global architecture and design firm Ware Malcomb, noted that alternative work spaces are more popular now. Social spaces—lounges, coffee bars and cafes—are often up front. Work spaces range from communal areas to small conference or "huddle" rooms and spots for "focused, heads-down" work. Office furniture is more flexible, including sit-stand desks and monitor arms that make it easier to show the screen to a colleague.

CBRE was one of the first big U.S. companies to try "the untethered office." It now has about 30 Workplace 360-designed offices, 17 in the U.S., noted Emily Neff, an associate with the *(Continued on page 14)*





WORK

Global Workplace Strategy Practice. Employees can seamlessly work throughout the space using cloud-based software, laptops, wireless headsets and a building-wide, ID-based printing system.

JLL has also been redesigning its offices, including its Chicago headquarters, through its Office Renew program. Many employees still have assigned seating, but may have sit-stand adjustable desks and adjustable panels to provide privacy, said Sabrina Lutz, a senior project manager on JLL's Project and Development Services team who oversaw the Sacramento, Calif., project. There can be bench-style seating for those who want an open atmosphere. To encourage flexibility and reshape spaces easily, furniture is often on casters.

JLL also uses the latest technology, including calls ringing through to both the desk and mobile phone and smart whiteboards and monitors for video-conferencing. Writeable walls, covered in either writeable paint or glass, encourage creativity.

What's next? More "smart" offices with personalized LED lighting and temperature controls, electric car charging stations and eventually driverless cars that drop off workers, then park in a structure removed from the building. And since Millennials and Centennials will own fewer cars, landlords will make Uber credit deals with tenants.

The more pragmatic Centennials will prefer branding to amenities, English predicted. "They want to walk into a space and feel connected immediately with where they are working. (The company) needs to be able to tell their story through their space."

—Gail Kalinoski

Steiner + Associates' 1.7 million-square-foot, mixed-use Easton Town Center in Columbus, Ohio, is an early example of open-air, pedestrian-friendly retail.

PLAY

Retail-sector executives have their hands full today, as they navigate trends and incorporate the latest industry innovations into their portfolios and plans, faced with challenges ranging from changing consumer preferences to constantly evolving technology advances to outdated spaces and underperforming stores.

"It's still a very cautious marketplace," said Garrick Brown, vice president of retail research, Americas, for Cushman & Wakefield. "I don't know of a single development that is going forward without an anchor, even in a neighborhood shopping center."

And the first-quarter earnings probably didn't help. Major retailers like Macy's, Kohl's and JC Penney had lower sales. Bankruptcies and store closings made headlines. "Everybody has been down, regardless of what sector you're in," noted Greg Maloney, president & CEO, Americas, for JLL Retail.

But if you take a closer look, the picture has many bright spots. First-quarter vacancy at U.S. shopping centers was 7.9 percent, marking the 16th consecutive quarter in which overall vacancy was steady or declined, according to Cushman & Wakefield's MarketBeat U.S. Shopping Center Snapshot. New development was just over 4.2 million square feet, and another 21.5 million square feet is expected through 2017. C&W noted that most demand is for new Class A space, and tenants are willing to pay for it.

JLL Retail reported that rent was up 1.5 percent in the first quarter. Supply-constrained markets have seen significant rent increases since 2007, up 23.8 percent in San Francisco and 6.9 percent in Hawaii since the recession.

Development activity is still "modest," with 70.2 million square feet delivering in the first quarter, according to JLL.

Much of the development that is occurring is mixed-use. Yaromir Steiner, founder & CEO of Steiner + Associates in Columbus, Ohio, recently opened Liberty Center near Cincinnati. The 1.3 million-square-foot first phase includes office, hotel and housing space, along with dining, cinemas and other entertainment options. Steiner said 25 percent of phase one is non-retail, and that number will rise to 50-50 when Liberty Center is built out in the next eight years. The emphasis is on *(Continued on page 16)*

PLAY

gathering spaces because younger generations—Millennials and Centennials—don't consume as the older generations have, instead preferring to have shared experiences in social settings.

Cutting back, changing use

America is still over-retailed, though, and Steiner expects "a drastic reduction in the amount of total retail space, lots of demolitions" over the next 10 to 15 years.

At Steiner + Associates' Liberty Center, a new mixed-use property northeast of Cincinnati, 25 percent of the 1.3 million-square-foot first phase is non-retail, including office, housing and a hotel.

That's where mixed-use projects will fill in.

"Our malls are too big. However, the malls are typically on great pieces of real estate," said Jeff Green, retail industry consultant and principal of Jeff Green Partners.

He said owners are "finally waking up" to non-retail and mixed uses and beginning to redevelop their properties to include multifamily and/or hotels. "There's a lot planned, and it's all going to come at once. By late 2017, we will see this as quite a trend."

Multifamily residents and hotel visitors will help feed the growth of dining options in America's retail centers. Brown's C&W team, which released its first "Retail & Restaurant Expansion Guide for North America" in May, found that roughly half of the planned unit growth this year is in restaurants. That follows five years of restaurant growth, driven by franchises, fast-casual chains and the hot new trend: food halls.

"Thirty major developments came online in the U.S. this year or will be delivered in the first half of next year that are just food halls," Brown noted.

Jim Lynch, director of retail management at RiverRock Real Estate Group, a property management firm serving the Western U.S., said food-oriented tenants are also growing in neighborhood shopping centers. So are wellness options like Orange Theory and Planet Fitness, gym chains that offer smaller "studios" to attract those interested in personal training, yoga, Pilates and massage, according to Lynch and Steve Core, RiverRock's president. And big-box chains are opening smaller concepts like ALDI, Target Express and Whole Foods 365.

Back at the mall, department stores are introducing a "store within a store" concept, said Green, citing Macy's adding Blue Mercury into some stores, while JC Penney leases space to Sephora.

Haendel St. Juste, managing director with Mizuho Securities USA Inc.'s Americas research team, said mall owners like General Growth Properties are experiencing strong demand from fashion retailers including L Brands, which owns Victoria's Secret and Henri Bendel stores, and top fast-fashion retailer Zara.

And more online-only retailers are opening brick-and-mortar locations, since buying online does not replace the social and tactical experience of shopping, observed Vicki Cantrell, senior vice president of communities & executive director of Shop.org at the National Retail Federation. The store may just work as a "showroom" where shoppers can try things on, then place an order for delivery.

The use of smartphones for shopping has also skyrocketed, Cantrell noted, emphasizing that retailers and landlords need to be "thinking small screen first" because 44 percent of all retail traffic and 31 percent of sales transactions online come from mobile devices. Retailers are also giving employees tablets so they can better aid shoppers.

Mall operators are beginning to catch up with retailers' technological advancement, installing beacons, or indoor location positioning systems, to help shoppers locate stores, restaurants, restrooms and their cars. They also send texts with promotional offers and provide data analytics. CPE MHN

—*Gail Kalinoski*