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RealEstateMatters

In This Issue

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C&I Council:
2022 Real Estate Outlook

Following are selected highlights of remarks by Mark Fitzgerald and the High Real Estate Group leadership team to the Lancaster Commercial & Industrial Real Estate Council webinar in February 2022. Download the slide presentation: https://bit.ly/3s01rTc.

Economic Recovery Accelerates –

2021 GDP grew at 5.7%, significantly outpacing the Federal Open Market Committee (FOMC) December 2020 forecast of 4.2%. For 2022, FOMC projects GDP to grow by 4%; again, exceeding previous projections.

Congress primed the pump by instituting tremendously accommodative policies, including six different COVID relief programs totaling $5.6 trillion. Additionally, the infrastructure bill added another $1.2 trillion, bringing the total government support to $6.8 trillion.

Further, the Fed cut the federal fund rate to near zero, where it remains today. They also grew their balance sheet by purchasing an additional $5 trillion of bonds.

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A Place to Heal and Grow
An Interview with Susan Blue, CEO, Community Services Group

REM: What is Community Services Group (CSG)

Susan: Community Services Group provides community-based services in Pennsylvania to individuals with mental health or intellectual and developmental disability needs. Our mission is to promote growth and enhancement of human potential through an effective, efficient, and innovative system of care.

We are celebrating our 50th year of operation. We achieved "B" corporation certification three years ago.

REM: How did CSG get its start?

Susan: CSG was formed in 1972 following the passage of federal and then state legislation to develop a community-based care system for those with mental health and intellectual disabilities. Our first contracts were with Lancaster County for residential services for those with intellectual disabilities followed by a day treatment program for individuals with mental illness. We have expanded and now provide services in over 19 counties in Pennsylvania, largely in the central and northeastern part of the state.

REM: Tell us about the work you do and the programs you offer.

Susan: We provide outpatient treatment

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President's Message

The Lancaster Commercial and Industrial Real Estate (C&I) Council has been bringing industry professionals together for 36 years. We are honored to have begun this tradition of sharing our expertise, and to have continued it this year with our second annual livestream market forecast. Thanks to everyone who joined, and for those who would like to dive deeper than the summary on these pages, please visit **https://bit.ly/3sTzdJf** to download the slides.

Though we couldn't meet in person, I am encouraged by the overall decline in COVID cases and the widespread acceptance of vaccines. As a society, we're making hard-won progress that has brought better performance to key sectors. We continue to feel the effects of pandemic-related supply chain issues, particularly in construction, however real estate markets generally are well-positioned for growth.

As your full-service real estate resource, we're proud to bring you the insights of the entire High organization. In addition to the C&I report, this issue of Real Estate Matters includes thoughts from John Vozzella in the High companies' Treasury Department. Few real estate companies can muster the resources of an organization like ours, and we are happy to make them available to you whatever your needs may be.

Finally, I would like to extend my special thanks to Susan Blue, CEO of Community Services Group, who kindly shared her vision and experiences on the cover of this issue. Our business relationship extends back more than two decades and is emblematic of the value we seek to provide to our customers. I hope that we will soon have the opportunity to serve you, too.

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A Place to Heal and Grow continued from page 1

including psychiatry, psychiatric day treatment, residential services that include group homes and supported living, case management, including homeless outreach, clubhouse, vocational and psychiatric rehabilitation as well as children's services. The children's services we provide include, outpatient treatment, school-based services, psychiatric partial hospital treatment, family-based service, after school programs, services to juvenile firesetters, and case management. We also provide training for businesses, schools, and community organizations.

We provide residential services to individuals with intellectual and developmental disabilities including group homes and Life Sharing. We also provide day programs and community-based services to individuals in their homes.

REM: How has your organization grown and changed over time?

Susan: I joined the organization in 1976 with a background in mental health. I led the psychiatric day treatment program, then oversaw mental health services. Later in the 80s I acquired the organization. Since then, we have grown and expanded substantially and now serve more than 15,000 people annually.

Community Service Group's headquarters opened in Greenfield in 2020.

REM: What are the issues challenging service providers such as CSG?

