



Real Estate Perspectives: The Future of Housing, Apartments, Commercial, Industrial, and Medical Uses

Michael Carney and Mary Ludgin
Illinois Financial Forecast Forum
January 2024

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A REAL ESTATE INVESTMENT MANAGEMENT FIRM

Numerous Sources of Uncertainty for Real Estate Investors HEITMAN



**HIGHER
FOR
LONGER**



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US Private Real Estate Has Likely Devalued $\approx 20\%$

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INDEX CHANGE SINCE END-2021
UNITED STATES, 2022 - 2023 DECEMBER, DAILY

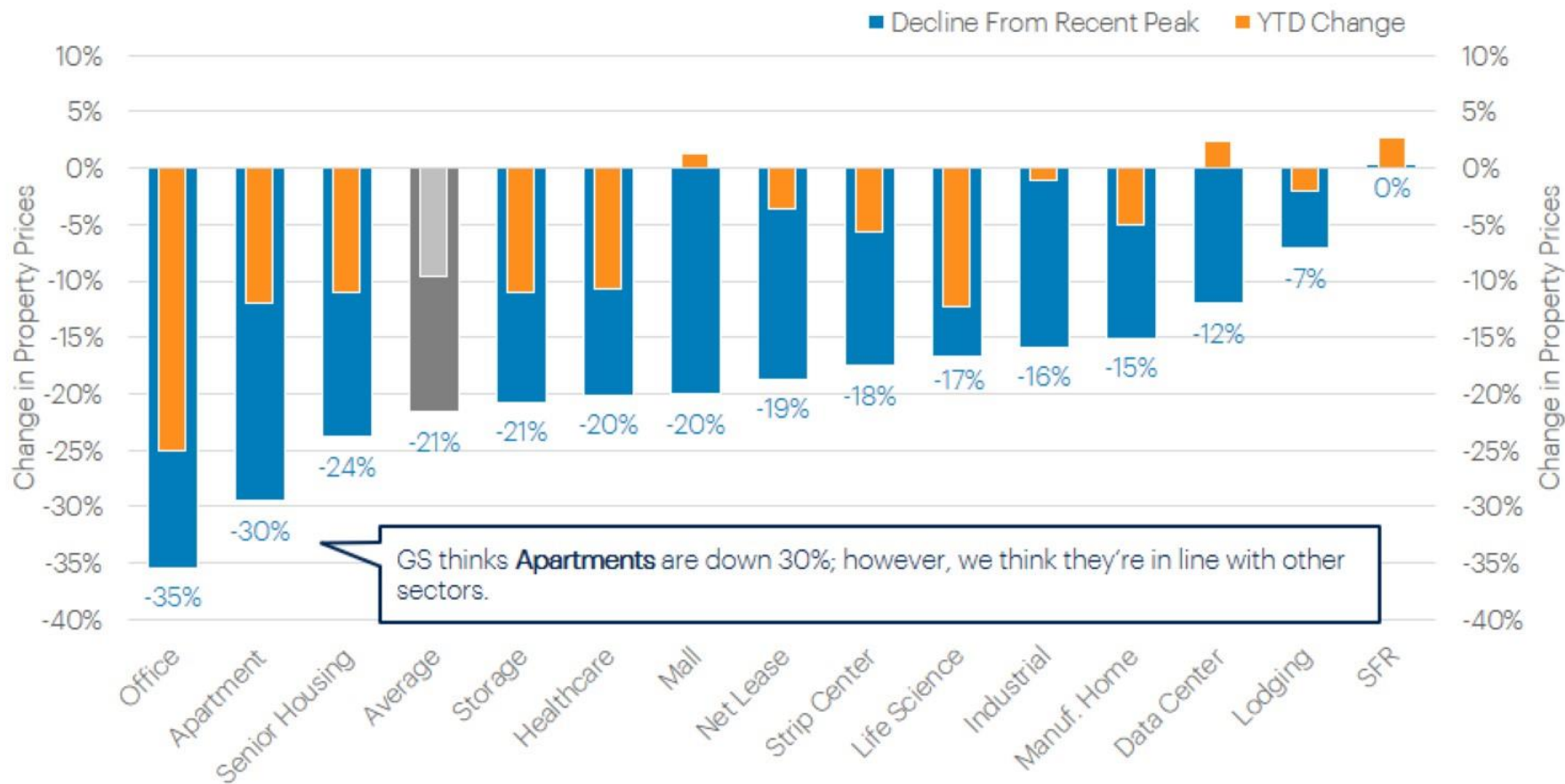


Sources: Green Street & Investing.com databases, accessed 2024 Q1

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Office Leads Value Declines But Rate Hikes Have Triggered Broad Repricing

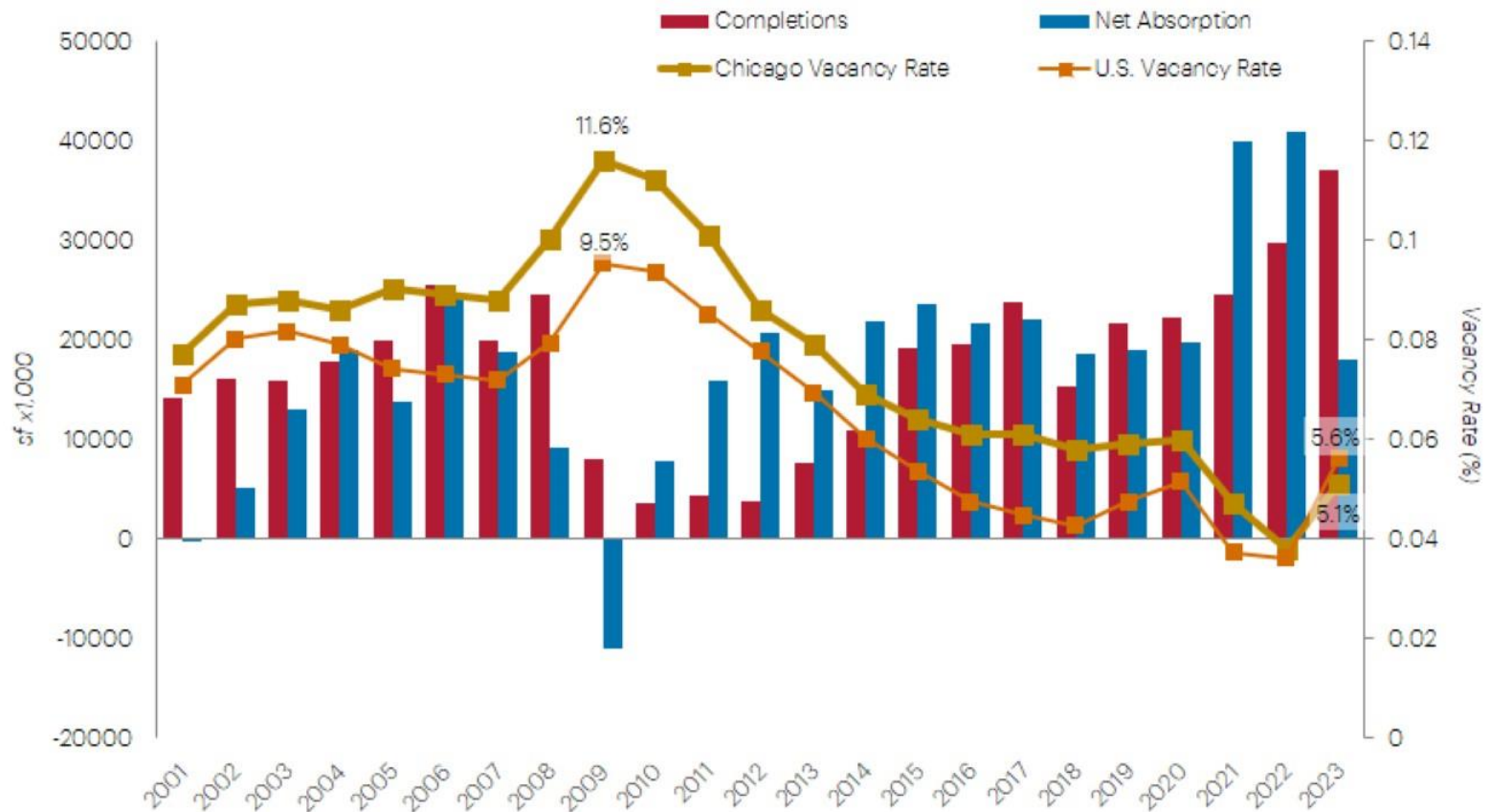
**CHANGE TO PROPERTY PRICES YTD & TOTAL DECLINE FROM RECENT PEAK
AS OF 2023 DECEMBER**



Underlying Data Sources: Green Street Commercial Property Price Index (CPPI), accessed 2023 Q4

Chicago Industrial Market Healthier Than US For the First Time Since 2001

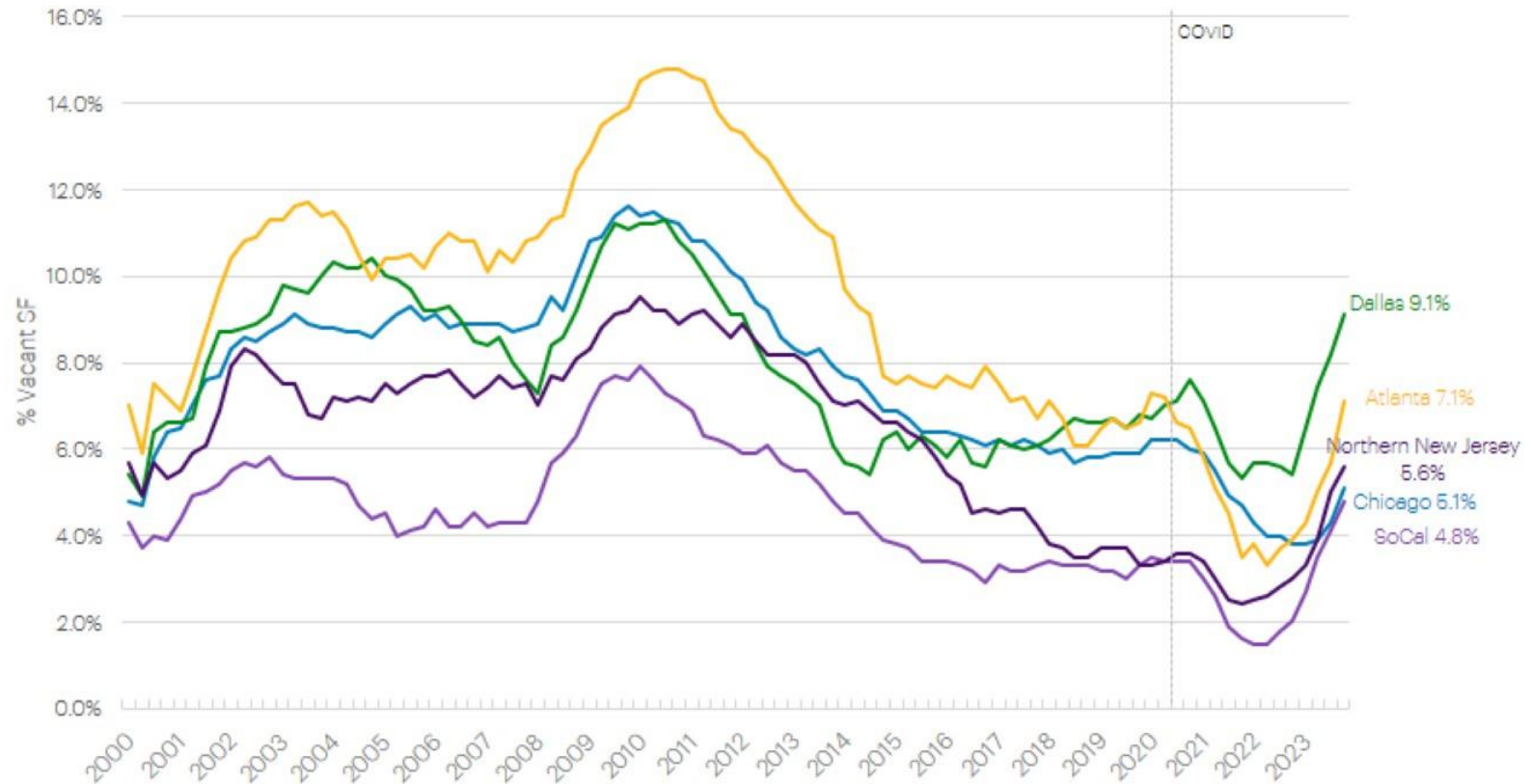
**INDUSTRIAL COMPLETIONS, NET ABSORPTION, AND VACANCY
CHICAGO 2001-2023 YEARS ENDING Q4**



Underlying data source(s): CoStar

Chicago Has Second Lowest Industrial Vacancy Among Largest US Markets

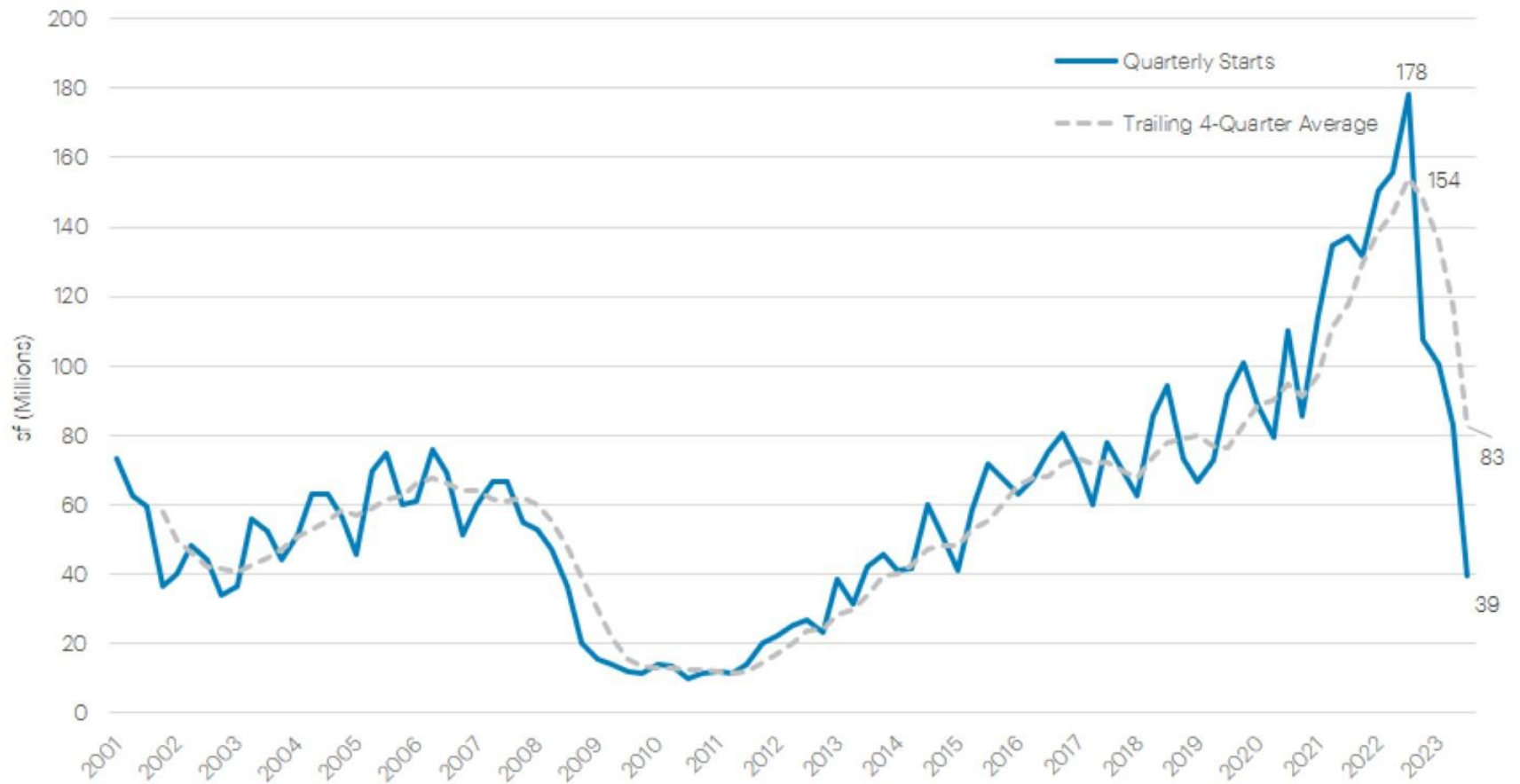
INDUSTRIAL VACANCY RATE
CHICAGO vs TOP 5 US MARKETS 2000 Q1 - 2023 Q4



