

Factors Impacting Commercial Real Estate in 2022 and Forecasting Into 2023

Featured Speakers

Jim Larkin – SVP Industrial Practice Leader, Colliers International

Jenifer Kraemer – Attorney/Shareholder , von Briesen & Roper s.c.

John Buresh – SVP Commercial Real Estate, Johnson Financial Group

Justin Abbott – VP Real Estate Vertical Leader - Insurance, Johnson Financial Group



Real Estate Forecast

Jim Larkin



Colliers Wisconsin



Comprised of
+200
Professionals



Management
13.5M
Square Feet



Revenue
\$50M
(US\$)



Established in
3
Cities



Brokerage
17M
Square Feet



Maintenance
56M
Square Feet

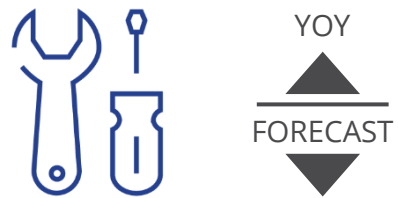
Office Market Data



Vacancy Rate
15.7%



Net Absorption
-53K_{SF}

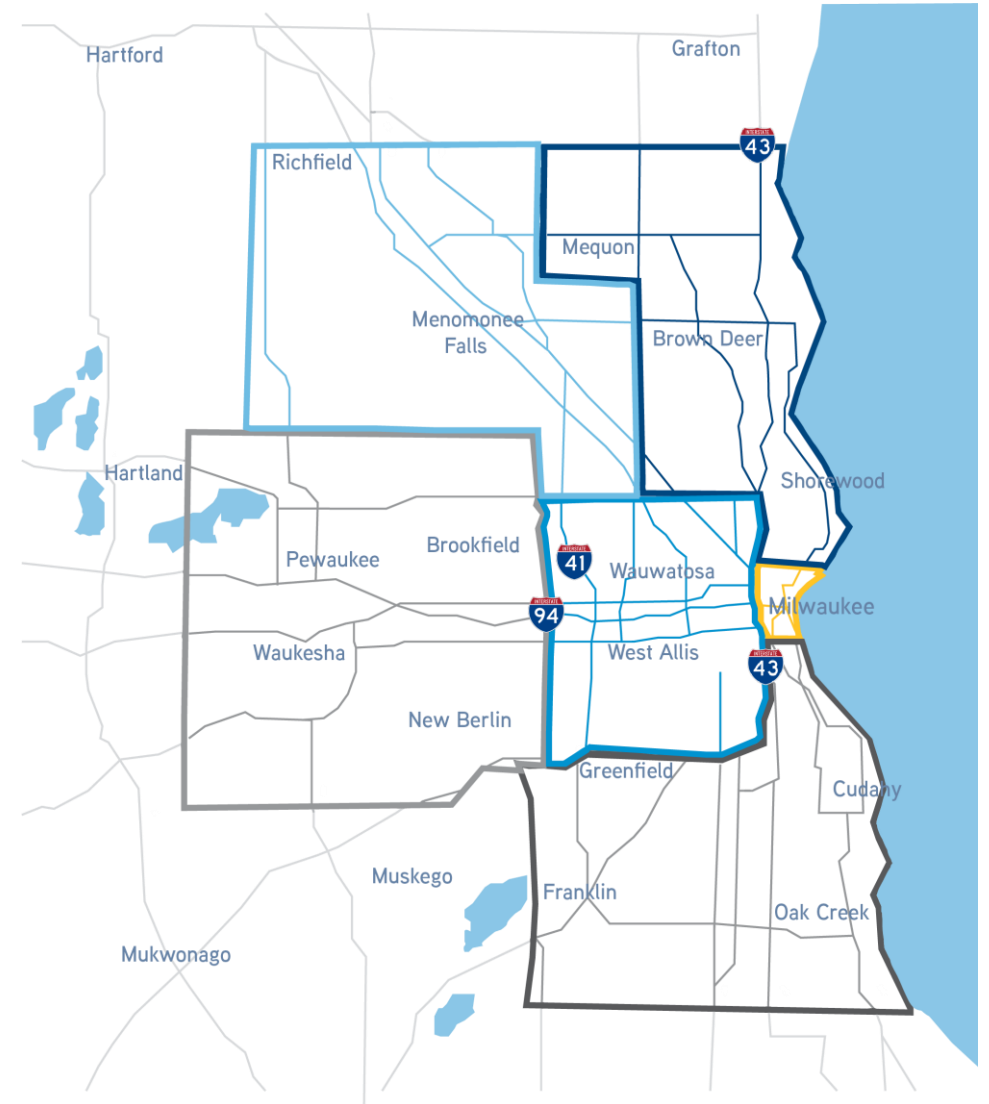


Under Construction
600k_{SF}



Overall Class A Asking
Lease Rates (FSG)
\$26.60/SF

Office Submarkets



Office Market Trends & Activity

Activity among tenants seeking office space has grown significantly throughout the market, but this activity has not yet translated to notable positive movement when it comes to absorption.

Downtown vacancy remained relatively stable in Q3.

Suburban office market experienced a more pronounced increase due to larger tenants downsizing and vacating space.