Susan: The biggest challenges CSG has are similar to organizations around the world at this point in time. Workforce is the challenge. We currently employ just under 1,500 people. Two years ago, that number was just under 1,700. The pandemic and the "Great Resignation" wave have impacted us tremendously. As I indicated, we provide residential care for individuals who are dependent on that care and staffing those services has become extremely difficult. Also, for some of the professions such as psychiatry, nursing, social work, and psychology, we are finding fewer people entering those

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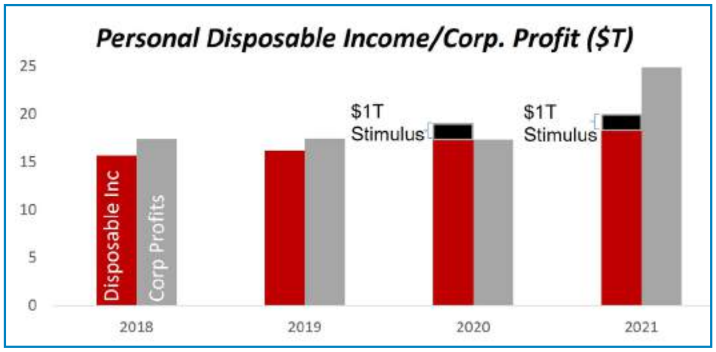
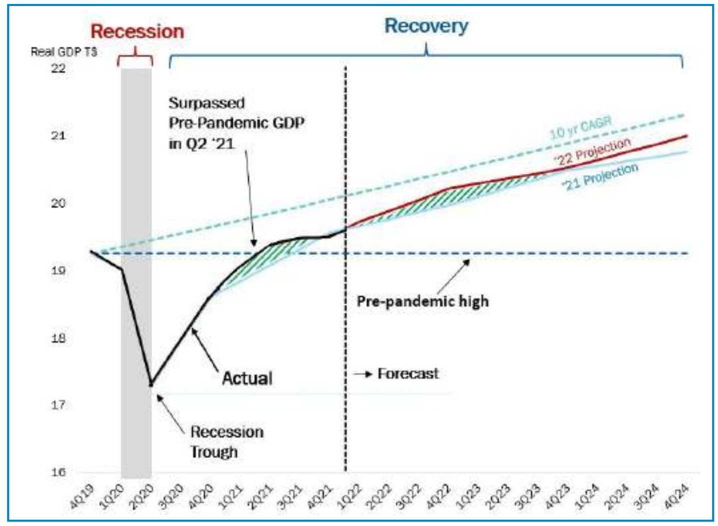
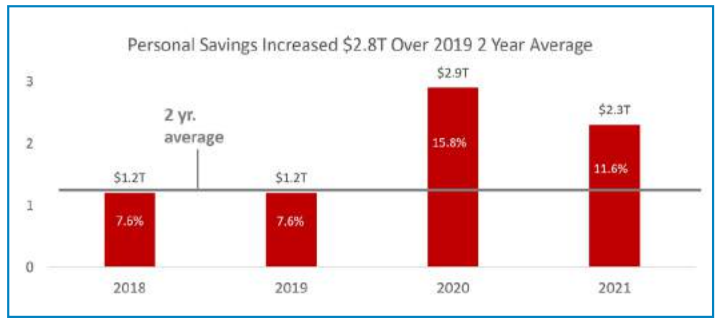
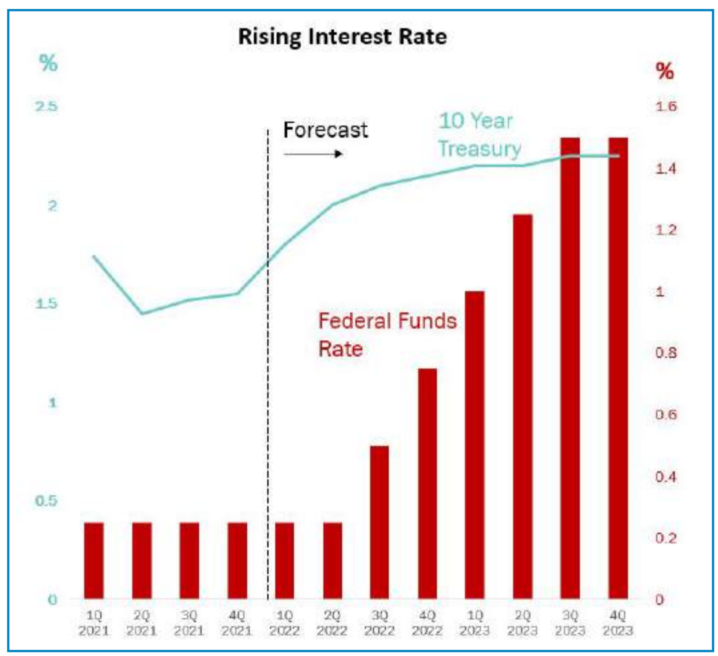
Personal Disposable Income and Savings – Disposable personal income — income that people earn less their income taxes — increased during the pandemic. Additionally, of the $5.6 trillion COVID relief passed by Congress, consumers received $2 trillion over a two-year period. In 2020, consumers saved $2.9 trillion versus an average $1.2 trillion in 2018 and 2019. The increased savings trend continued in 2021 with $2.3 trillion saved. Consumers continue to have a tremendous amount of dry powder to fuel economic growth going forward.