Underlying data source(s): CoStar

Plummet in Industrial Starts Sets Stage for Soft Landing HEITMAN

INDUSTRIAL SECTOR STARTS US 2001-2023 Q3



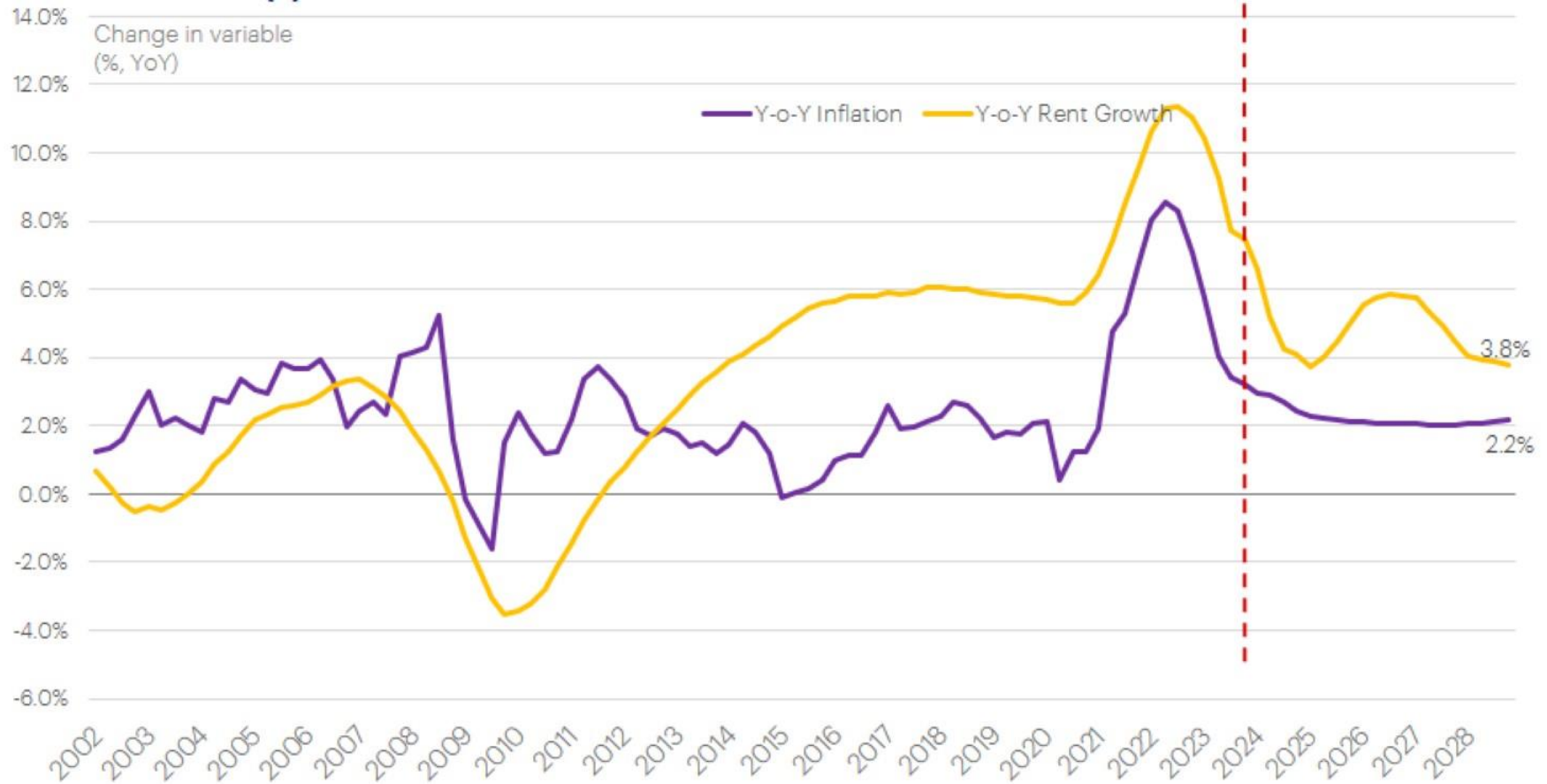
Source: CoStar; Heitman Research

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Industrial Rent Growth Expected to Outpace Inflation Through the End of 2026

LOGISTICS RENT GROWTH VERSUS US INFLATION (CPI)

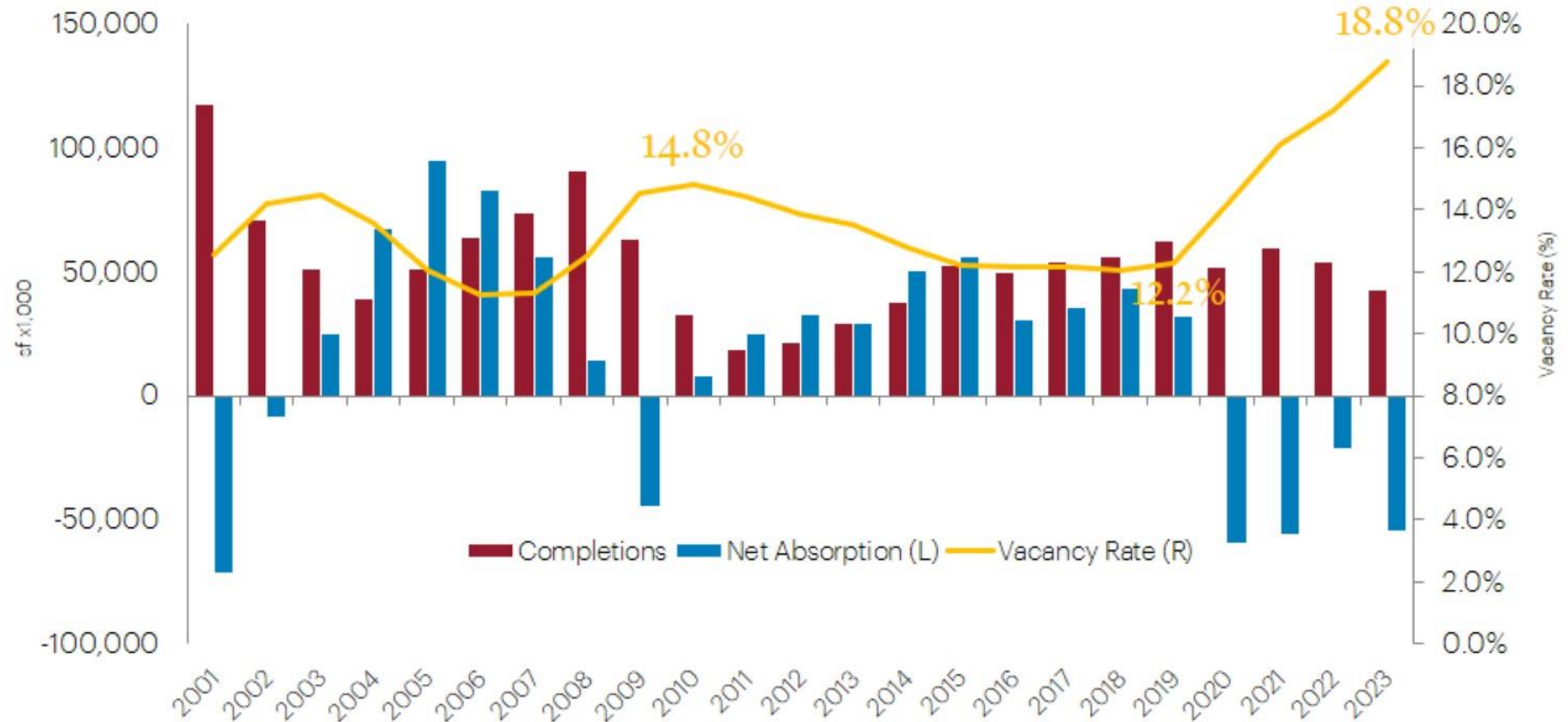
US 2002 - 2027(F)



Source: Bureau of Labor Statistics, Moody's Analytics, CoStar

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**OFFICE COMPLETIONS, NET ABSORPTION, AND VACANCY
US 2001-2023 (YEARS ENDING Q4)**

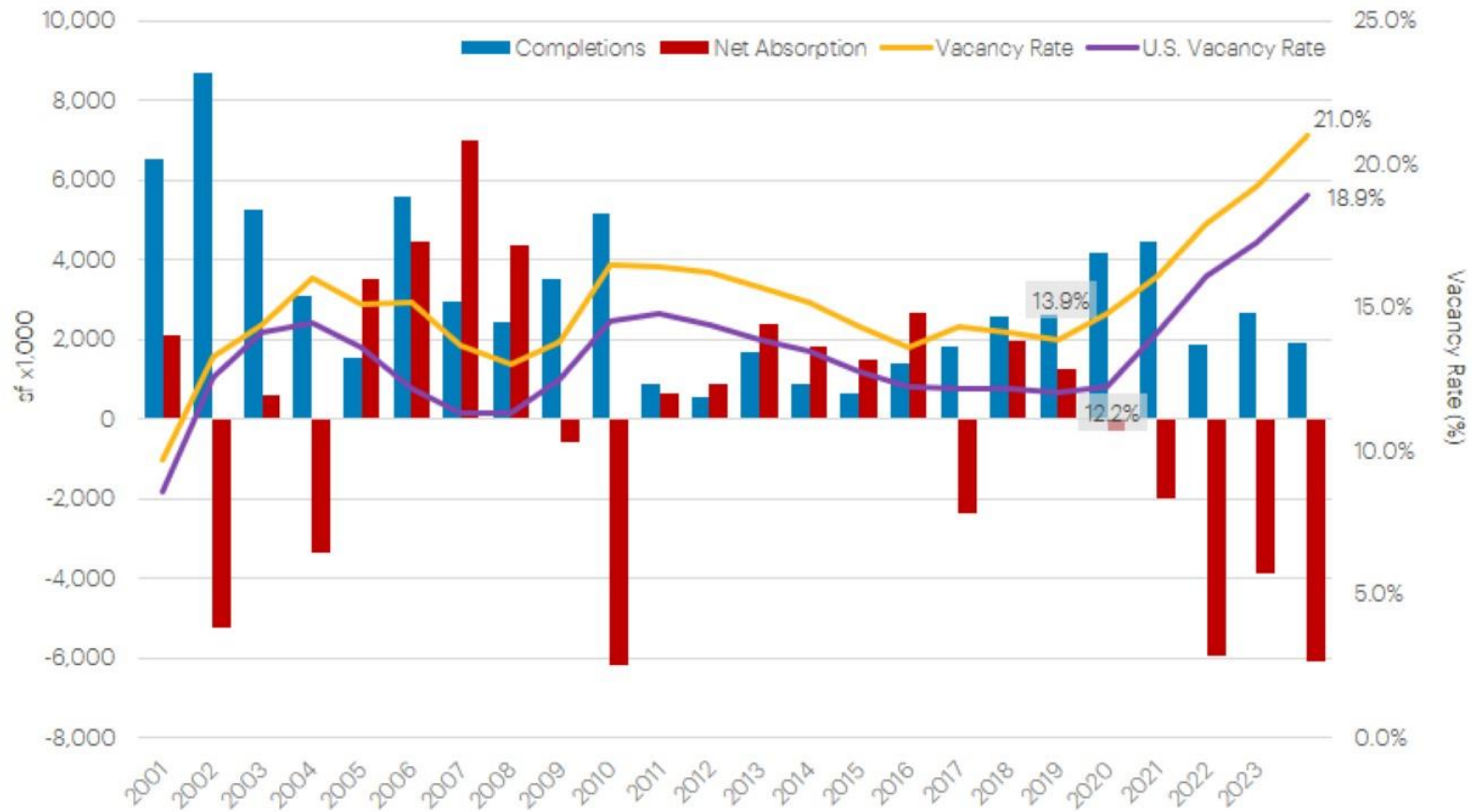


Underlying data source(s): CoStar

Chicago Office Vacancy Remains Above Nation

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**OFFICE COMPLETIONS, NET ABSORPTION, AND VACANCY
CHICAGO 2001-2023 YEARS ENDING Q4**



Underlying data source(s): CoStar

Office Leases Are Occurring But They are Fewer, Smaller, Shorter

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-19%

Average lease size

dropped 19% versus 2015-2019 average¹



-27%

Average leasing volume down 27% versus pre-pandemic average as of Q2 2023²



-32%

Average lease term

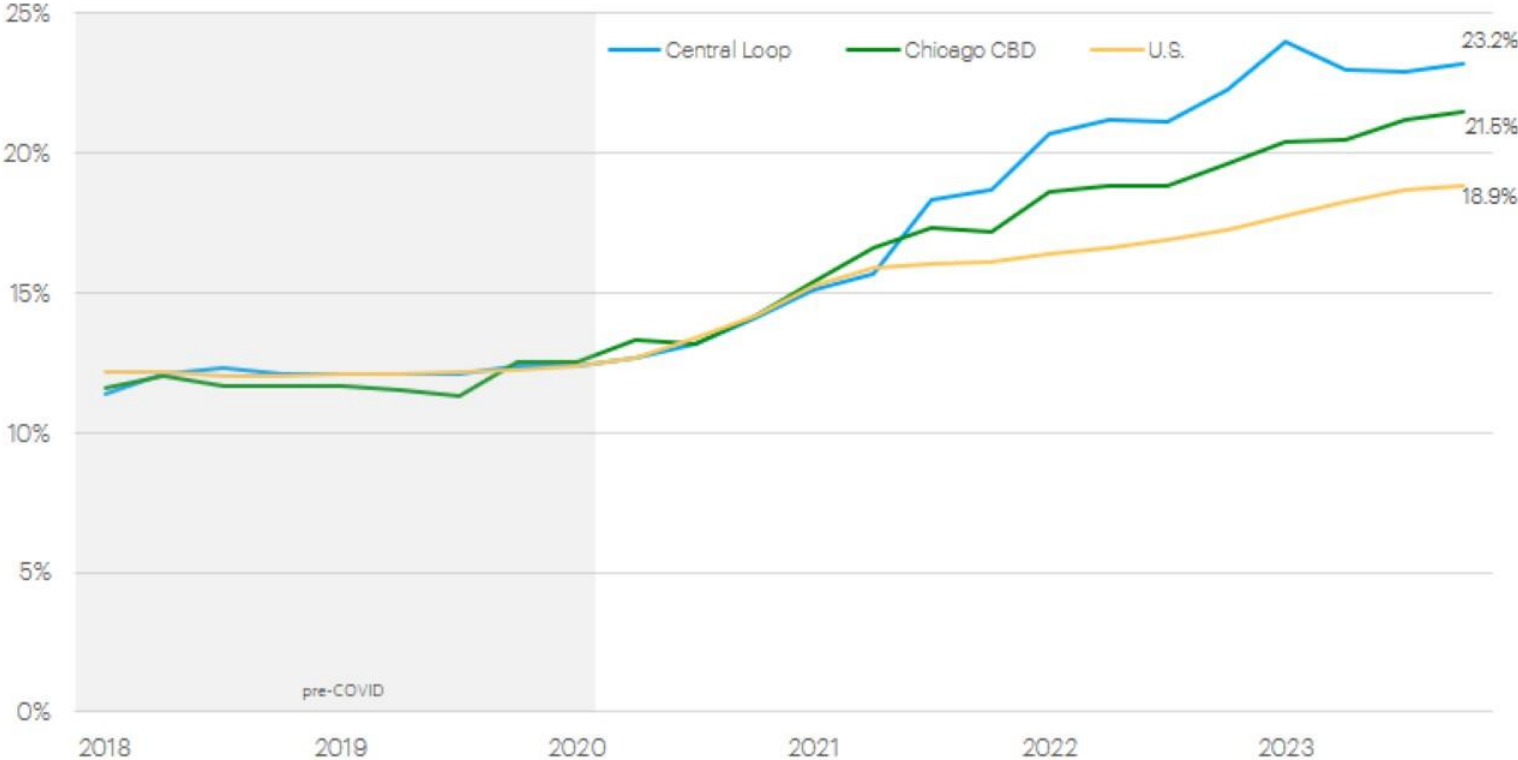
decreased from 9.1 years for past 12 months as of Q1 2022³ to 6.2 years as of Q3 2022⁴