The Dohmen Company Foundation



Irgen's Golf Parkway Corporate Center



Software One



Rite-Hite

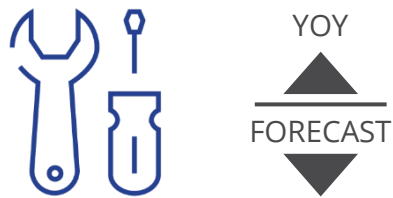
Industrial Market Data



Vacancy Rate
6.75%



Net Absorption
1.3m SF

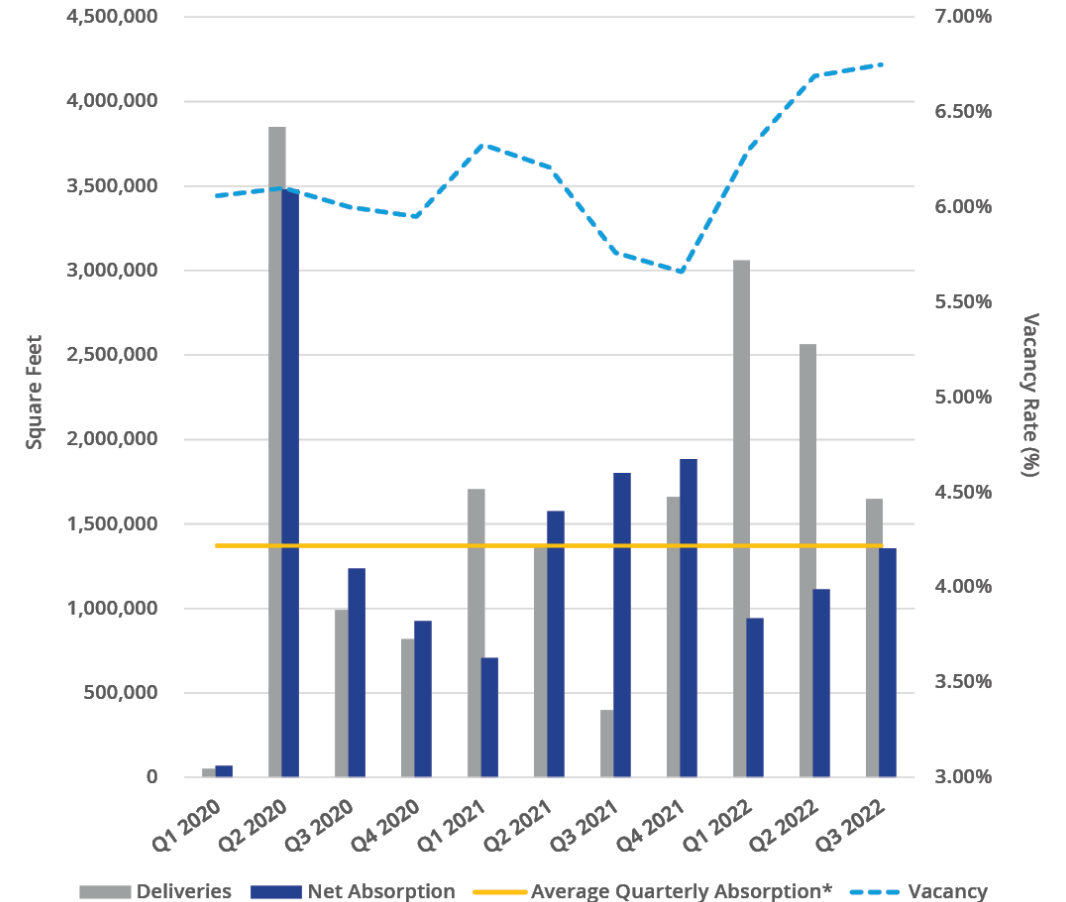


Under Construction
9.03m SF



Overall Class A Asking
Lease Rates (FSG)
\$7.98/SF

Deliveries, Absorption & Vacancy



Industrial Market Trends & Activity



With 6.8 million square feet of available speculative space on track to deliver over the next 12 months, a rise in vacancy can be expected, particularly in the South and Central submarkets.

All tracked submarkets, as well as all property types, experienced positive net absorption in Q3 2022.

Construction levels are the highest since Colliers | Wisconsin began tracking quarterly industrial data in 2013.