Employment Recovery – At the end of 2019, 156.6 million people were employed. During the pandemic, employment dropped to 133 million and has steadily grown back, ending 2021 with 157.1 employment. While total non-farm employment exceeded 2019 levels, the labor participation rate ended 2021 at 61.4 percent, a 40-year low. Approximately 4 million left the workforce because of the pandemic. This is having a major impact for employers and will be a drag on the economy going forward.

Inflation – We ended 2021 with an inflation rate of 7.5%, higher than previously projected. Notwithstanding an average salary increase for all private workers of 5.9%, many workers saw a decrease in their purchasing power in 2021 due to the impact of inflation. In an effort to slow the pace of growth, the Fed is anticipated to increase the funds rate throughout 2022, substantially increasing short-term borrowing rates.

Ten-year Treasuries have increased by about 50bps since January indicating a possible increase in cap rates. Given the wider than historical spread between 10-year Treasuries and Multifamily/Industrial cap rates, there's still room for 10-year Treasuries to increase without seeing an immediate impact on cap rates.

Real Estate Investment Sentiment is Up – Nationally, real estate investors are optimistic about the prospects for acquisitions and development for nearly every asset class. Industrial and multifamily continue to lead in investor demand for acquisitions. Development prospects are very good in the industrial and multi-family space. There's a tremendous amount of capital interested in warehouse and multi-family. Surprisingly, we saw increased interest in neighborhood retail and limited-service hotels, being partially driven by investors' pursuit of yield.

Underwriting Criteria are Improving – From an underwriting perspective, maximum loan-to-values are increasing, except for suburban office and retail, cap rates are decreasing, values are higher, and spreads are decreasing as we see 10-year Treasuries rise. Despite improving underwriting criteria, the all-in interest rate is projected to increase because of the increase in 10-year Treasury.

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Lancaster Market – *Key Observations by Asset Class*

Office and Industrial

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Office – In Lancaster, a 74,000-square-foot project was added for Armstrong Flooring's headquarters in Greenfield. Three buildings totaling 146,000 square feet are either under construction or proposed. Class A is 93 percent occupied with existing space renting at $23 to $26 per square foot gross and new space at $32 to $35. Net absorption for Class A space was 4,200 square feet, and vacancy rates dropped from 7.6 to 7.1%. Class B&C Office had negative absorption of 36,000 square feet due to the migration to Class A, but still ended the year at a low 4.7% vacancy rate. Business centers had positive absorption of 11,000 square feet, but still ended the year with a vacancy rate of 14.4%.

Industrial – Lancaster had its second-best highest absorption in over 35 years, with 1.3 million square feet absorbed. Vacancy decreased from 6.5 to 2.5% and rents saw a 9.2% increase. Two new buildings added 125,000 square feet to the market, bringing current available space to 412,000 square feet. Six projects are under construction or proposed. However, supply chain issues are delaying delivery and making existing assets even more attractive. New product is being marketed from $6.75 to $7.50 a square foot. Flex space is leasing at $9.95 a square foot, a 3% increase. Flex absorption was negative 186,000 square feet as a single-tenant owner-occupied building came back on the market. Traditional flex space is still virtually non-existent.