1. CoStar, Q2 2023
2. JLL, Q2 2023 (excl. coworking)
3. Trailing twelve months as of Q1 2022
4. JLL, Q3 2022

Chicago's Once-Healthy Downtown Now Challenged

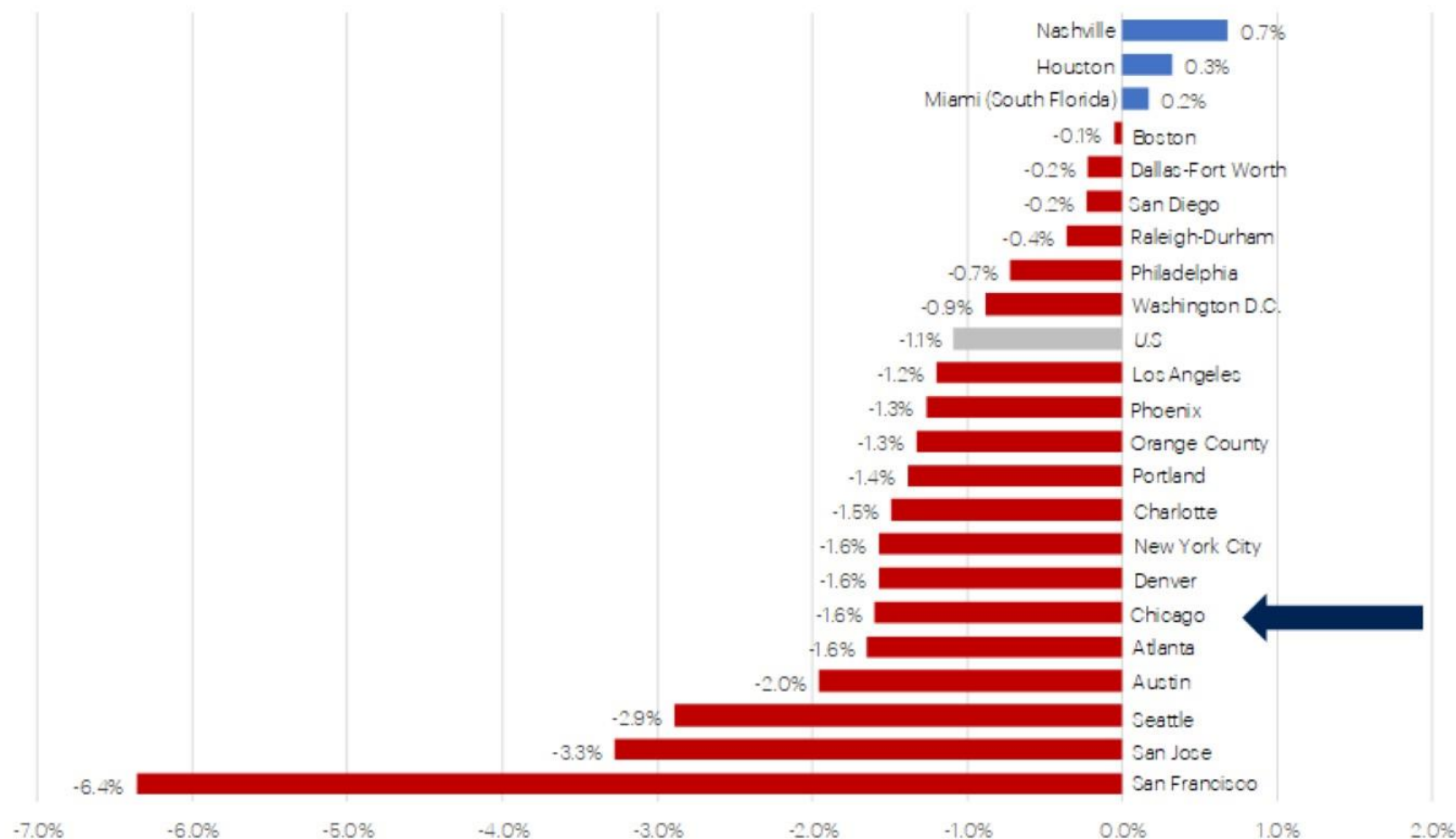
CHICAGO CBD VACANCY vs US
2018 Q1 - 2023 Q4



Underlying data source(s): CoStar

Office Tenant Demand Remains Negative Across Markets

NET ABSORPTION - SHARE OF EXISTING INVENTORY SELECT TOP MARKETS Q1 2023 - Q4 2023



Underlying data source(s): CoStar

Office-to-Residential Conversions: Most Viable in Expensive Apartment Markets

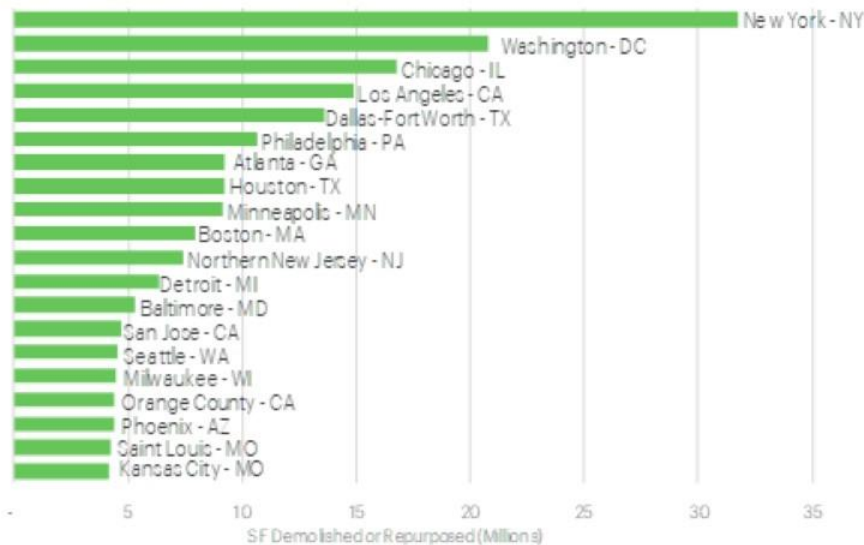
*“A **third** of older office building stock in some of the largest cities across the U.S. and Canada is considered ripe for conversion into apartments, potentially providing one way to revive urban vibrancy in cities where workers haven’t fully returned to the office.”*

– CoStar

Avison Young: **34%** of office buildings across 14 major North American markets candidates for adaptive reuse

Gensler: **25-30%** of the hundreds of buildings Gensler has analyzed across North America are conversion candidates

OFFICE DEMOLISHED OR REPURPOSED Q3 2013 - Q3 2023 TOP 20 MARKETS



Underlying data source(s): CoStar

Market	Stabilized PGF Figures (Average)				
	Office		Apartment		Delta
	NOI PGF	Value	NOI PGF	Stab Value	
New York - NY	\$20.30	\$266.59	\$37.99	\$826.80	\$560.21
Boston - MA	\$15.05	\$184.04	\$29.09	\$639.93	\$455.90
Orange County - CA	\$18.41	\$229.28	\$26.52	\$653.28	\$424.00
Long Island - NY	\$15.95	\$167.83	\$27.61	\$661.92	\$404.08
San Diego - CA	\$19.46	\$237.91	\$26.75	\$622.33	\$384.43
Ventura - CA	\$16.39	\$172.22	\$24.02	\$537.23	\$365.01
Los Angeles - CA	\$24.12	\$324.67	\$28.31	\$652.02	\$327.35
East Bay - CA	\$21.32	\$275.67	\$26.60	\$593.92	\$318.26
San Francisco - CA	\$32.17	\$483.16	\$33.38	\$779.55	\$296.39
Seattle - WA	\$18.24	\$232.40	\$23.40	\$519.29	\$286.89
Ann Arbor - MI	\$14.35	\$125.23	\$25.58	\$406.57	\$281.34
New Haven - CT	\$13.68	\$123.60	\$25.19	\$401.47	\$277.87
Chicago - IL	\$14.86	\$146.13	\$23.56	\$419.74	\$273.61
San Jose - CA	\$25.48	\$372.82	\$28.16	\$640.16	\$267.35
Inland Empire - CA	\$15.68	\$169.28	\$19.81	\$434.70	\$265.42
Stamford - CT	\$16.86	\$163.10	\$23.09	\$421.41	\$258.32
Manchester - NH	\$11.93	\$103.26	\$18.95	\$357.14	\$253.88
Northern New Jersey - NJ	\$14.68	\$140.52	\$20.90	\$378.61	\$238.09
Sacramento - CA	\$14.21	\$149.18	\$18.41	\$378.14	\$228.96
Washington - DC	\$20.94	\$216.39	\$22.78	\$436.41	\$220.02

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Low inventory, high rates & prices stymie homeownership

Resilient housing demand, lack of for-sale product buoys rented residential

Affordability a growing national concern, but less pronounced in Chicago

Record apartment construction to bend cost curve, but starts slowing

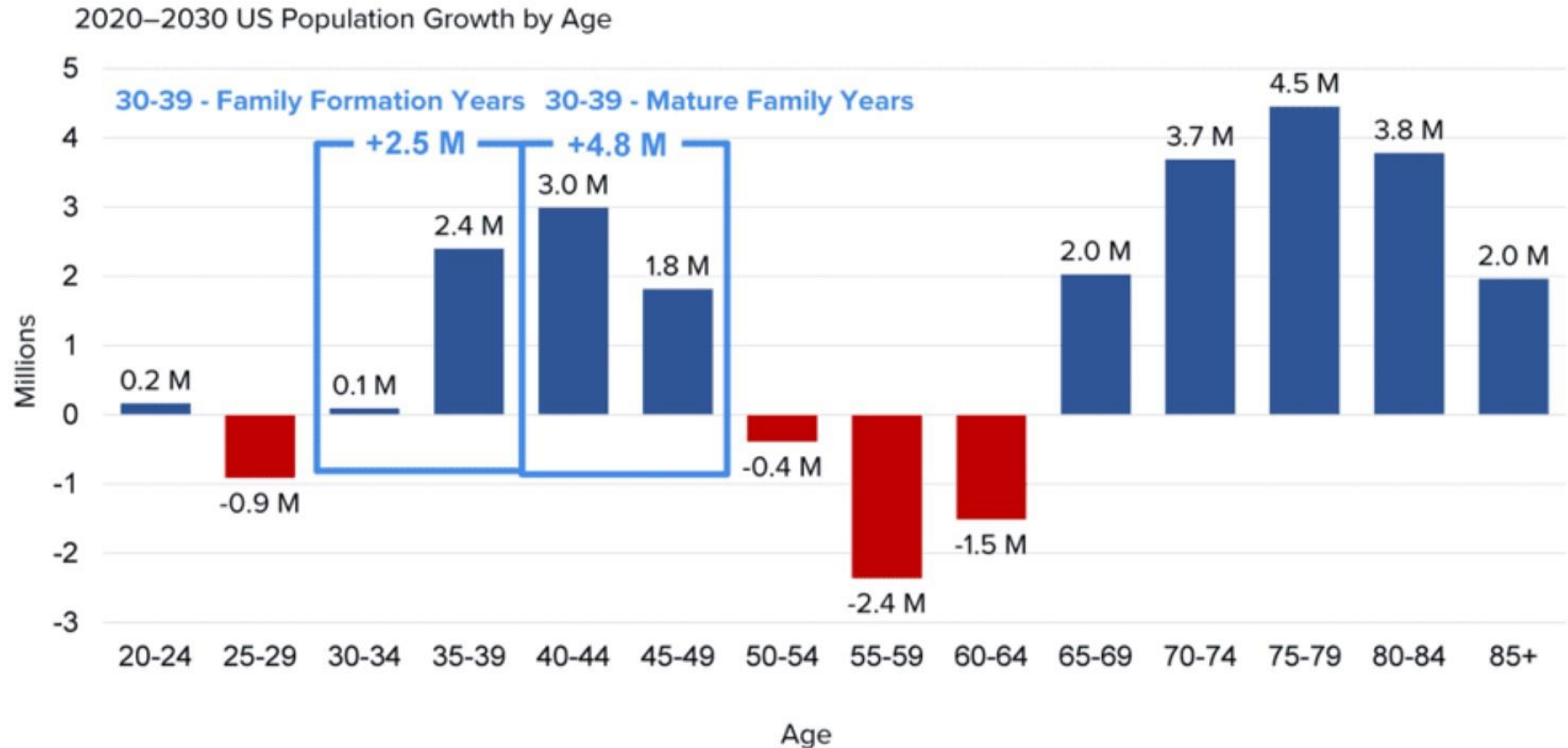
Chicago development remains concentrated downtown, and high end

Transaction volume and pricing subdued; but things looking up?

Flexibility and creativity are key for new housing production

35-44-Year-Olds Are the Fastest Growing Non-Retirement Cohort...

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Forbes ADVISOR

Homebuyers Running Out Of Options As Housing Supply Hits All-Time Low

Updated: Sep 28, 2023,

BUSINESS • REAL ESTATE

TIME

Why There Are No Houses to Buy in Many U.S. Metro Areas

BY ALANA SEMUELS MARCH 9, 2023 1:24 PM EST

HOUSING > HOUSING MARKET

Money

Published: Apr 25, 2023

Why Are There So Few Houses on the Market?

npr

WBEZ
CHICAGO

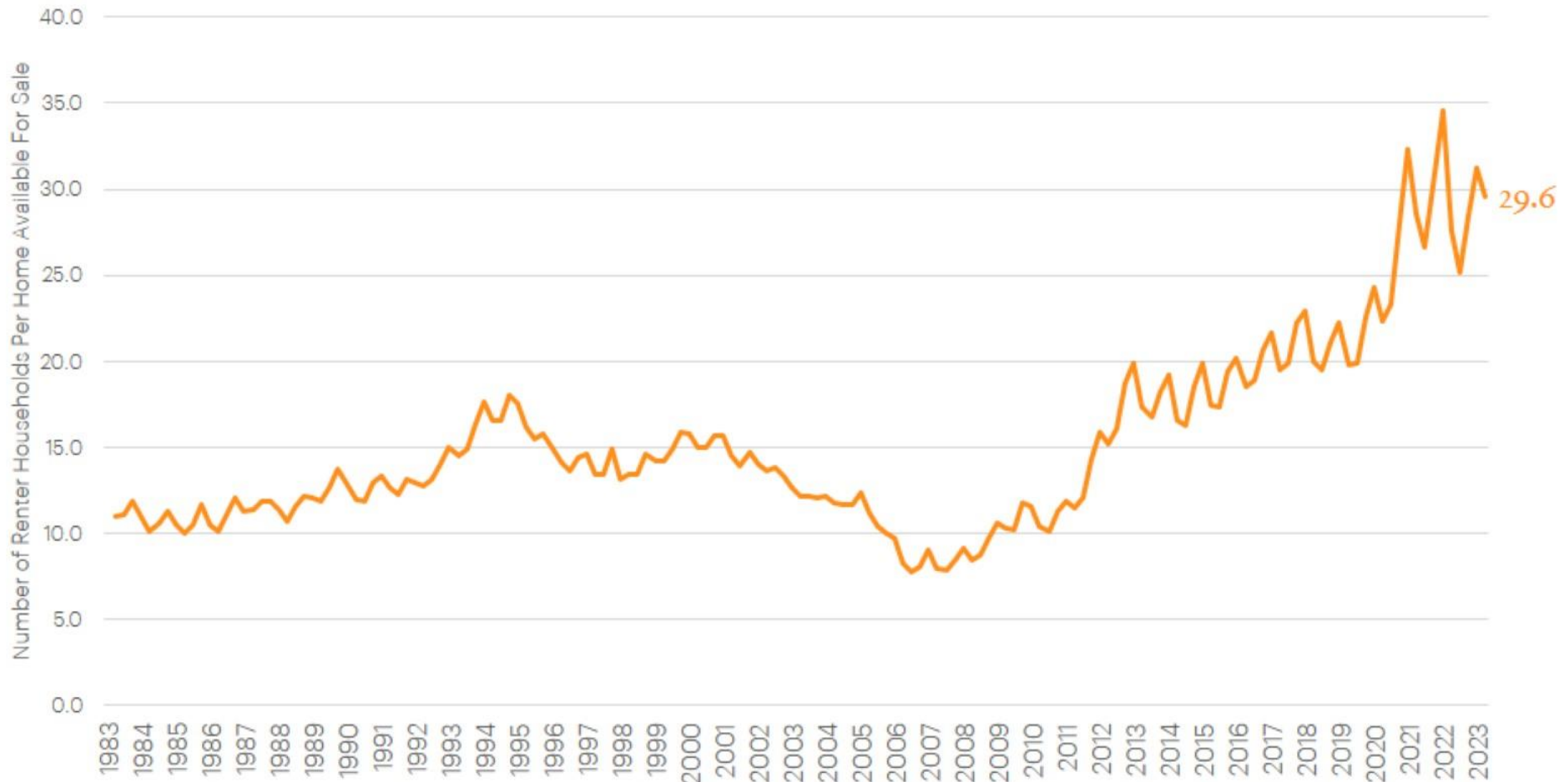
There's never been such a severe shortage of homes in the U.S. Here's why