Great Lakes Warehousing



Asteroid Precision



Becknell Industrial

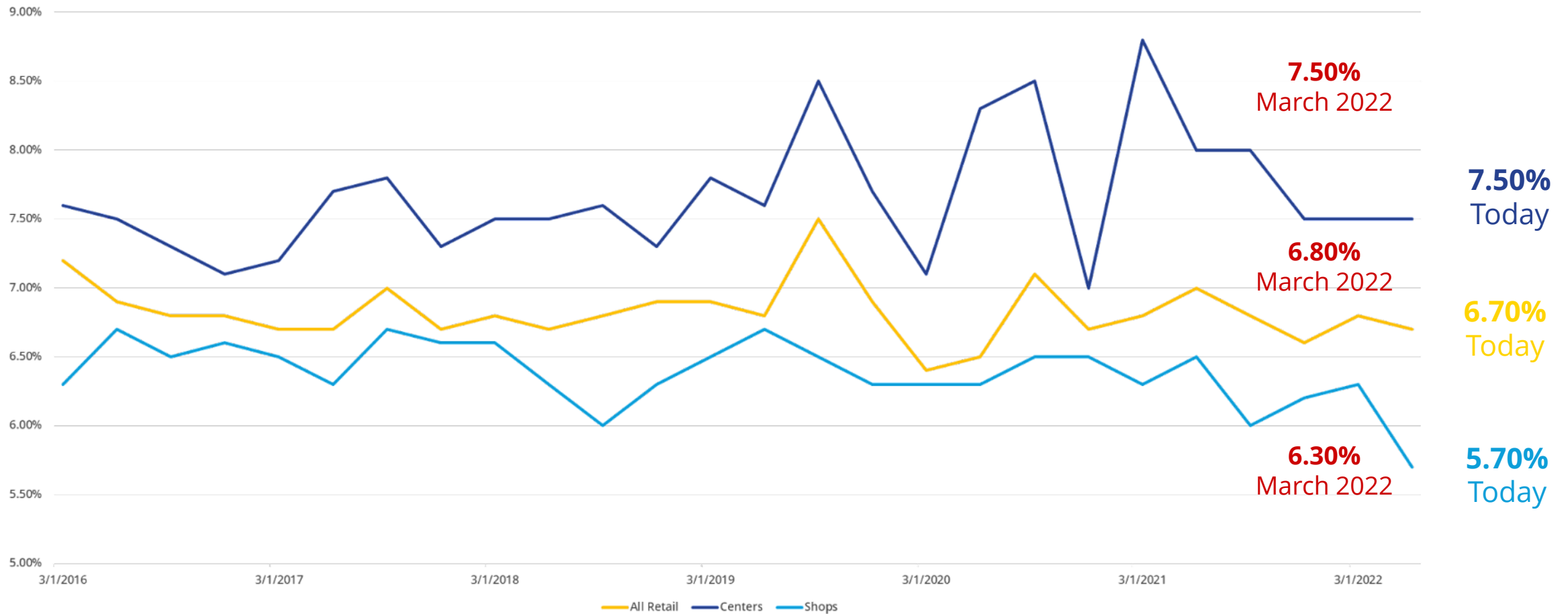


HSA Commercial Real Estate

Investment Sales Retail Market Data



Pricing Trends | Cap Rates



Investment Sales Retail Trends

Private & All-Cash Buyers Drive Grocery Center Demand



2023 Forecast



Office

Industrial

Investment Retail Sales



Real Estate Law Update

Jenifer Kraemer



Purchases

- Step One: Need a written purchase agreement.
 - Purchase Price: still seeing offers coming in over asking price
 - Fewer contingencies because of competition
 - But lots of uncertainties in the market
 - 1031 exchange?
 - Low inventory makes finding replacement properties challenging



Purchases

- Due Diligence considerations in today's market
 - Interest rates climbing
 - Try to lock rates early and get approvals quickly
 - Adds to uncertainty because already dealing with fluctuating construction/tenant improvement costs
 - Uncertainty in market makes it difficult to prepare proforma or predict how long you'll want to hold vacant land before development
 - Longer due diligence/feasibility contingencies?



Construction Costs

- Vacant land to be improved?
 - Need to deal with fluctuating costs of materials
 - Supply chain issues affecting your completion deadlines (and therefore, tenant delivery)
- Existing space
 - Improvements or repurposing call the same issues into question
 - Maintenance and repairs can be difficult to complete



Construction Costs

- Construction Contracts
 - Contractors including price escalation language
 - Contractors including right to additional time for supply chain delays
 - Need to make sure that language doesn't give contractor remedy if delay is due to their failure to order or lock in pricing in a timely manner
 - Need to build in your damages for delays caused by Contractor (including remedies you had to give to tenants)



Leases

- Current issues:
 - Delivery dates
 - Landlords are being pinched by construction delays and supply chain issues
 - Subs and suppliers commit to a schedule but then come back later because supplier/manufacturer tells them equipment won't be available (often, despite having been ordered)
 - Electrical panel issue causing 4 month delay on one project
 - Some tenants have blackout periods when they won't take the space
 - Careful about tenant remedies in the event you can't meet the delivery date – often rent abatement and/or termination



Leases

- Construction costs
 - If Turn-key, need to build in some limits or a reconciliation process for tenant to contribute over \$x
 - Often don't know what you're building at the time lease is signed, so can't have accurate pricing until later, but cost escalation is adding to landlord risk
 - Landlord or Tenant buildout
 - Contingency or cost-sharing mechanism if buildout costs exceed budgeted amount



Leases

- Termination rights?
 - Landlord contingency if costs are too high to move forward with project
 - Often if Landlord has a termination right, Tenant may want to be reimbursed for costs incurred in moving forward to plan for space, like design fees, etc.
 - Consider putting cap on potential exposure
 - Landlord contingency for lease up/financing requirements
 - Still seeing retail tenants taking new space, but office and other areas are less certain



Leases

- Existing tenants wanting to return space
 - Office space from employers whose workforce has shifted or is slow to return to the office
 - Requires Landlords to demise space, incur tenant improvement costs sooner than expected, repurpose existing space
 - Consider termination fees to cover gap in obtaining new tenant, unamortized broker fees, and portion of buildout or renovation costs.



Leases

- COVID relief
 - Still seeing tenants proposing rent abatement language for COVID or other pandemic.
 - Generally taking the approach that it has to shut them down to have rent abated in full, or
 - Have proportional abatement based on percentage of business impacted (i.e., limits on number of customers, affect on business revenue because can only use drive-thru, etc.)