Multi-Family

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The strong economy and tight labor market drove an 11% average increase in asking rental rates in 2021 nationally, slightly less in the Northeast, and an astounding 20 to 25% in some Southeast markets. With median home prices increasing even more than rental rates, we're seeing challenges with housing affordability. Occupancy rates hit 96% in most markets, with unit turnover dropping from 42 to 45% to just 30%. Supply is challenged by availability of zoned land and increased construction costs due to supply chain issues and labor availability.

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Hospitality

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The recovery is underway. Hotels that are in drivable markets, with ample leisure opportunities, or near water are by and large back to 2019 RevPAR levels. Economy and extended-stay properties fared better than urban core hotels. Recruiting and retaining talent is the top industry challenge. COVID variants delayed the return of corporate travel, but also stemmed new supply. Strong ADR and demand growth have Lancaster and York on track for 2019 RevPAR by the end of 2022, while government-dependent Harrisburg hotels recover more slowly. Investors are seeking yield, particularly in select-service hotels in attractive markets. Capital markets and loan-to-value have improved, and we have seen favorable term sheets for assets we have out in the market.

Retail

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Suburban retail returned to pre-pandemic foot traffic and sales levels early in late 2021, due in part to consumers being flush with stimulus dollars and increased savings. The trend led to positive retail absorption of almost 25 million square feet in the second half of 2021. Moreover, more retail locations opened in 2021 than closed. Decreasing vacancies led to a predicted total return on retail investment comparable to 2016 and 2017. "B" and "C" malls continue to be razed or repurposed as mixed-use facilities, higher quality open air facilities, or grocery-anchored shopping centers. Owners are re-tenanting and reimagining their properties for the ways people shop now, and are rewarded with capital appreciation, cap rate reductions, and sustainable assets.

Understand Flood Risk for Your Commercial Real Estate

By John Vozzella, CMA, CPA, Assistant Treasurer, the High companies

Most real estate locations are subject to a flood risk exposure. The exposure and awareness have increased with climate change. If your property is mortgaged with a lender, it is likely that you must maintain flood insurance while you finance your property.

Typically, you can obtain flood insurance through commercial property insurance policies if the property is NOT located in a Special Flood Hazard or Coastal High Hazard area as designated in the flood zone maps developed by the Federal Emergency Management Agency (FEMA). If your property is in a flood zone, you can apply to the **National Flood Insurance Program** (NFIP), which is overseen by FEMA, to cover low-to-moderate risk property, high-risk flood area property, and/or when coverage is not provided in your commercial property policy. Your insurance agent or broker will assist you in the NFIP application process.

NFIP offers commercial real estate coverage for the building and/or the contents up to a maximum limit of $500,000 each. Deductibles are available at various levels up to $50,000 per occurrence. Along with the specifics of the flood exposure, the dollar limits and deductibles you choose will help to determine your insurance premium. You will need to review your loan agreements to determine how much flood coverage your lender may require. If it's not negotiated out of the loan agreement up front, it is possible that the lender will require full replacement cost or some other limit more than the maximum NFIP limit of $500,000. In this case, you will need to work with your insurance agent to obtain Supplemental Excess Flood Insurance in addition to NFIP coverage. There is a niche market of carriers that provide this type of excess coverage.

Several **factors determine your flood risk exposure:** type and size of the building; number of floors; basement or crawlspace; elevation of lowest floor; and geographic location are just a few. This information is captured in an Elevation Certificate, a document your insurance agent will recommend for quoting a flood premium. It comes at a cost, but the Elevation Certificate

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Understand Flood Risk for Your Commercial Real Estate continued from page 6

is the best way to know the building's lowest floor elevation for comparison to the Base Flood Elevation. For flood policies in place based on an outdated or no Elevation Certificate, it may be worth the cost to update the Elevation Certificate, especially if the FEMA map has changed.