MARCH 29, 2022 · 7:00 AM ET

...But For-Sale Supply Isn't There To Meet Demand

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**NUMBER OF RENTER HOUSEHOLDS PER HOME AVAILABLE FOR SALE
1983 - 2023 (Q2)**



Sources: John Burns Real Estate Consulting; St. Louis Fed; US Census

Homeownership Elusive For First-Time Buyers

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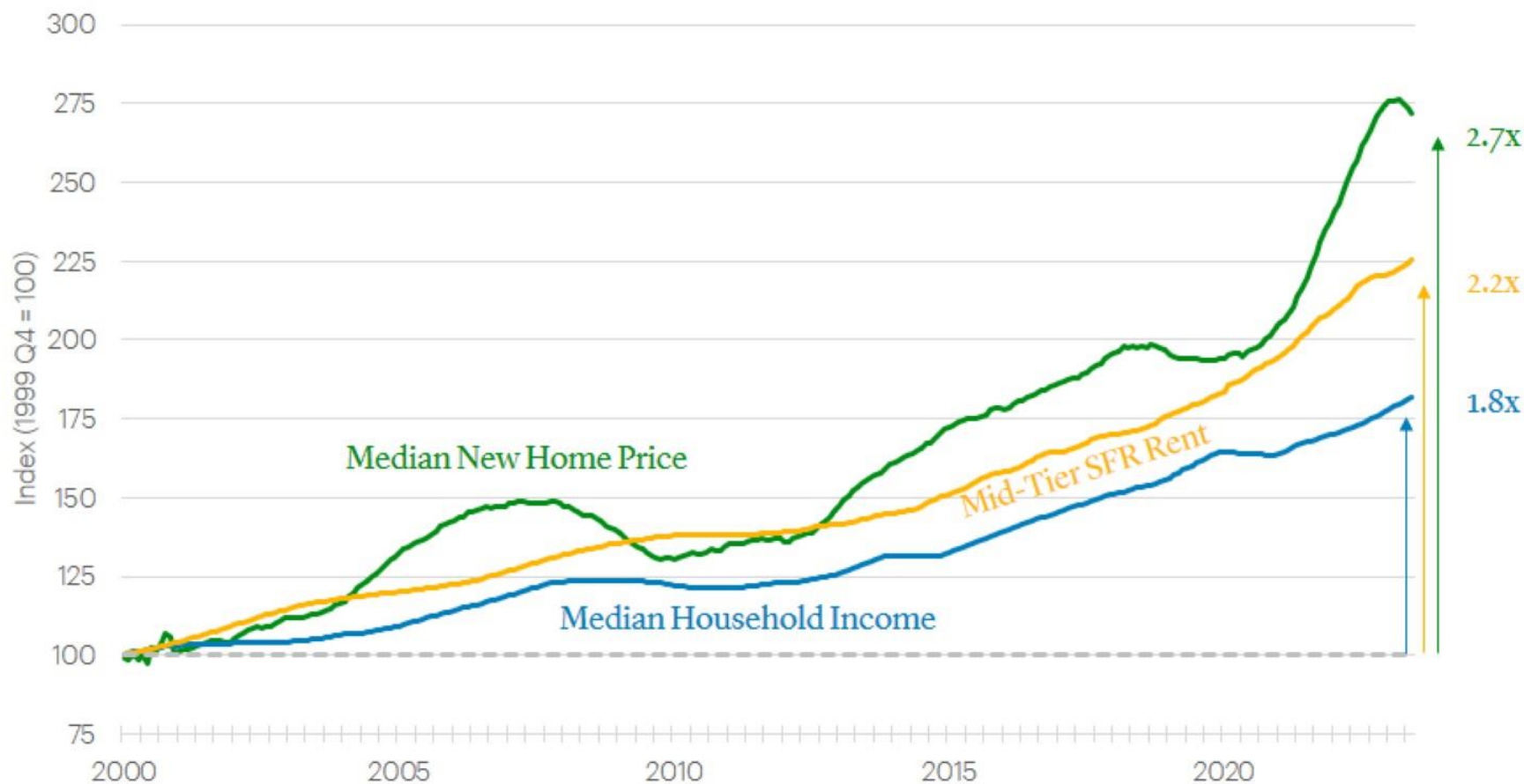


Source: tucsonlifestyle.com

The Supply-Demand Mismatch Has Pushed Prices For All Housing Types

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HOUSING COST VS MEDIAN INCOMES OVER TIME
US, 2000 - 2023 JUNE

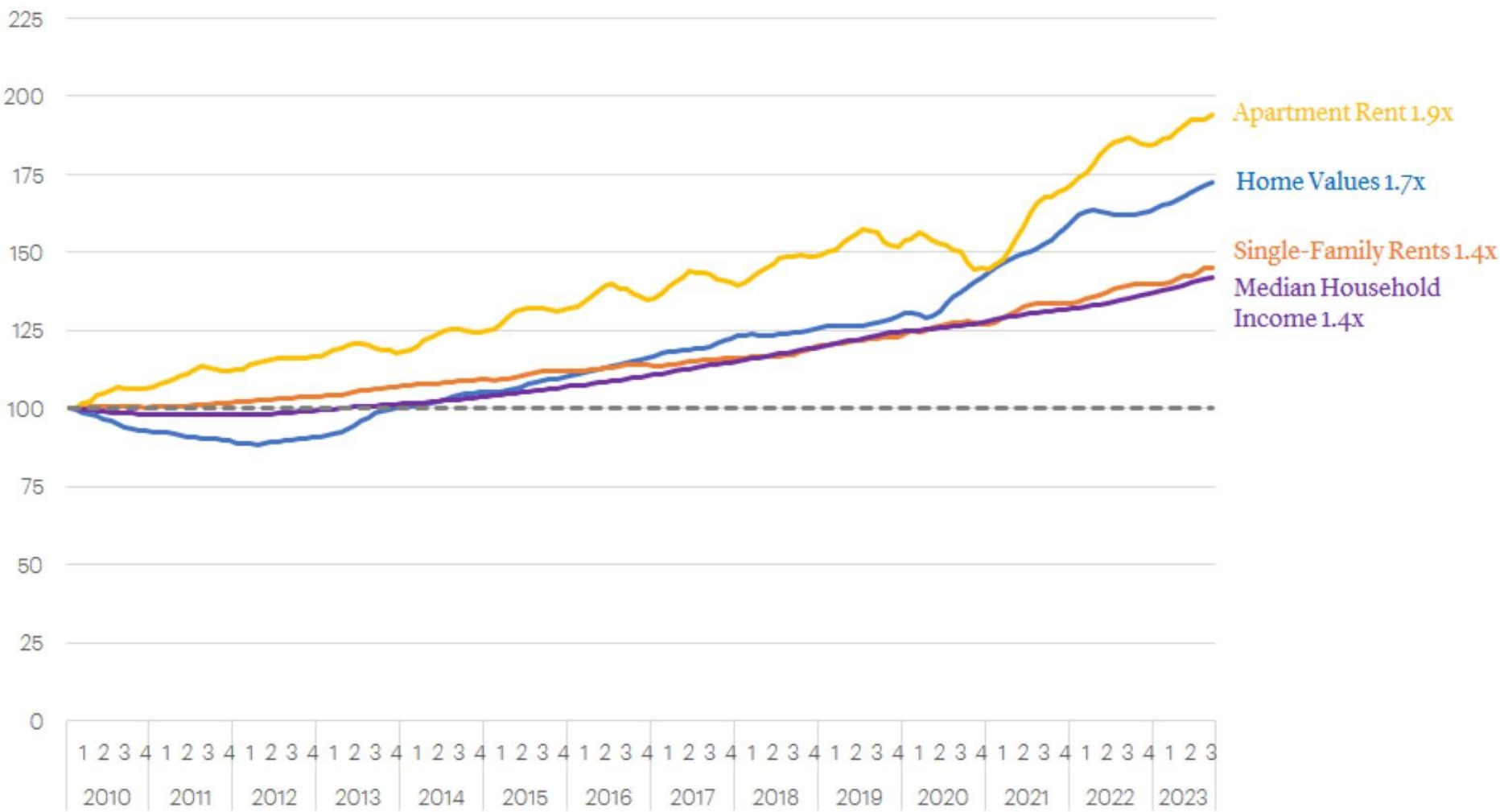


Source: JBR&O & Green Street databanks, accessed 2023 Q3

Slow & Steady Chicagoland Not Spared Either; Affordability Is Crunched But Relatively OK

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INDEX OF HOME VALUES, APARTMENT RENTS, SINGLE-FAMILY RENTS, AND MEDIAN INCOMES (2010 = 100)
CHICAGO, IL MSA 2010-2023 (SEPTEMBER)

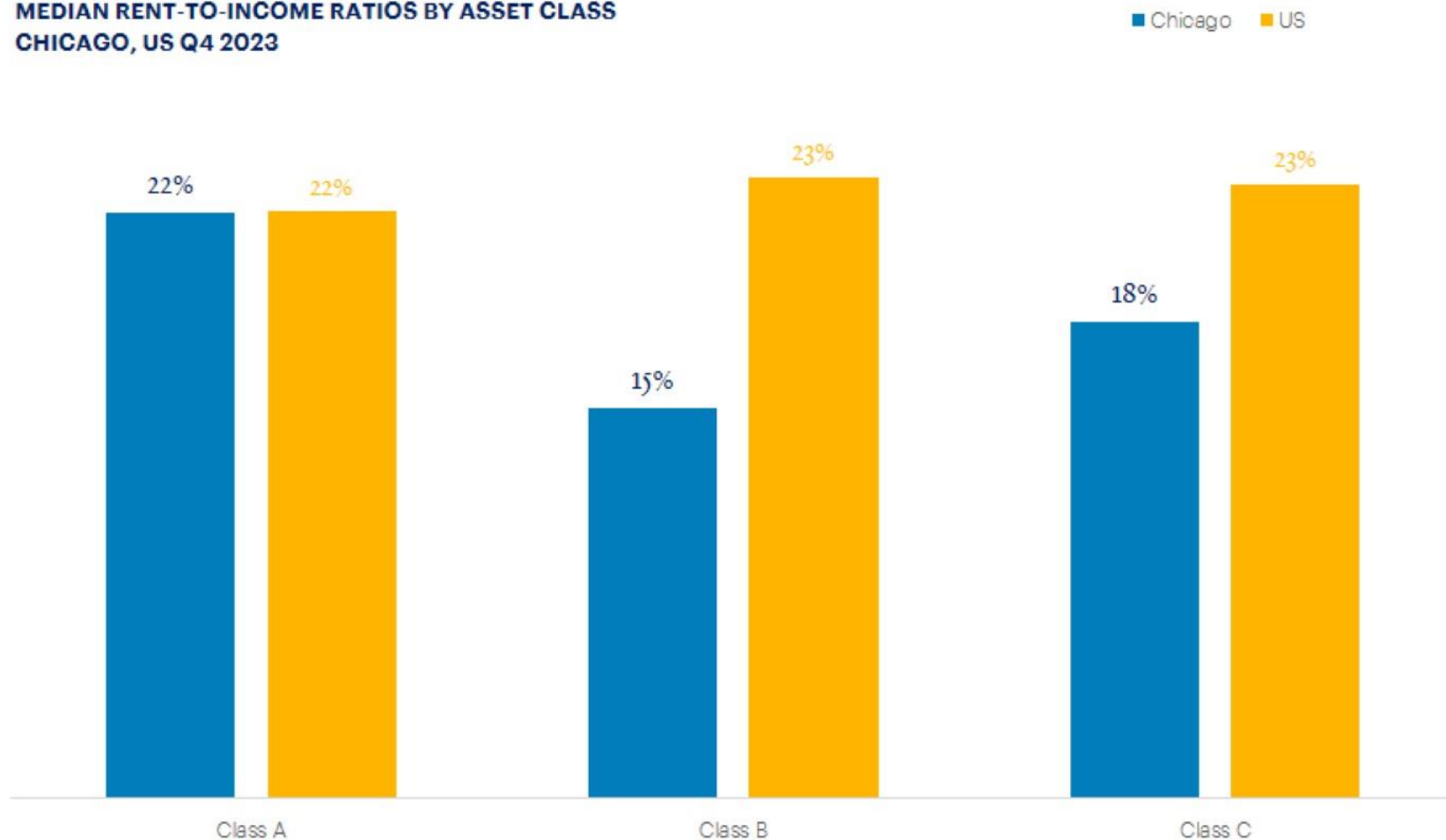


Source: John Burns Real Estate Consulting; RealPage, accessed 2024 Q1

Slow & Steady Chicagoland Not Spared Either; Affordability Is Crunched But Relatively OK

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**MEDIAN RENT-TO-INCOME RATIOS BY ASSET CLASS
CHICAGO, US Q4 2023**

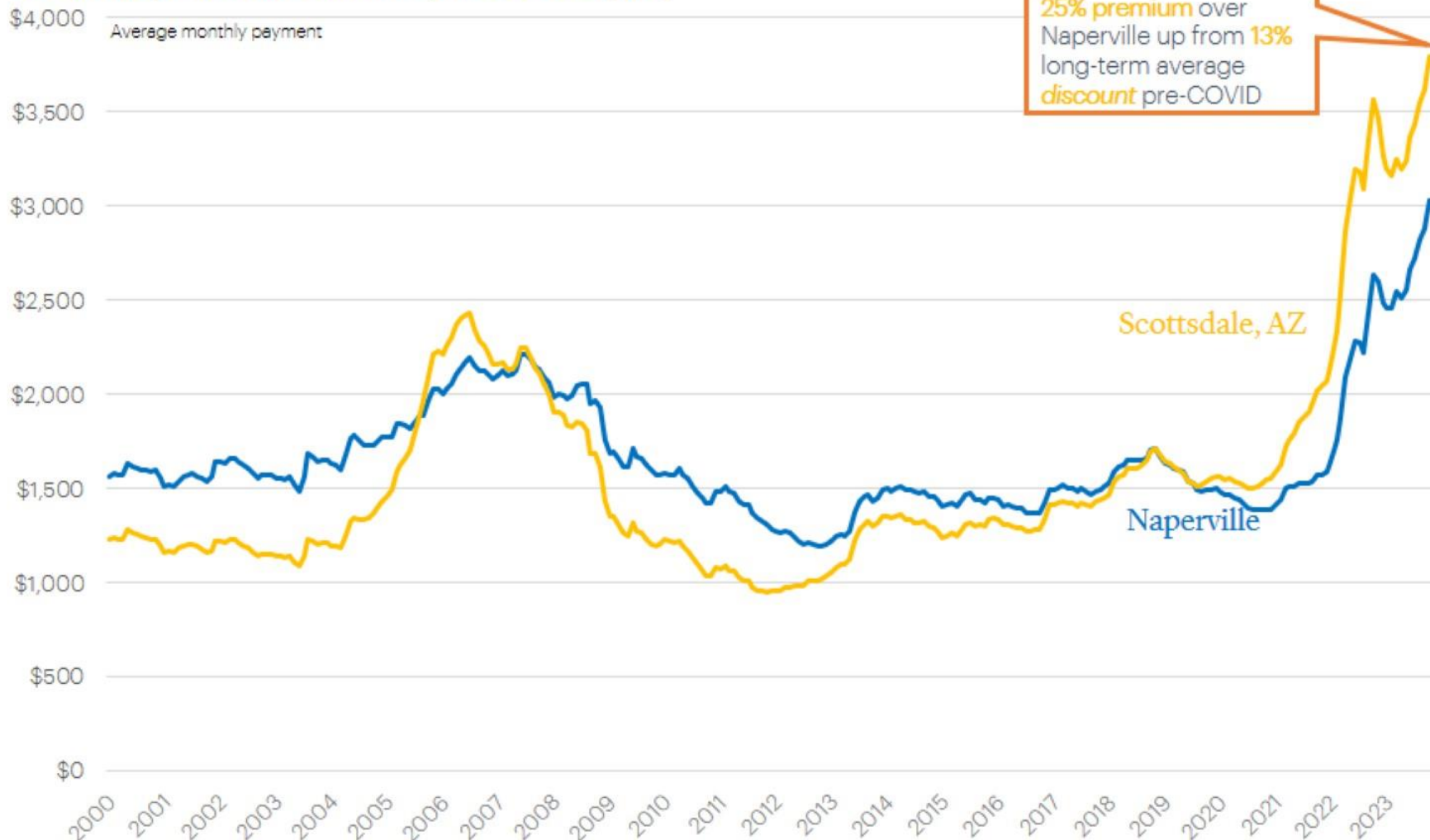


Source: RealPage, accessed 2024 Q1

The Sunbelt Affordability Story Is Eroding; Cause For Optimism In Chicagos Of The World