**Commercial Real Estate
Lending Update**

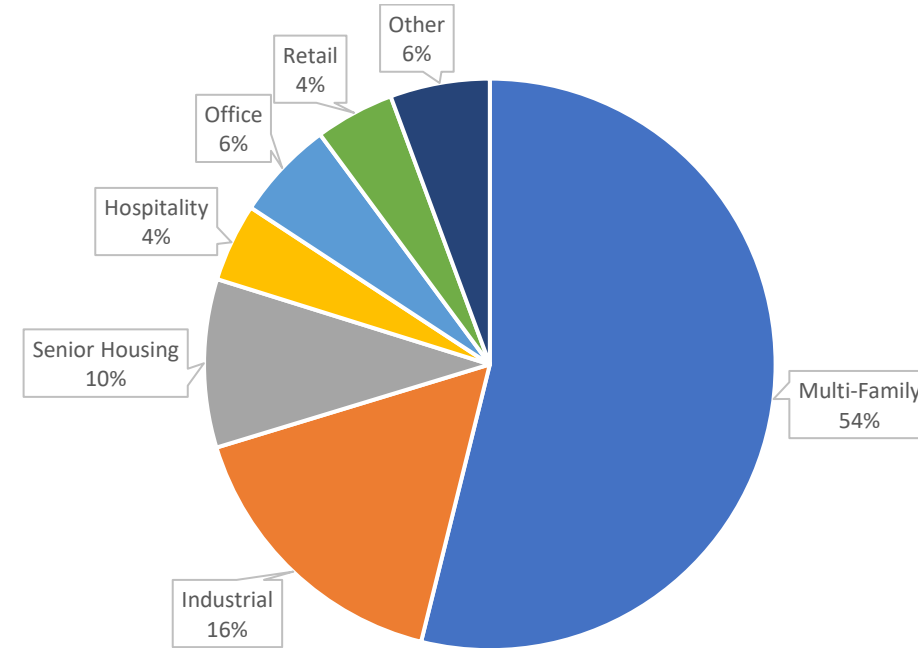
John Buresh



Johnson Financial CRE Summary

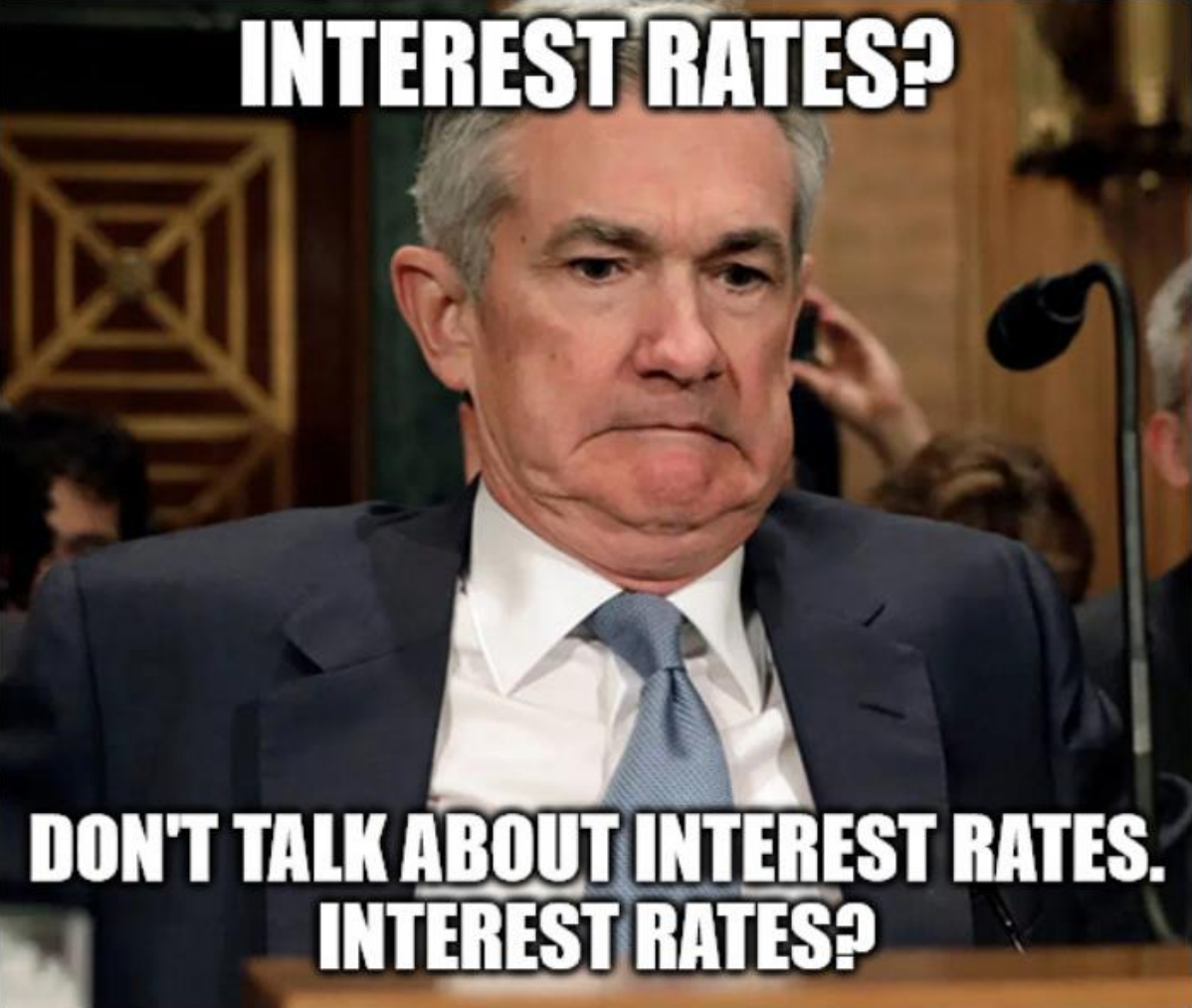
- 3 Offices
 - *Milwaukee*
 - *Madison*
 - *Minneapolis*
- 17 Associates
- Dedicated to CRE Lending

- \$1.3B in Commitments / \$1.0B Outstanding



- 35% Construction Loans
- Loan Sizes from \$5M - \$25M
- Relationships up to \$75M

It's All About The Rates!