Effective October 1, 2021, FEMA updated the NFIP risk rating methodology called Risk Rating 2.0: Equity in Action (RR 2.0) with the intent to improve premium pricing by leveraging best practices and incorporating more flood risk variables. Certain information on elevation certificates is useful in identifying the flood risks but with RR 2.0, Elevation Certificates are now optional for NFIP policies. Note, however, the information provided on Elevation Certificates, when provided with the NFIP application, will be used by FEMA to determine premium discounts for the building. FEMA's RR 2.0 will utilize new rating elements like Replacement Cost Value, first floor height, number of floors, number of prior losses and construction type to name a few. Using an algorithm approach from these rating elements, the insurance rate as well as renewal rate increases and decreases will be more equitable. More information on FEMA's RR 2.0 can be found at https://www.fema.gov/flood-insurance/risk-rating.

How do I find out what my property's flood risk is?

As provided on FEMA's Map Service Center, flood zones are defined by geographic areas. FEMA develops flood zone maps and labels each location with flood zone classifications—

- Special Flood Hazard Areas – High Risk (1 percent annual flood chance event): A, AE, AH, AO, AR, A99
- Coastal High Hazard Areas – High Risk (1 percent annual flood chance event with additional hazards from storm-induced waves): V
- Moderate-to-Low Risk Areas (0.2 to 1 percent annual flood chance event where base flood depths are less than 1 foot): B, C, and X
- Undetermined Risk Areas (Unstudied areas and have no mandatory flood insurance purchase requirements): D

A FEMA flood map for the property can be obtained from the FEMA Map Service website at https://msc.fema.gov/portal/home. Simply enter your property address on this site. By FEMA standards, even if a small portion of the building is touching the high-risk flood zone, the entire building is considered a flood-exposed risk.

My property is in a high-risk flood zone, now what?

Your insurance agent or broker will be able to obtain quotes for the necessary coverage for your property. Note that NFIP premiums have set standard federally regulated rates for all carriers that service the program. Thus, it is not necessary to market NFIP coverage with different brokers/agents for competitive quotes. As noted above, with RR 2.0, the more information provided in the application process will aid in obtaining a fair and equitable quote.

You will need the following for the application process:

- NFIP flood insurance application – new questions on the application include –
  - o First floor height, # of floors, construction type (frame, masonry, etc.), square footage
- Replacement cost value (from your property policy)
- OPTIONAL - Flood Elevation Certificate from a surveyor, engineer, or architect
- Site plan with elevations, if available

Recent photos with stamped dates showing the building from all sides are required when the lowest floor elevation is two or more feet below the Base Flood Elevation.

Once you receive your quote and pay the premium, the coverage can be placed. For NFIP policies, coverage will take effect 30 days from when the premium payment is received by the insurance carrier.

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A Place to Heal and Grow continued from page 2

fields which results in fewer applicants for hire. So, the workforce is the greatest challenge we face. This is also happening at a time when the demand for services, particularly mental health, has grown exponentially.

REM How has High helped CSG?

Susan: Over 20 years ago, we had programs and services at Greenfield. We were looking to consolidate many of our individual offices that were scattered across Lancaster into one site. Unfortunately, at the time there was nothing available in Greenfield. So, High helped us locate to a large facility on the outskirts of the city.

A decade and half later, we were thrilled to have the opportunity to return to Greenfield. High built us a 32,000-square-foot building and we are tenants in two other buildings for specialized services. I feel like it is homecoming.

As a tenant of High's, I feel they understand our work and want to make sure the environment supports that work. They create an atmosphere in the park that makes people feel good about working and receiving services there. They are creating a *community* atmosphere with connections and learning opportunities and a beautiful environment to enjoy. We could not be happier to be back!

Susan Blue is the CEO, President, and owner of Community Services Group. She is a board member of the Lancaster Chamber of Commerce & Industry and the Lancaster County Coalition to End Homelessness, and is the Chair of the Rehabilitation and Community Providers Service Organization (RCPSO), a corporation exploring managed care for IDD and brain injury. She can be reached at 717.285.7121 or blues@csgonline.org.

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