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**AVERAGE MONTHLY HOME PAYMENT
NAPERVILLE, IL VERSUS SCOTTSDALE, AZ 2000-2023 (NOV)**



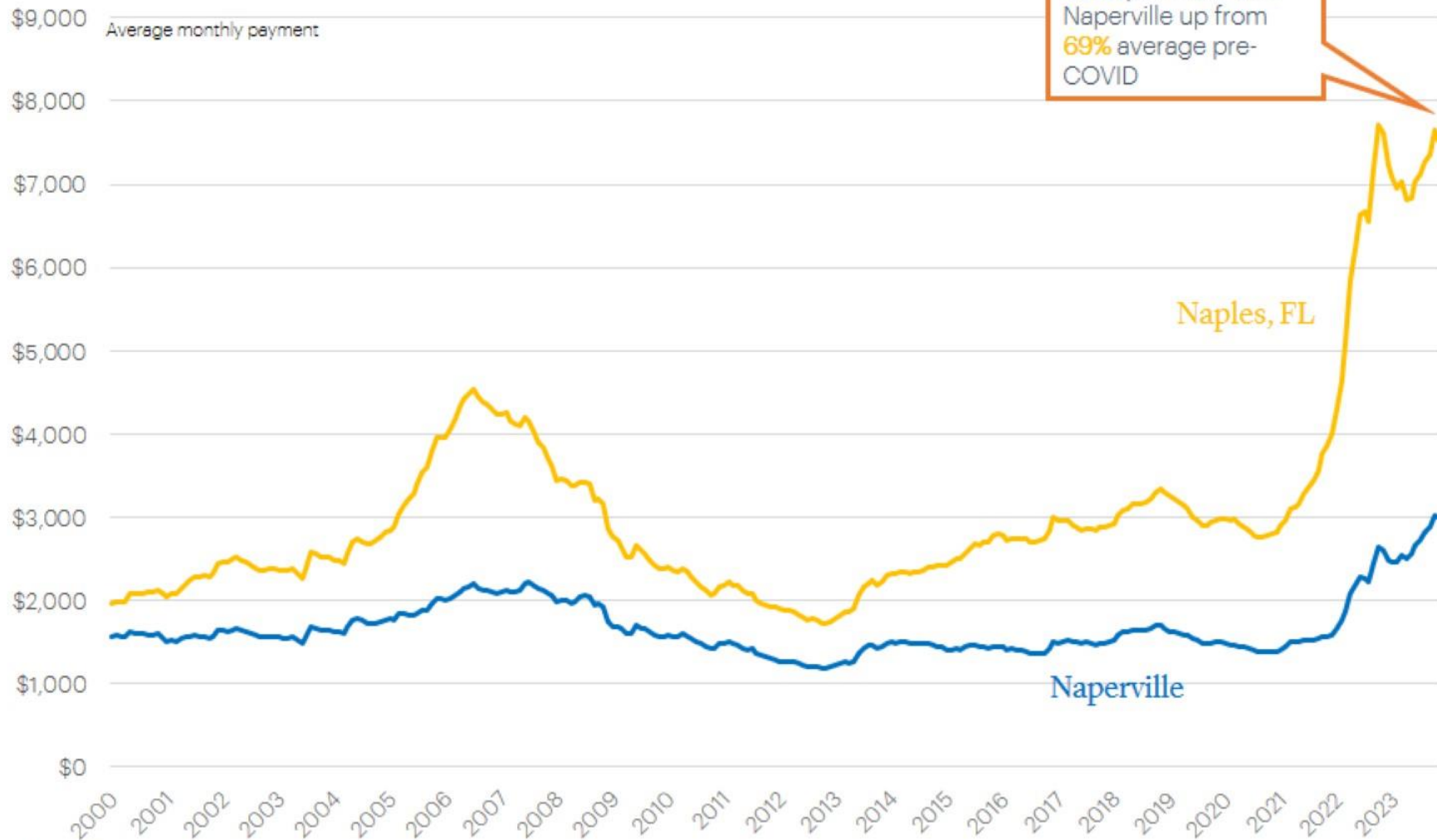
Source: Zillow

Note: 20% down, 30-year fixed-rate mortgage; Naperville ZIP code 60540; Scottsdale ZIP code 85260

The Sunbelt Affordability Story Is Eroding; Cause For Optimism In Chicagos Of The World

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**AVERAGE MONTHLY HOME PAYMENT
NAPERVILLE, IL VERSUS NAPLES, FL 2000-2023 (NOV)**



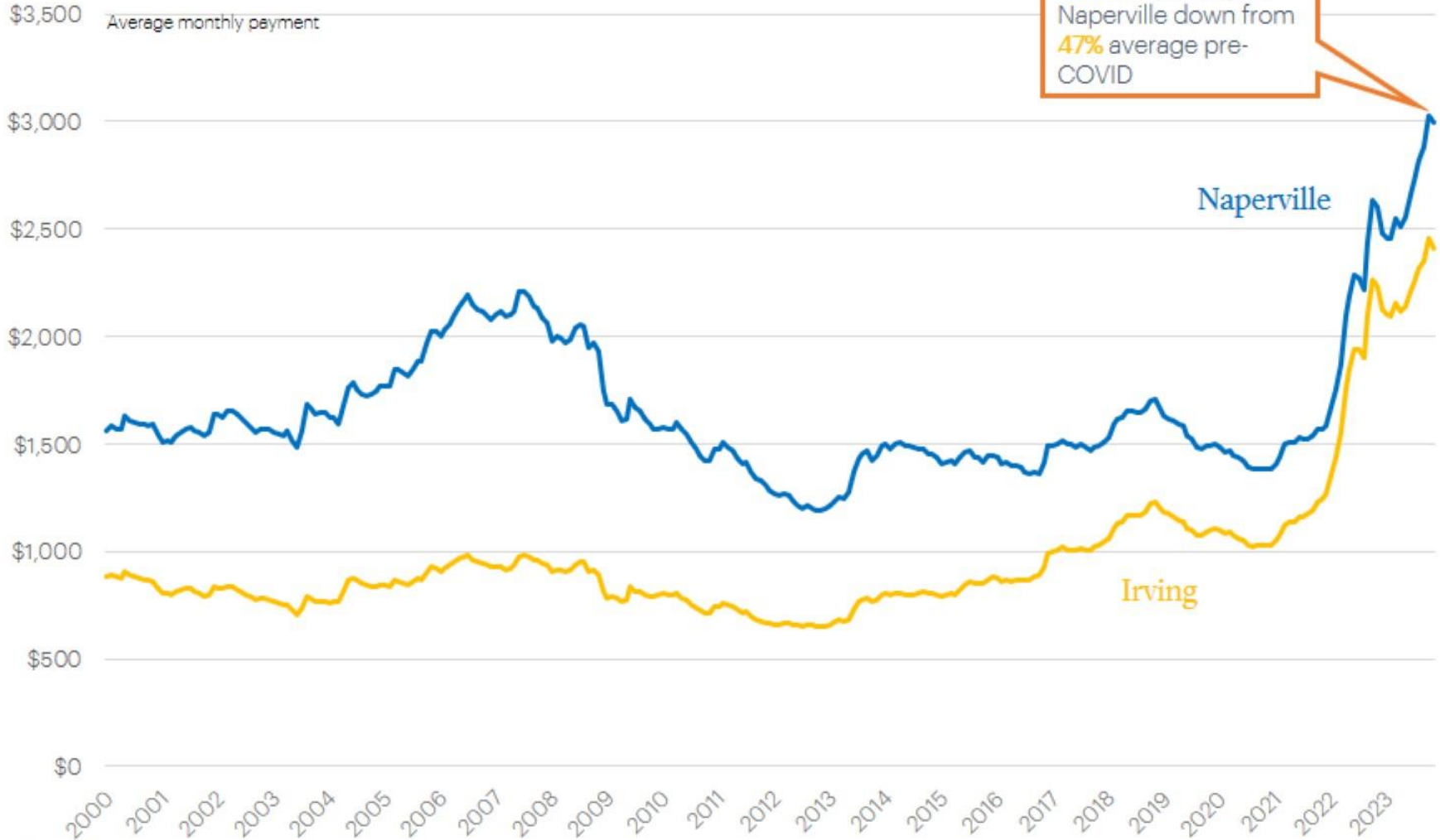
Source: Zillow

Note: 20% down, 30-year fixed-rate mortgage; Naperville ZIP code 60540; Naples ZIP code 34102

The Sunbelt Affordability Story Is Eroding; Cause For Optimism In Chicagos Of The World

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**AVERAGE MONTHLY HOME PAYMENT
NAPERVILLE, IL VERSUS IRVING, TX 2000-2023 (NOV)**

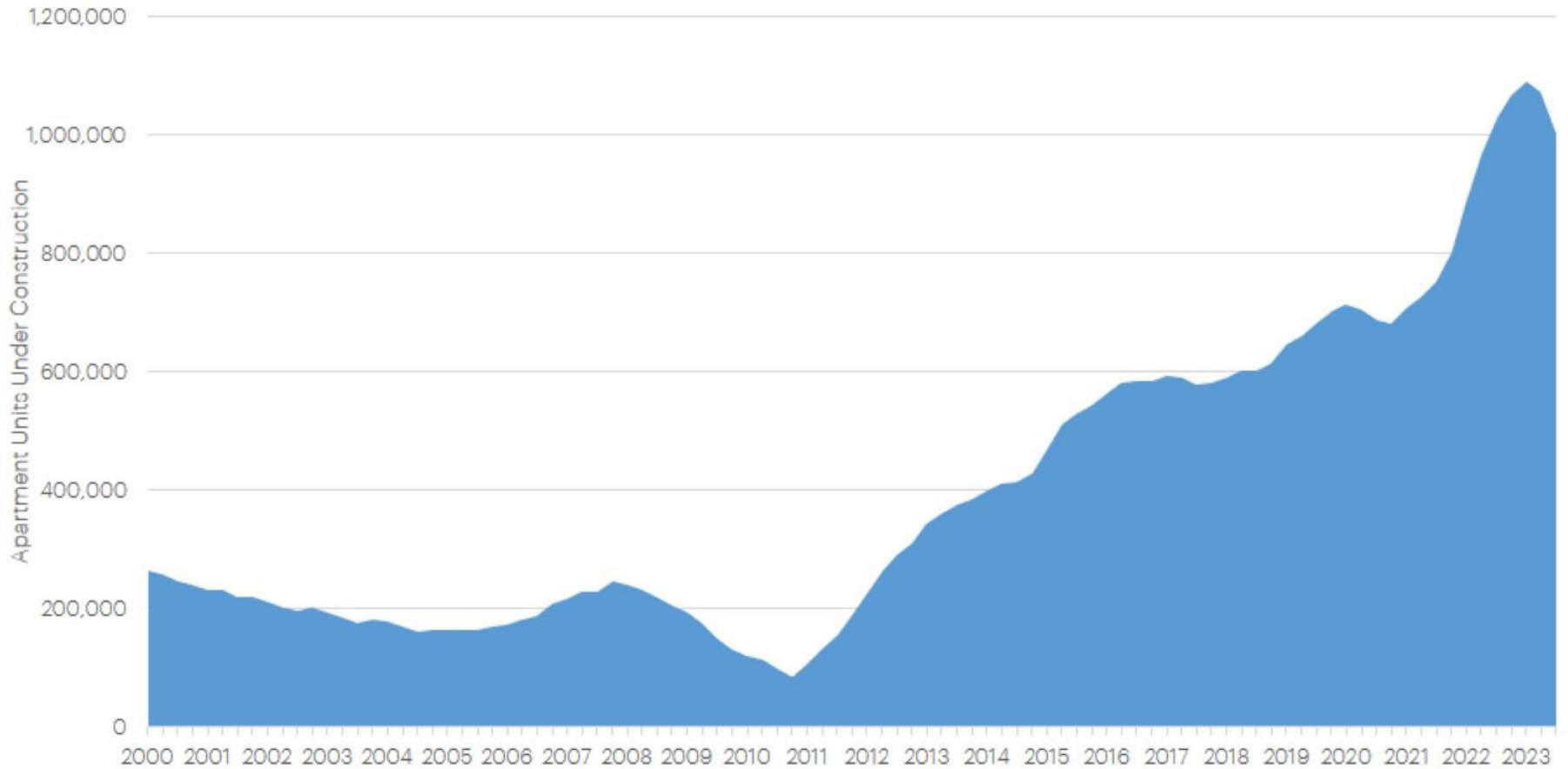


Source: Zillow

Note: 20% down, 30-year fixed-rate mortgage; Naperville ZIP code 60540; Irving ZIP code 75038

Units Under Construction At A Record 1 Million

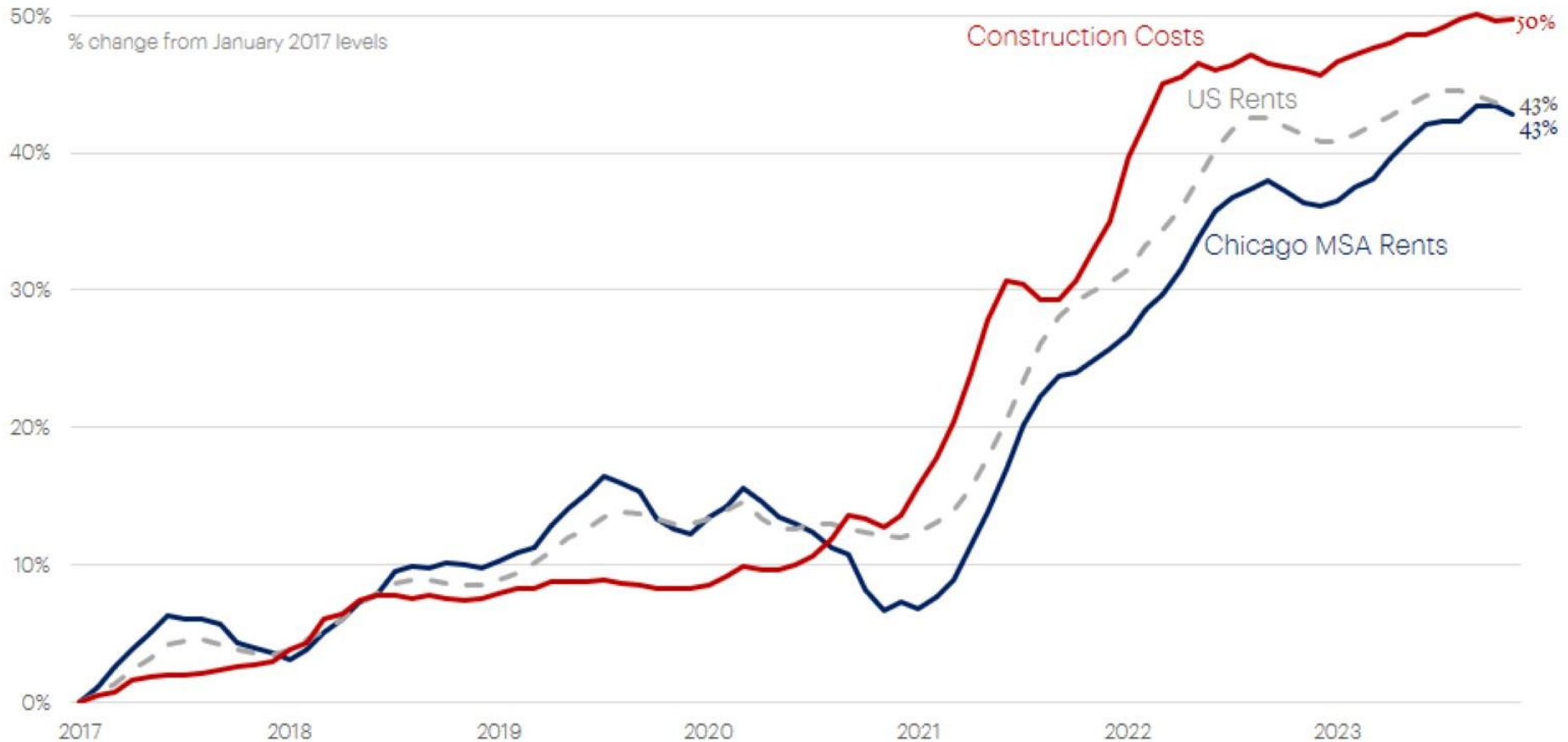
**APARTMENTS UNDER CONSTRUCTION
UNITED STATES 2000-2023 (Q3)**