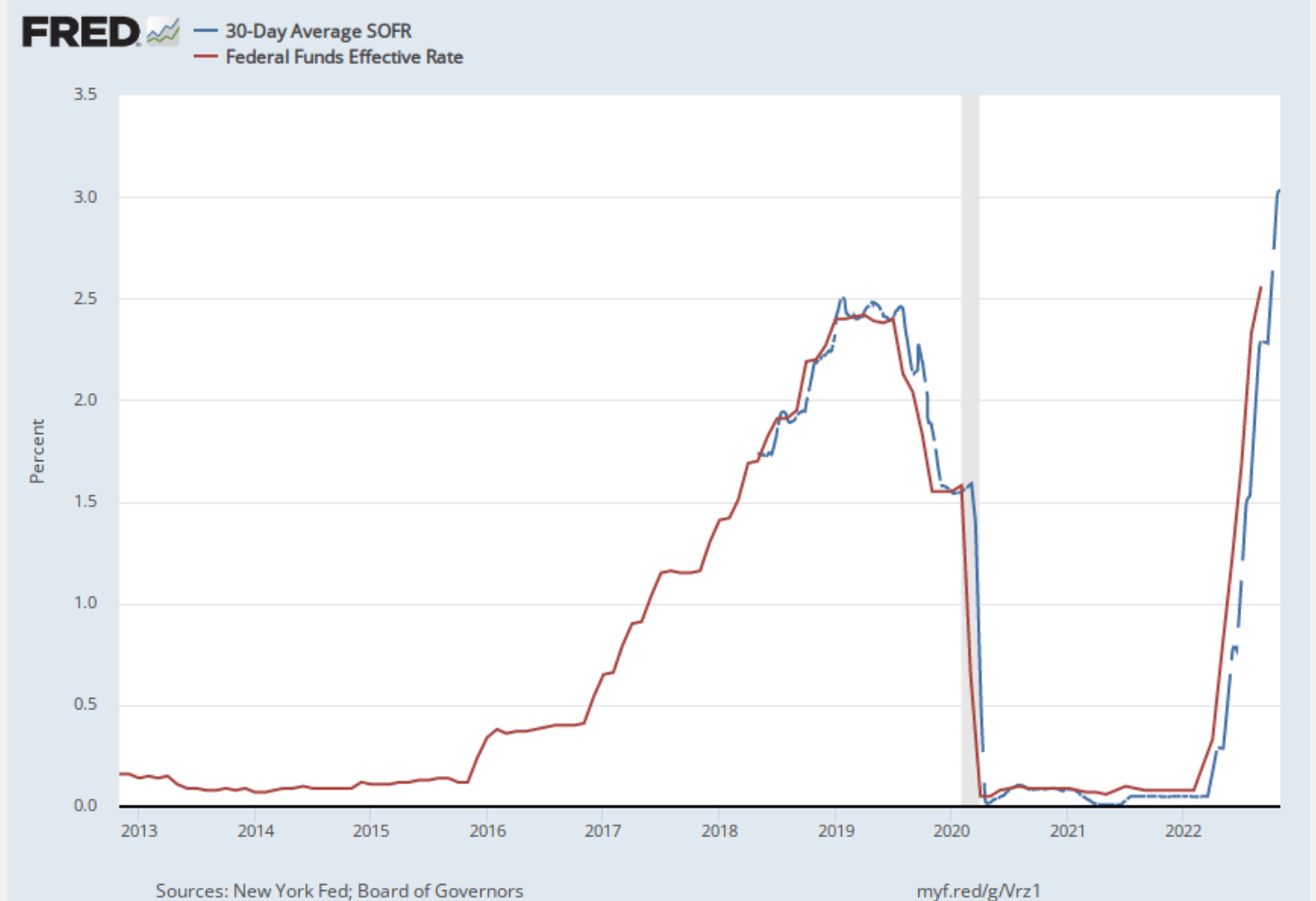
It's All About The Rates!

- Short Term Rates
- Long Term Rates
- Where Rates Are Going
- Interest Rate Effect on Underwriting & Credit
- Interest Rate Effect on Cap Rates
- Trends In Lending



Short Term Rates

- Fed Funds likely up another 75bps to 3.75% -4.00%
- Forecast another 50bps in December
- Peak estimate is 4.50%-4.75% in Q1 2023



Short Term Rates

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.5%
June 16, 2022	+75	1.5% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
December 20, 2018	+25	2.25% to 2.50%
Sept. 27, 2018	+25	2.0% to 2.25%
Jun. 14, 2018	+25	1.75% to 2.0%
March 22, 2018	+25	1.50% to 1.75%
Dec. 14, 2017	+25	1.25% to 1.50%
June 15, 2017	+25	1.00% to 1.25%
March 16, 2017	+25	0.75% to 1.00%
Dec. 15, 2016	+25	0.5% to 0.75%
Dec. 17, 2015	+25	0.25% to 0.50%



Short Term Rates – Why It Matters

- Construction Loans
 - *Is the interest reserve sufficient?*
 - *Spreads are widening – 2.50% -3.00%*
 - *All-in floating rate – 6.25% - 6.75%*
- Good news: Short-term rates have a muted effect on values and loan sizing

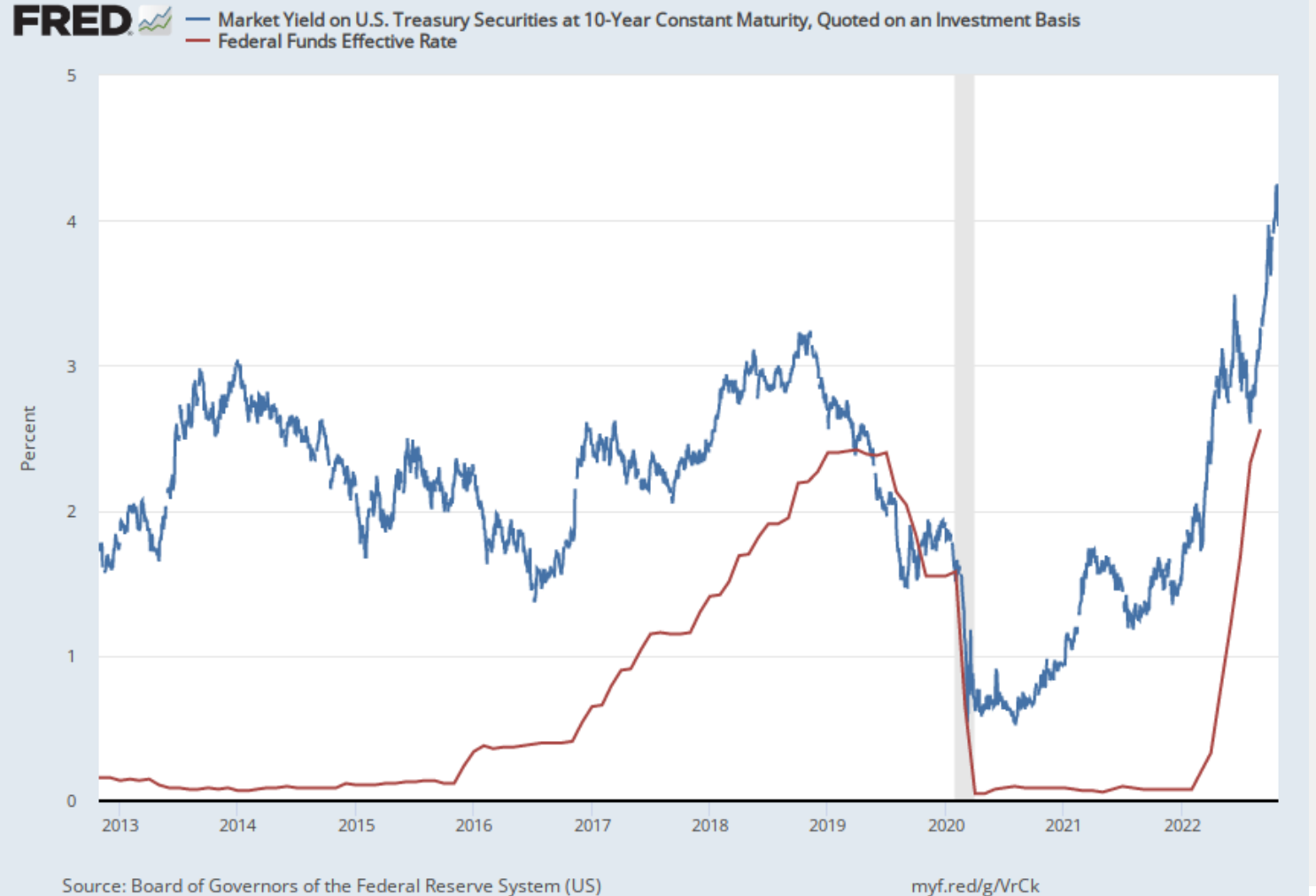


Long Term Rates

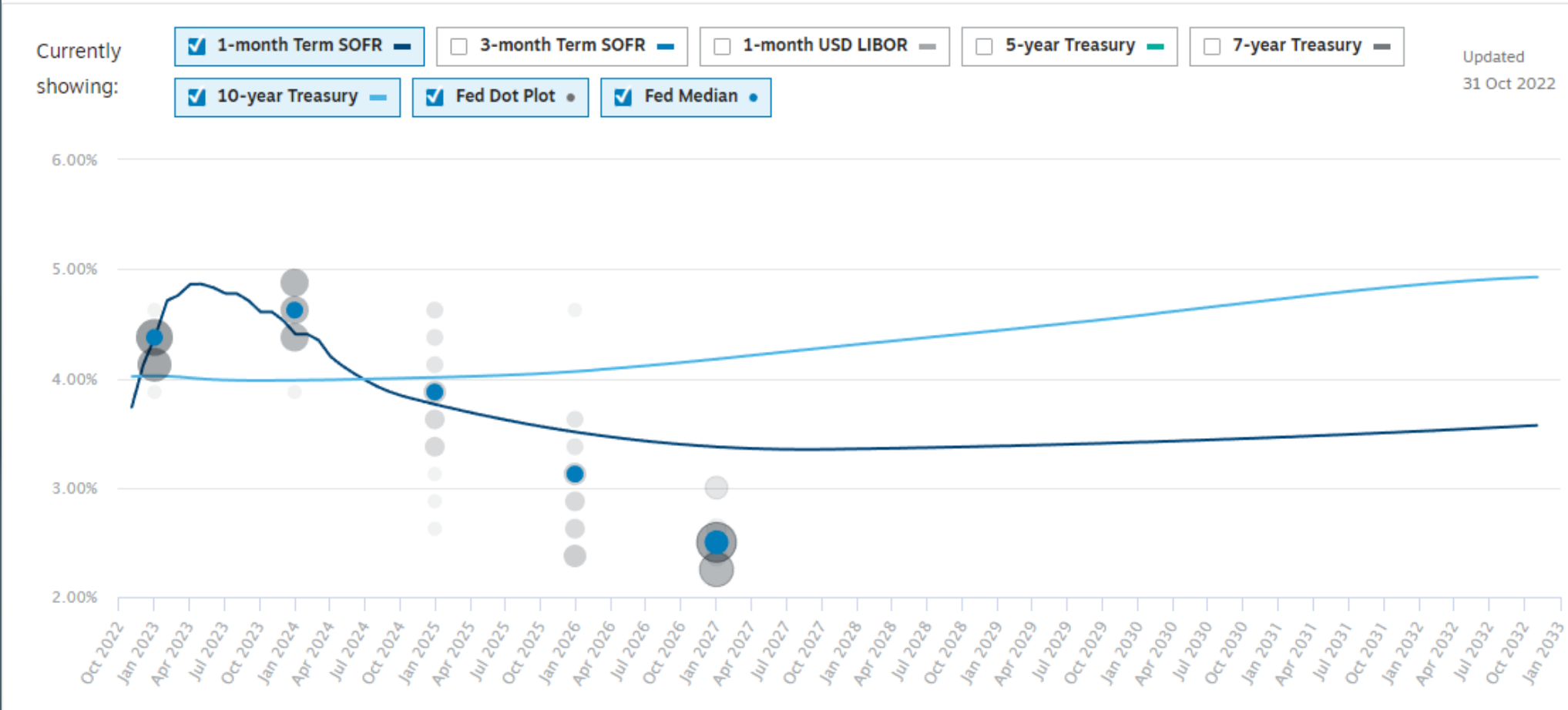
- Like short term rates, the 10-year is up 3.75% from its low

BUT

- The rise has been spread over a 2+ year period
- The 10-year has a much more profound effect on loan sizing and cap rates



Where Are Rates Going?



Interest Rate Effect on Underwriting

- Loan Sizing – Banks generally underwrite with long-term rates in mind
- Long-Term Rates have had a significant effect on loan sizing in the past 12-24 months
- Example below shows a 25% reduction in loan proceeds

NOI	\$1,000,000	
Target DSCR	1.25x	
Interest Rate		Loan Amount Supported
11/1/2021	3.58%	\$14,700,000
10/31/2022	6.09%	\$11,000,000



Interest Rates Effect on Cap Rates

- They are going up! How much and how fast is greatly unknown
- Transaction volume is slow so comps are hard to find
- The velocity of rate change has created uncertainty
- “Negative Leverage” doesn’t make sense!

NOI	\$1,000,000	
Cap Rate	5.25%	Unlevered Return
Value	\$19,000,000	
<i>Leveraged Return</i>		
Loan	\$11,000,000	
Equity	\$8,000,000	
Annual Cash Return	\$200,000	
ROE	2.50%	



Trends in Commercial Real Estate Lending

- Banks are tightening underwriting standards
- Some banks have stopped or greatly slowed lending
- Spreads are widening
- Costs are up...but developers have adjusted
- Participation / Syndication activity is high
- Relationships matter!