Source: RealPage

Construction Cost Increases Outpace Rents, Complicating Development Models

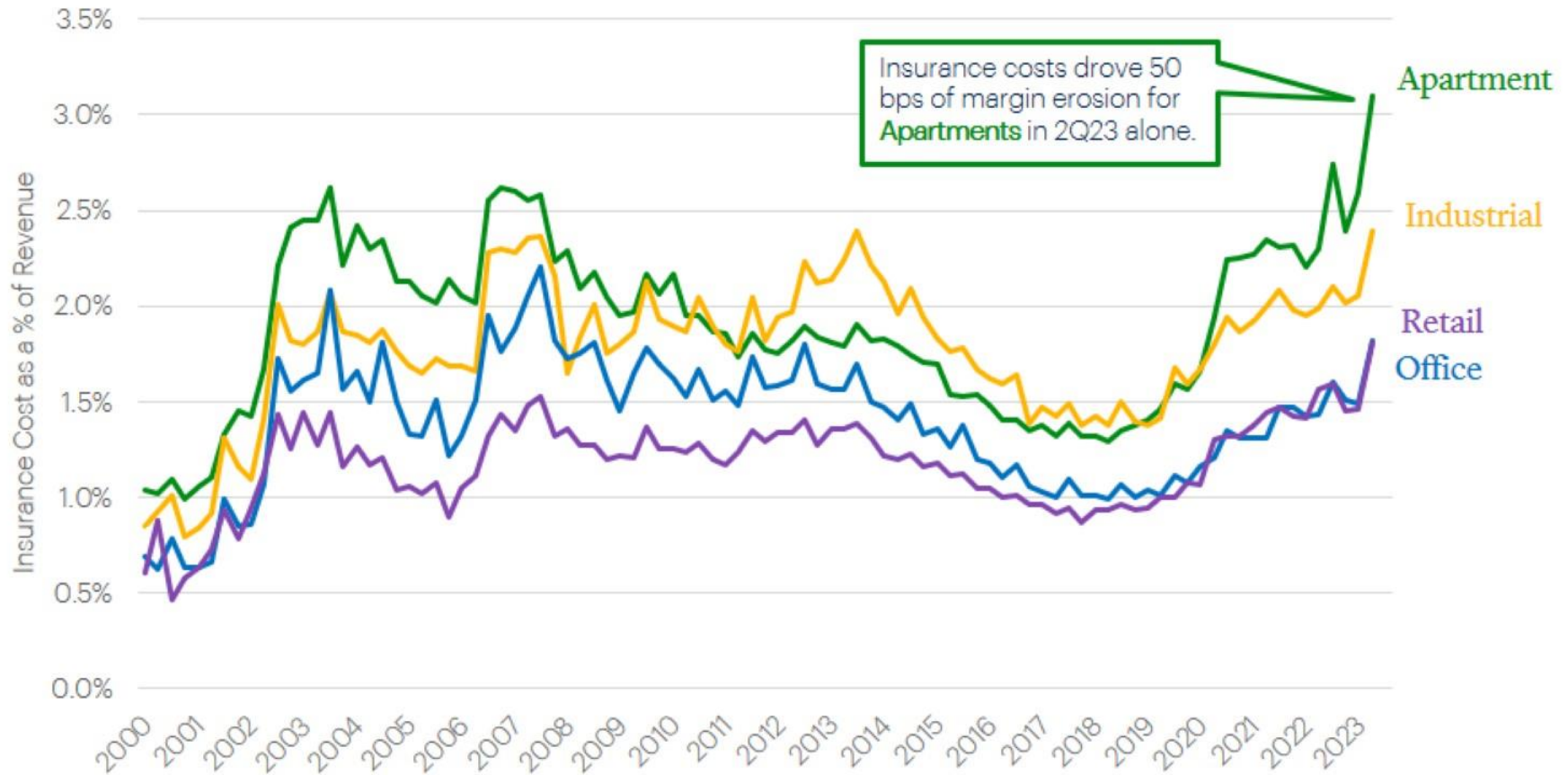
**APARTMENT RENT AND CONSTRUCTION COST GROWTH
CHICAGO, IL MSA AND US 2017-2023 (NOV)**



Sources: ReelPage; U.S. Bureau of Labor Statistics, Producer Price Index by Commodity: Inputs to Industries: Net Inputs to Multifamily Residential Construction, Excluding Capital Investment, Labor, and Imports

Insurance The New Underwriting Boogeyman

**NCREIF PROPERTY INDEX INSURANCE EXPENSES AS A SHARE OF PROPERTY REVENUE BY SECTOR
US, 2000 - 2023 Q2**



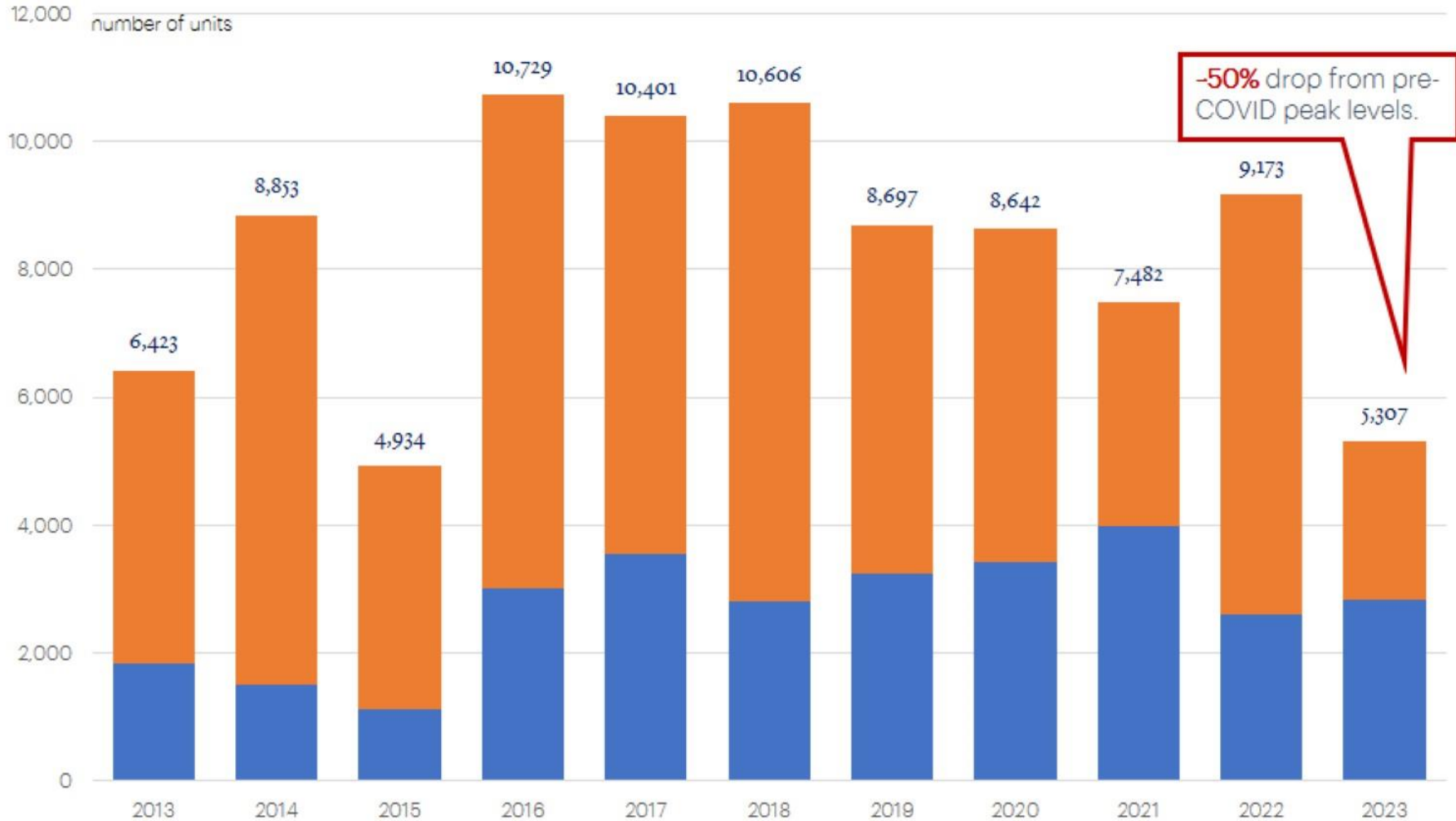
Underlying Data Source: NCREIF NPI database, accessed 2023 Q3

Chicago Apartment Construction On The Wane

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APARTMENT STARTS - ALL TYPES
CHICAGO, IL MSA URBAN VS SUBURBAN 2013-2023

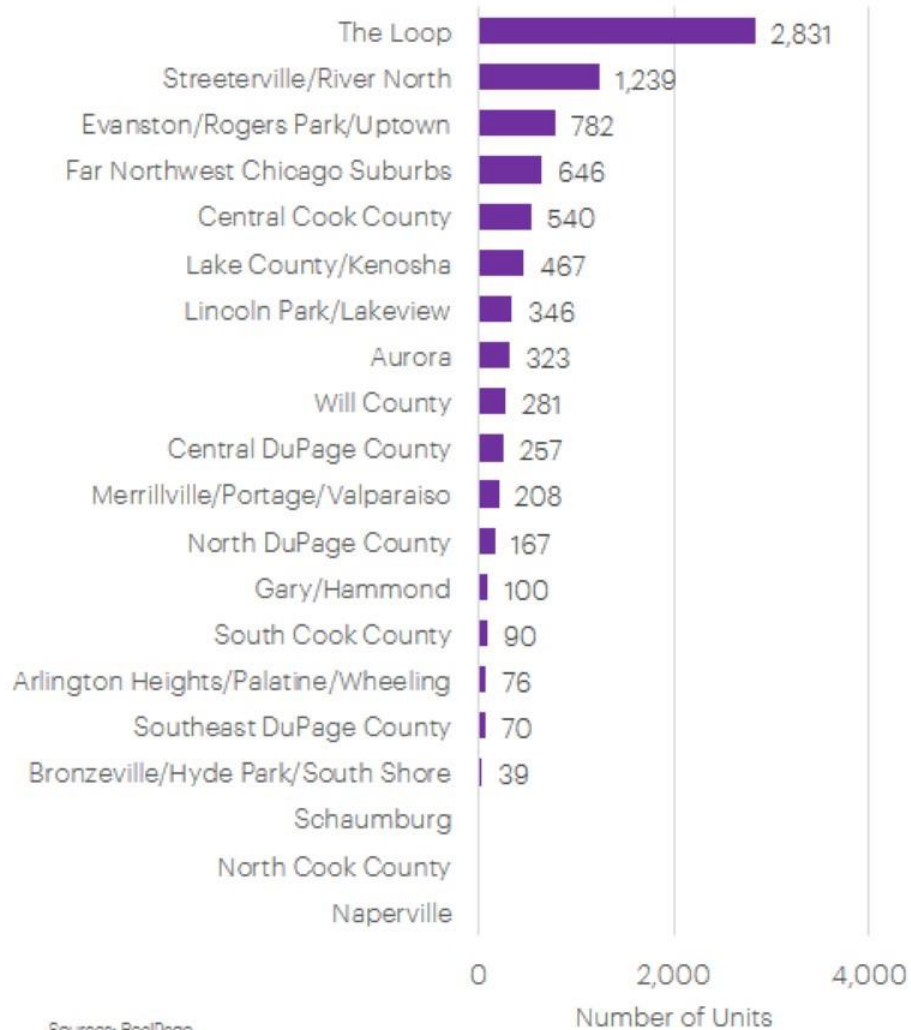
Chicago - Suburban Chicago - Urban



Sources: Yardi Matrix

Chicagoland's 2024 Apartment Deliveries Will Remain Concentrated In The City

PROJECTED APARTMENT DELIVERIES BY SUBMARKET CHICAGO, IL MSA 2024



Sources: RealPage



Springs of St. Charles; St. Charles, IL; Continental Properties

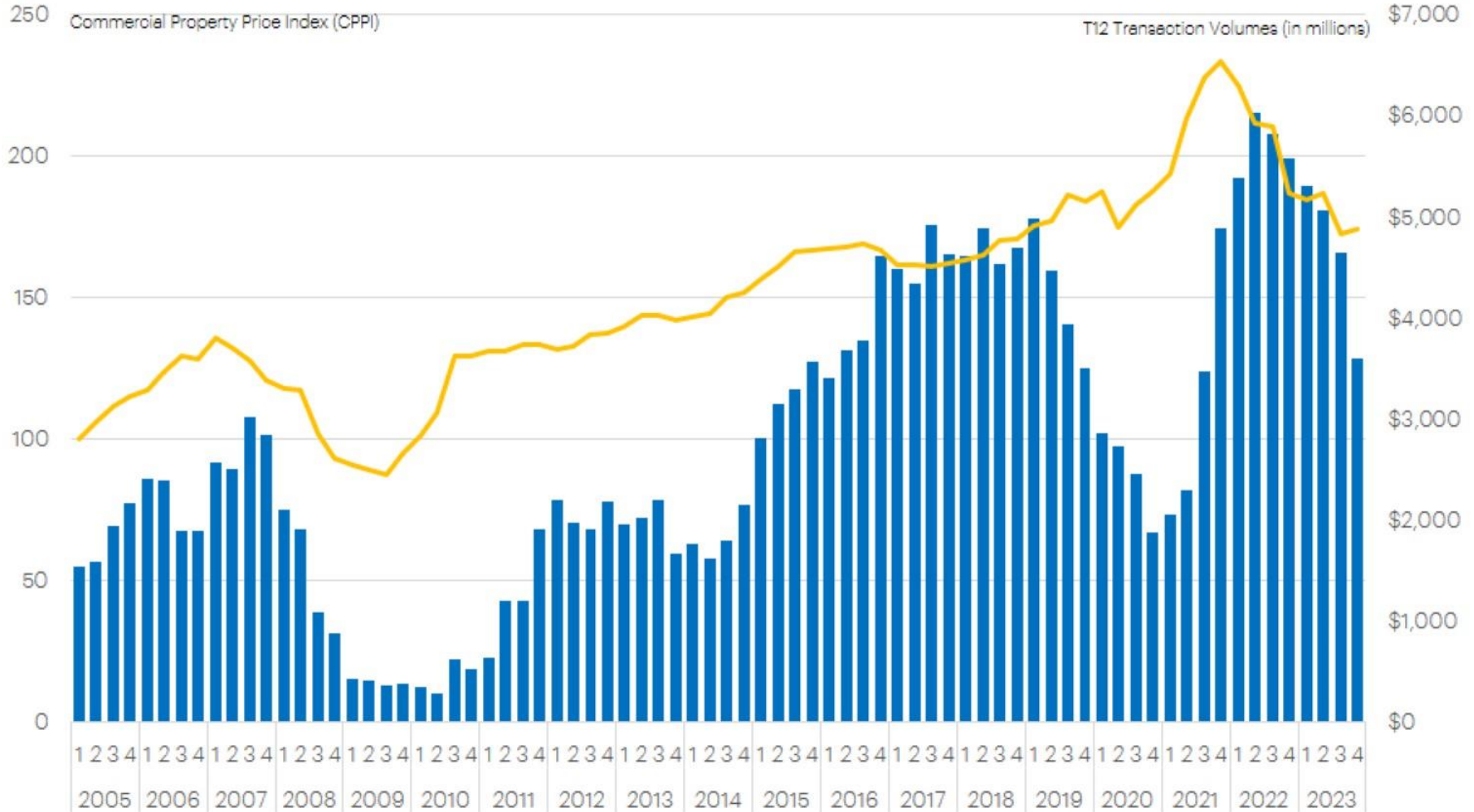


Porter; Oak Park, IL; Focus Development

Chicago Apartment Values Back In-Line With Pre-Pandemic Levels

**APARTMENT TRANSACTION VOLUME (TRAILING 12-MONTH TOTAL) AND VALUES
CHICAGO, IL MSA 2005-2023**

Transaction Volume (R) CPPI (L)



Sources: MSCI Real Capital Analytics; Green Street Advisors

Think Globally, Act Locally; Housing Policy Considerations For Local Govt

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Armchair urban planning; thoughts from a humble real estate researcher

- **Clearer, cleaner zoning rules:** more apartment development allowed as of right, less requirement for zoning variances and the lengthy (and uncertain) process that entails
- **Flexibility and openness** to multifamily housing of all types (e.g., for-sale and for-rent, high-density, senior, manufactured housing, market rate, and affordable)
- **Rethink the single-family only neighborhood.** Accessory Dwelling Units (ADUs), duplexes, and three-flats won't move needle significantly but a great part of a multi-pronged approach
- Waive/adjust **parking minimums** where appropriate
- Adjust **impact fees** from percentage of project cost to more
- **Property tax abatement** in exchange for affordable unit set aside