Summary / Outlook

- Debt capital will continue to be constrained in the near term
- Well-capitalized deals with strong sponsors will continue to get done
- Short-Term Rates will continue to go up over the next six months further muting new development
- Relief from higher short-term rates comes at the end of 2023
- The flat outlook for Long-Term Rates is a silver lining
- Cap Rates must adjust – outlook is very unclear



Summary / Outlook – Big Changes!

- Feb 10, 2022
 - *Aaron Rodgers named 2021 MVP*
 - *1-Month SOFR – 0.06%*
 - *10-Year Treasury – 2.03%*
- The world is very different!





Insurance Marketplace Update

Justin Abbott



Commercial Property Insurance Marketplace 2022

Understanding the Value of a Building for Insurance Purposes

Key Factors

- Total Insurable Value (TIV)
- Capacity
- Reinsurance / Cat losses
- Increase in Replacement Cost Values
- Inflation
- Underwriting Appetite



Comparing Valuation Methods

Market Value vs. Replacement Cost

What's the difference?

MARKET VALUE

How much someone is willing to pay for your home



location & neighborhood



school systems



market status

REPLACEMENT COST

How much it would cost to replace your home



cost of materials



cost of labor



cost of clean-up



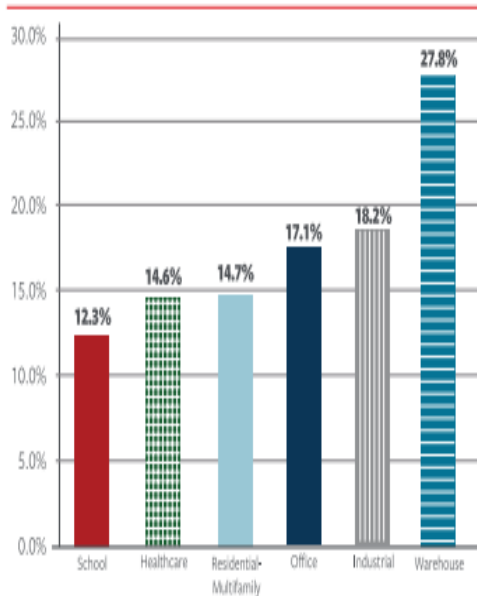
- Replacement Cost
- Market Value
- Actual Cash Value
- Functional Replacement Cost
- Co-insurance