Secular tailwinds driving demand, from users and investors

Counter-cyclical, recession-resistant asset class; portfolio stabilizer

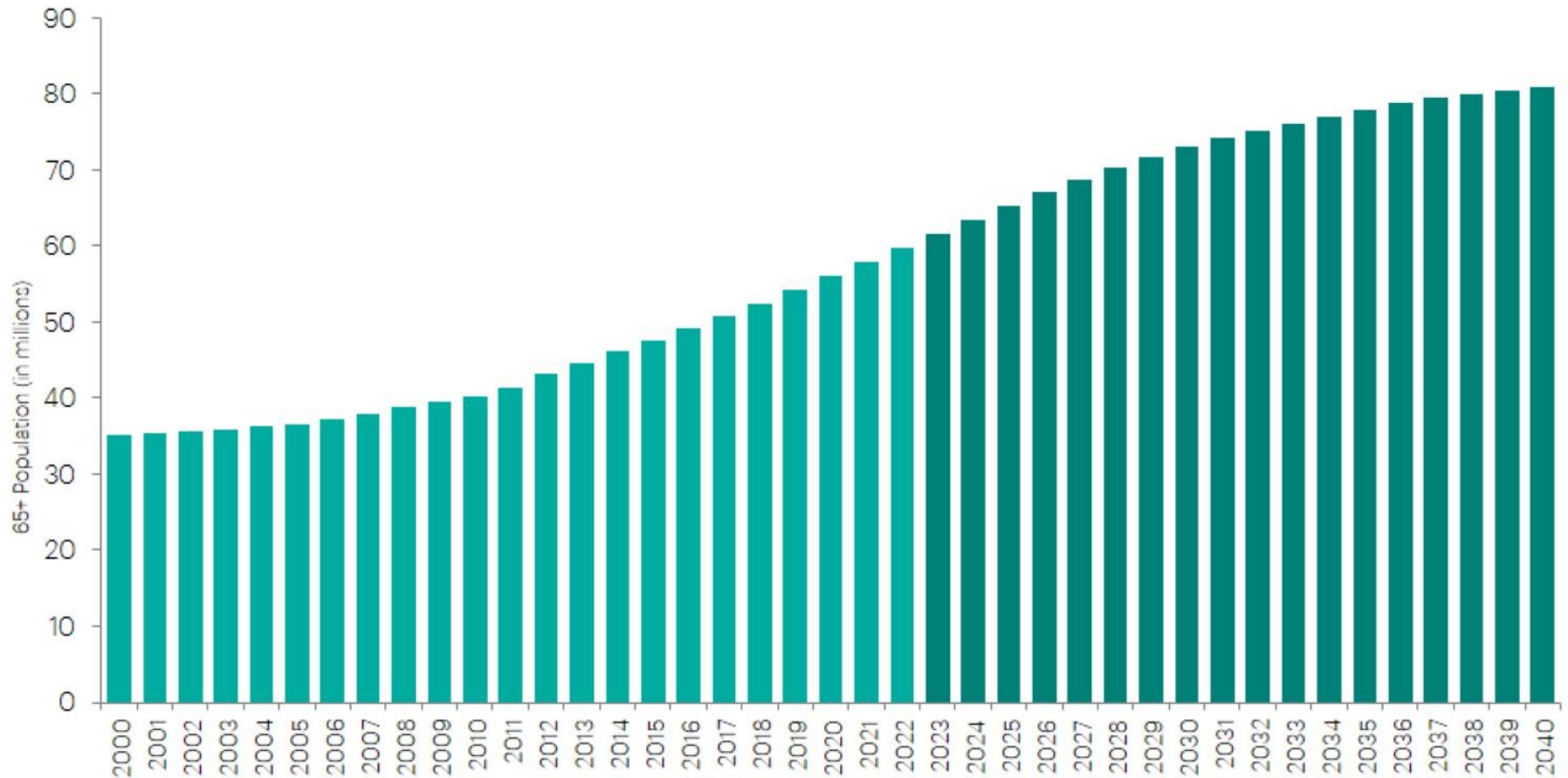
Retailization, med-tail, and the “billboard effect;” clinics in communities

Investors looking beyond the MOB; new sub-sectors coming into focus

Flexibility and creativity (again!) for convenient, cost-effective sites of care

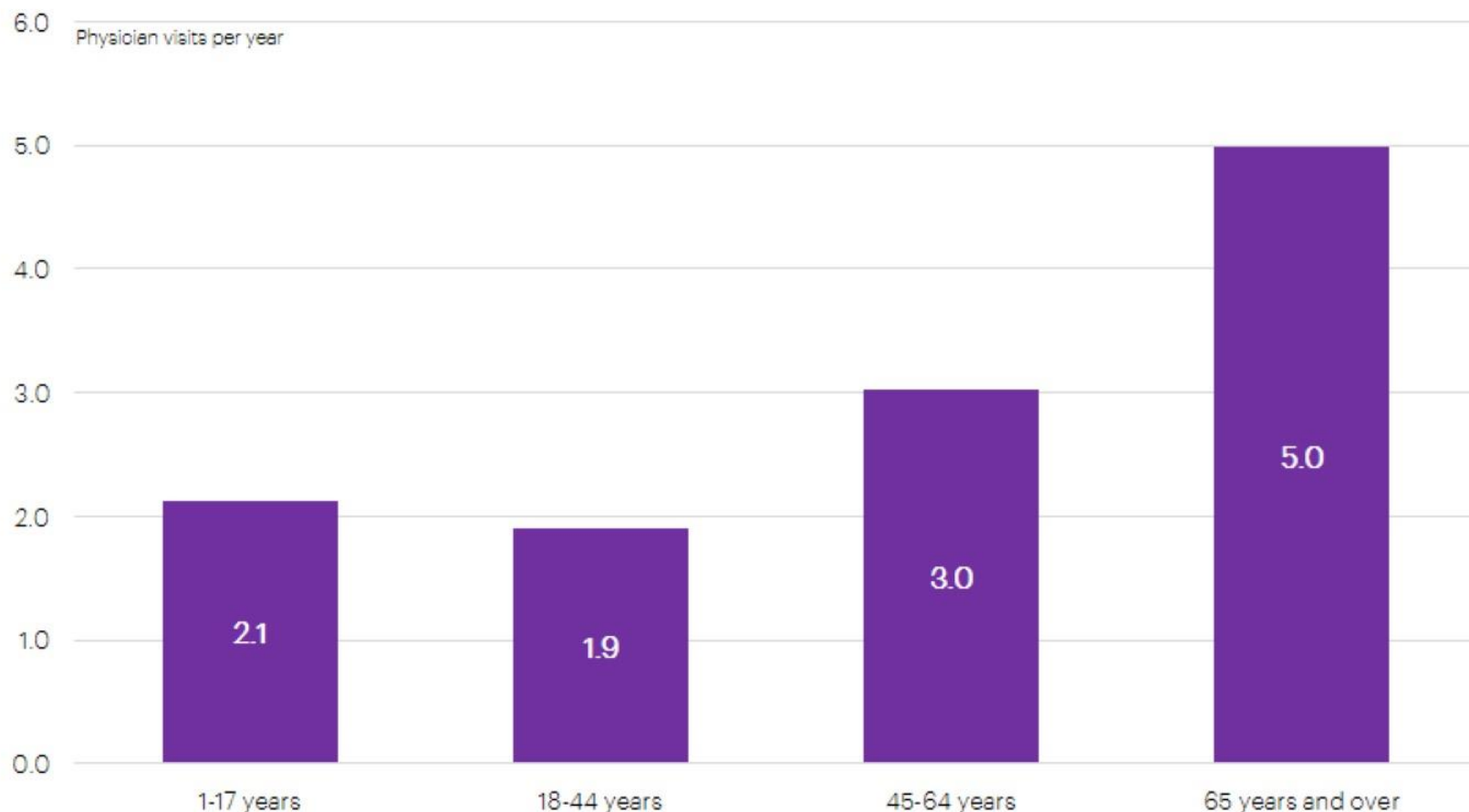
Driver #1: The Vaunted Silver Tsunami

POPULATION OF 65+ COHORT, US 2000-2040



Source: US Census Bureau

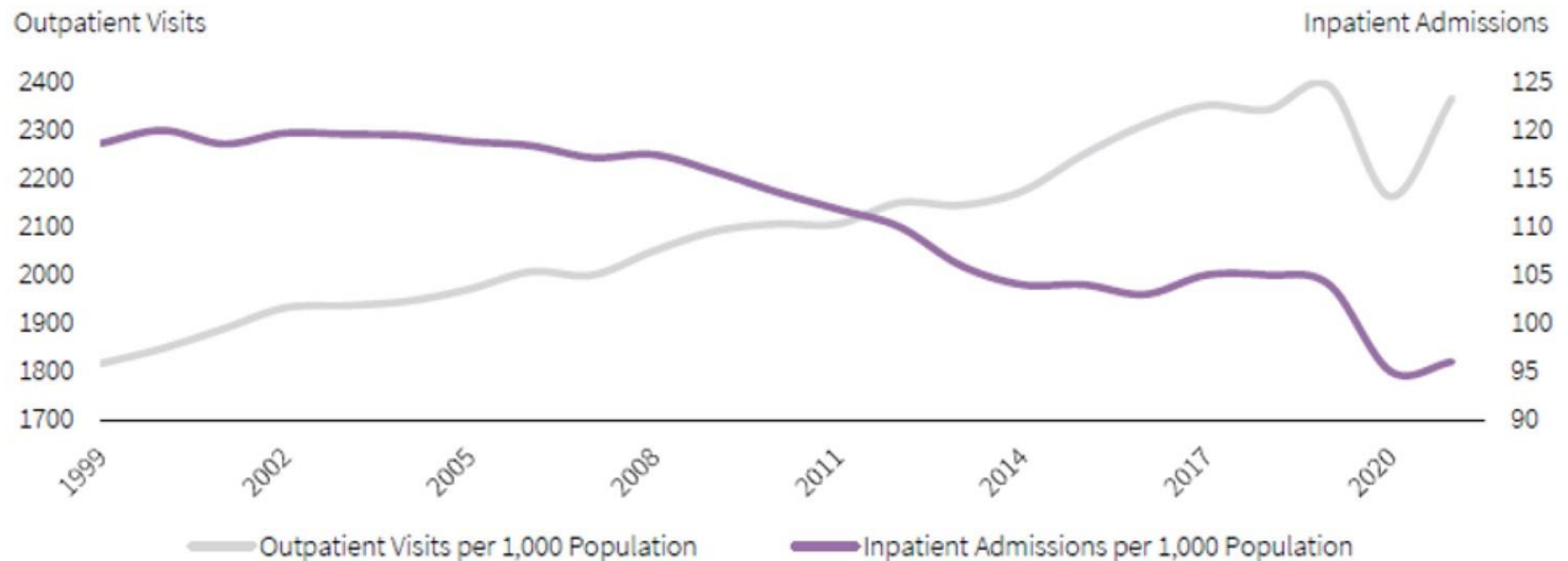
**NUMBER OF PHYSICIAN OFFICE VISITS BY AGE COHORT, PER PERSON, PER YEAR
US 2021**



Source: Centers for Disease Control and Prevention

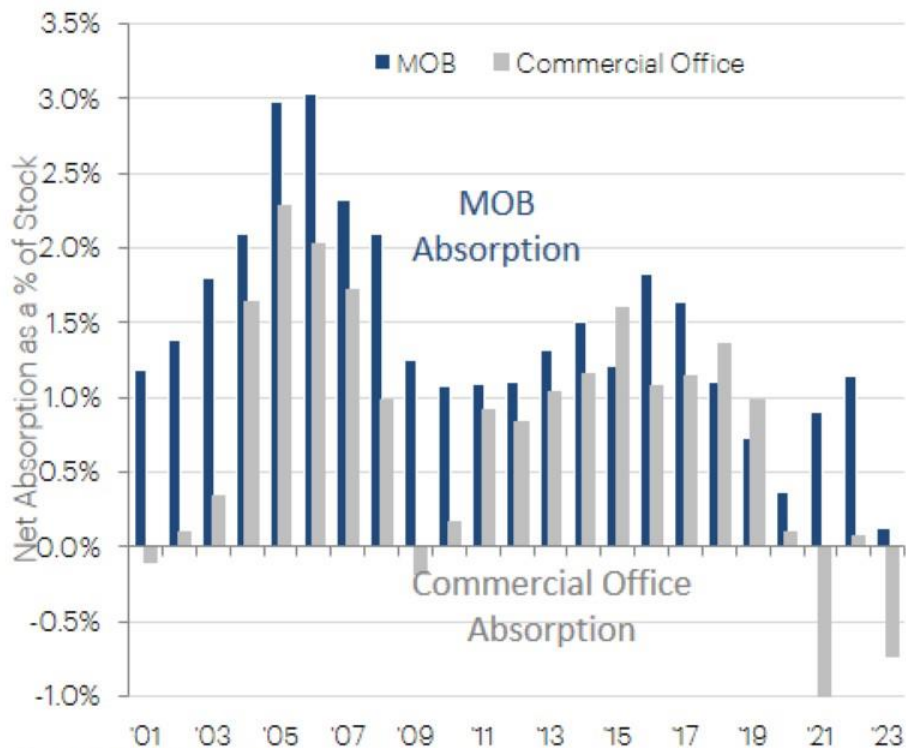
Outpatient sites dominate healthcare service delivery

U.S. outpatient visits vs. hospital admissions



Source: Kaiser Family Foundation, Advisory Board

**NET ABSORPTION AS A % OF STOCK
US, 2000 – 2023, YEARS ENDING Q3**



Source: CoStar Database

**VACANCY RATES
US, 2000 – 2023, YEARS ENDING Q3**



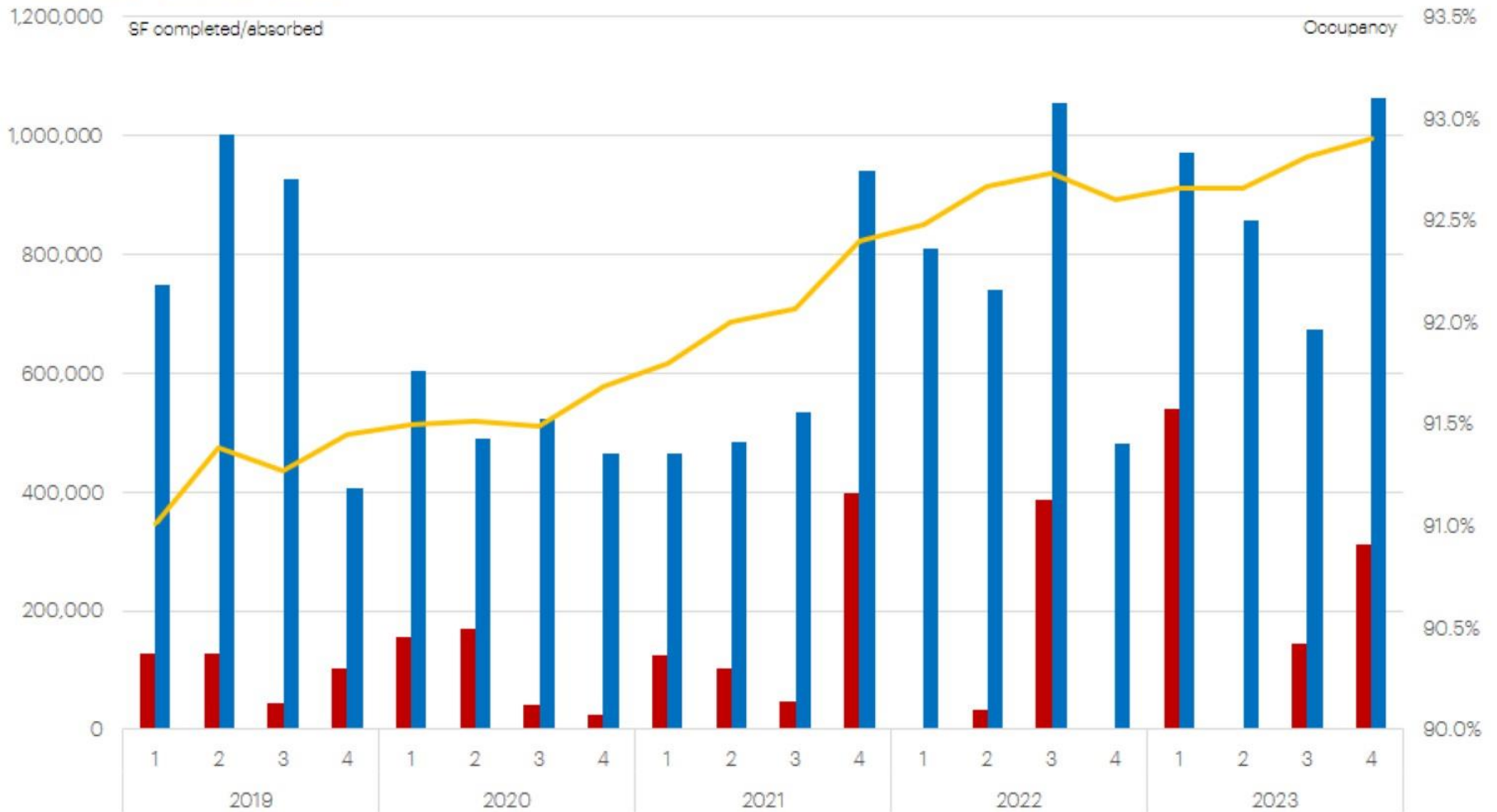
Source: CoStar Database

A Healthy, Dynamic MOB Market In Chicago

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**MEDICAL OFFICE COMPLETIONS, NET ABSORPTION, AND OCCUPANCY
CHICAGO, IL MSA 2019-2023**