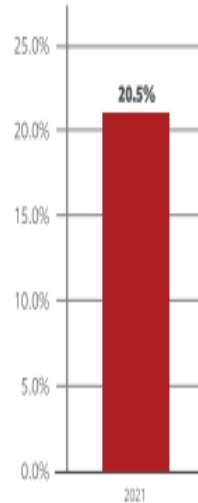
Key Factors Impacting Marketplace

BUILDING CONSTRUCTION COSTS AND MATERIALS PRICE MOVEMENT
JANUARY 2021-JANUARY 2022

NEW BUILDINGS BY TYPE²

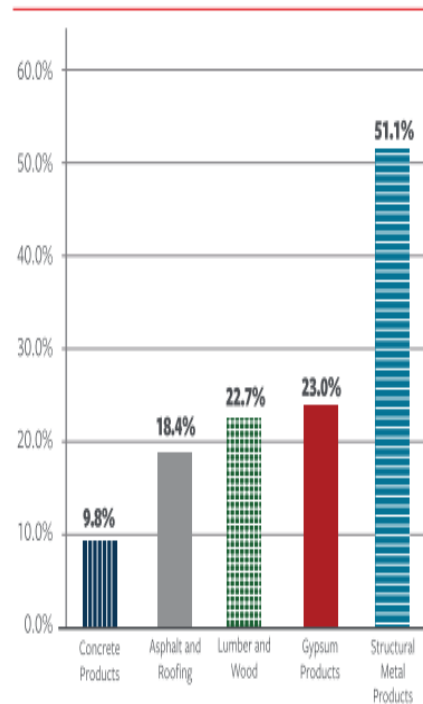


CORELOGIC[®] U.S. BUILDING CONSTRUCTION INDEX³



BUILDING CONSTRUCTION COSTS AND MATERIALS PRICE MOVEMENT
JANUARY 2021-JANUARY 2022

CONSTRUCTION MATERIALS²

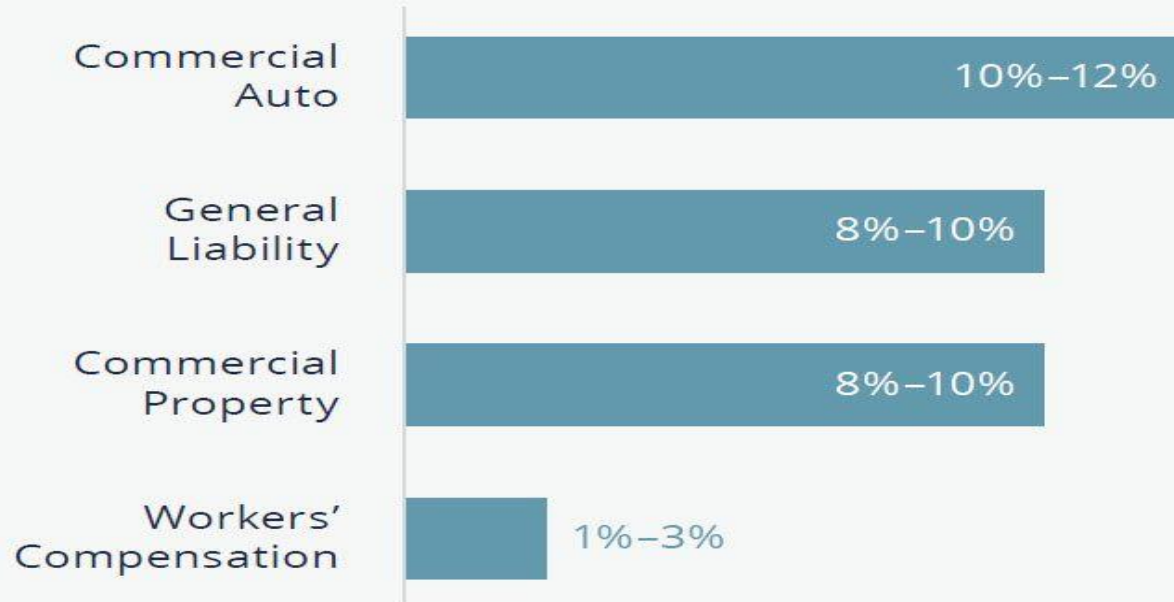


- Inflation
- Cost of Claims on the rise
- Material & Labor Costs
- Reinsurance / CAT losses
- Capacity limitations by carriers



Underwriting Factors

2022 Direct Premium Growth Estimates by Line (Contemplates Rate and Exposure)



- Value & Capacity
 - *does carrier need to purchase reinsurance*
- Location
- Use
 - *Office / Industrial / Mix-Use / Habitational*
- Age of Building
- Protective Safeguards
- Tenants
 - *types of operations happening on the building*
- Updates
 - *Roof / Electrical / Plumbing / HVAC*



Commercial Insurance 2023 Forecast



- Continued property rate increases - WI / US / CAT losses could change all of this.
- Replacement Cost valuations continue to steadily rise
- Insurance marketplace shrinking for certain type of Commercial Properties





Q & A

1. Use the Chat feature to type in your question
2. Email us directly after presentation



Contact Us!

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