■ Completions (L) ■ Absorption (L) — Occupancy (R)

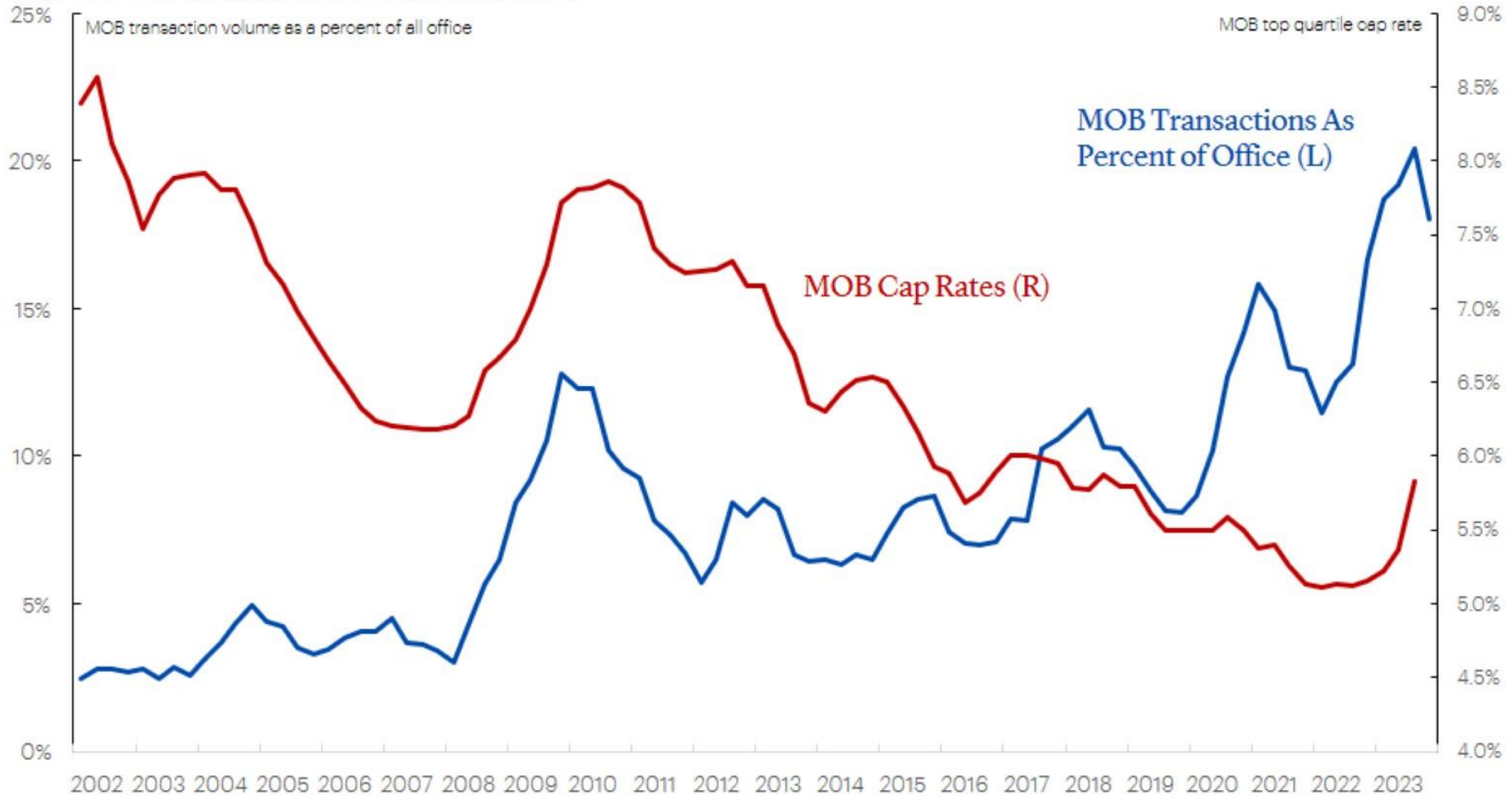


Source: Revista

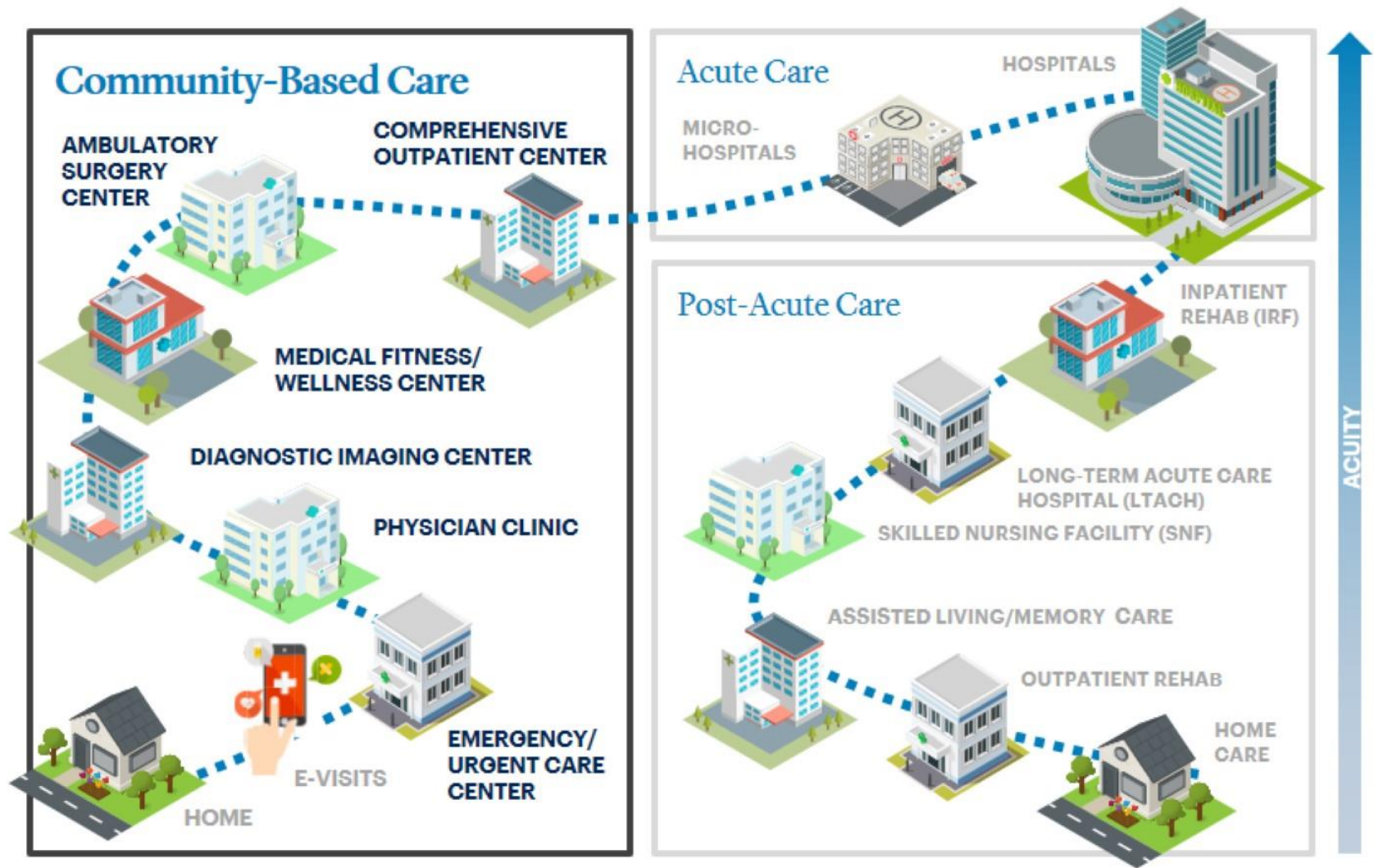
Steady, De-Linked Sector = Investor Darling

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**MEDICAL OFFICE TRANSACTION VOLUME AS A PERCENTAGE OF TOTAL OFFICE VOLUME
US, 2001-2023 (Q3), ROLLING 4-QUARTER AVERAGE**

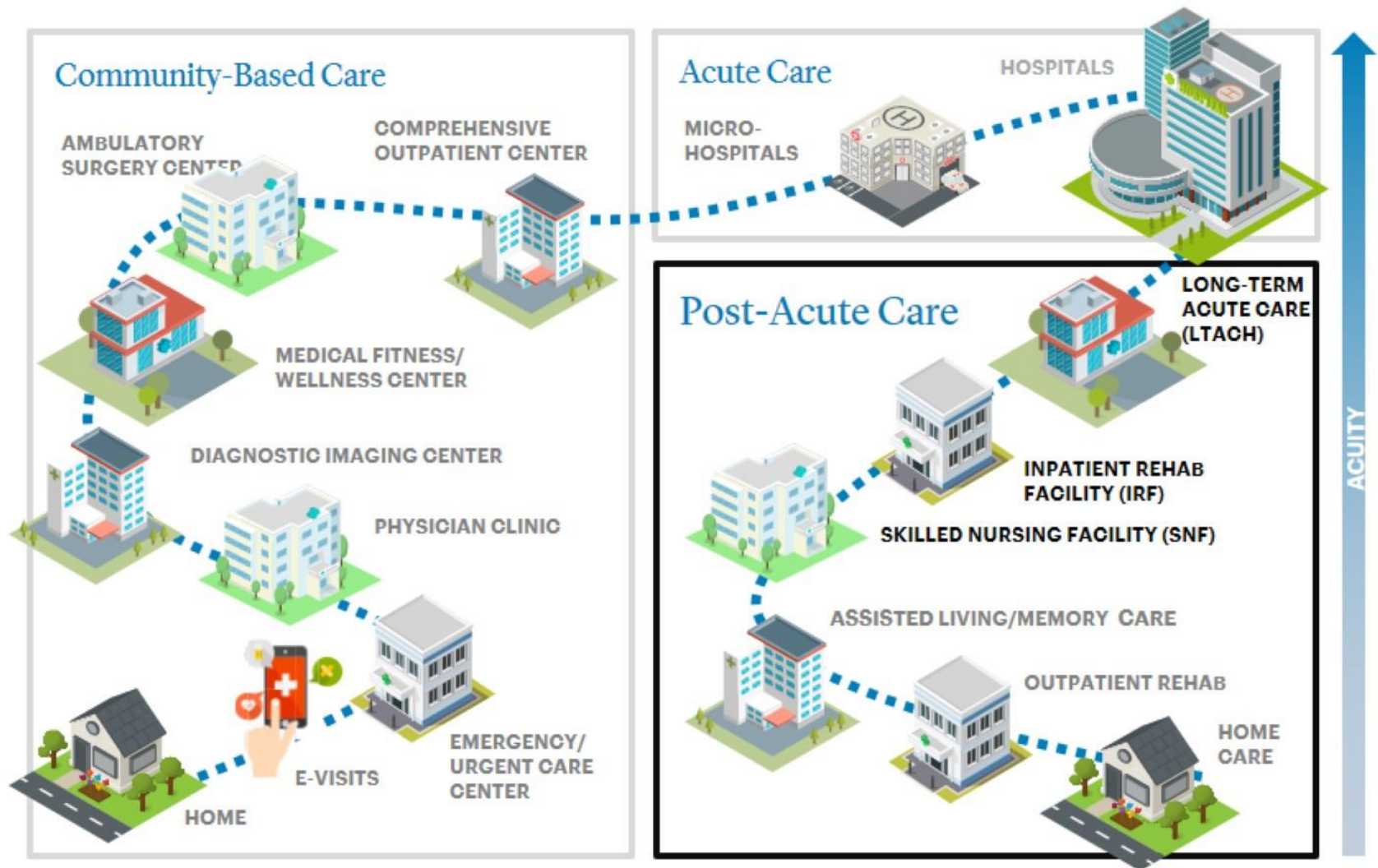


Source: MSCI Real Capital Analytics



Section Title

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Section Title

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MEDTAIL: WHEN HEALTHCARE MEETS RETAIL

Barrie Scardina • 12/8/2022



The rise of 'medtail': Why health care providers are moving into retail spaces



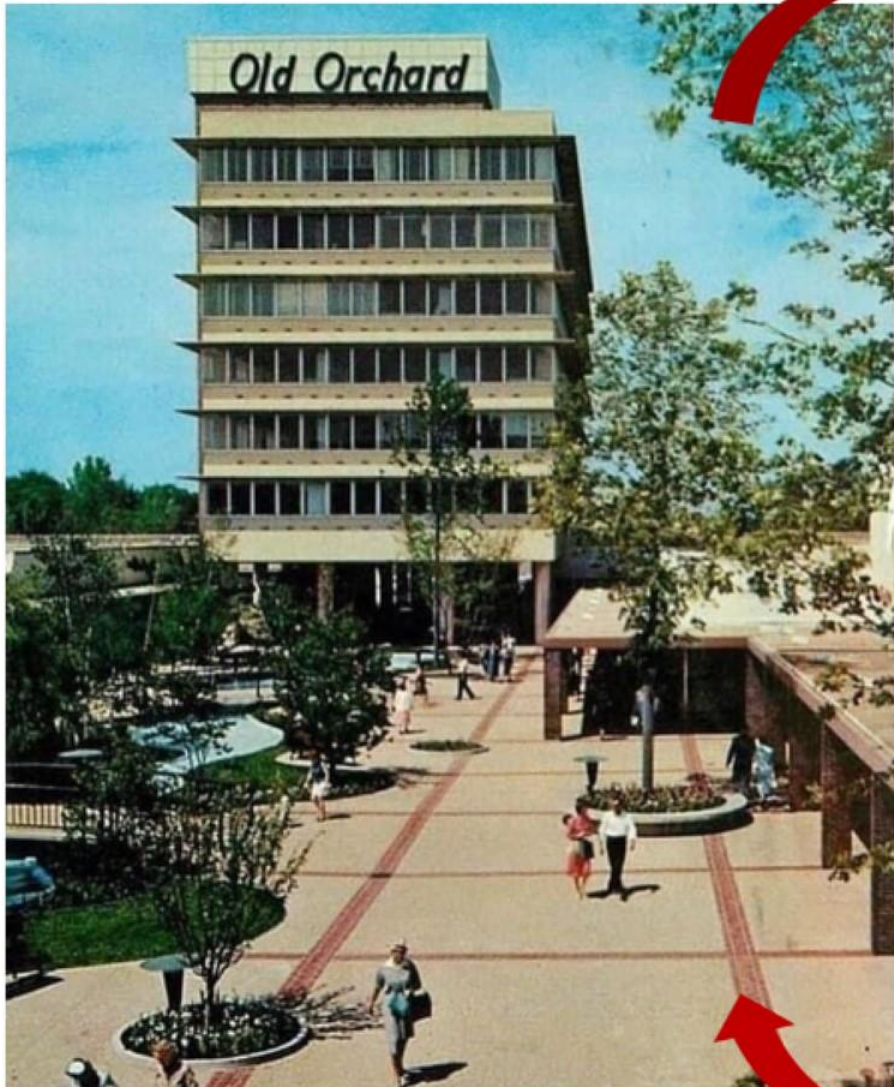
Med-Tail: Retail Sites Offer Opportunities for Healthcare



THE FUTURE OF MEDTAIL

“Retailization” And “Med-tail” Isn’t New!

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But Interesting Adaptive Reuse Projects Are

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Innovations With Modular Construction Can Aid In Efficient Reuse of Buildings

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