LIGHTBOX INVESTOR SENTIMENT REPORT

2021 OUTLOOK

LIGHTBOX

www.lightboxre.com

About LightBox Market Intelligence

LightBox creates and distributes Investor Sentiment Reports and other types of market intelligence as part of our deep commitment to clients' success. This research is based on our own internal analytics, as well as regular surveys and interviews with leading industry professionals to understand trends in the current commercial real estate market. We will continue to report on market developments that impact our clients' business and CRE analytics from across LightBox in our efforts to assist clients with their business planning and forecasting. Questions on this report, suggestions for future topics or requests for more information can be directed to: **LightBox Principal Analyst Dianne Crocker at dcrocker@lightboxre.com.**

Modest Optimism Amid Significant Areas of Uncertainty

Now that we are approaching the end of Q1'21 with a truly unusual year in the rear-view mirror, there are slow and steady improvements taking root. As the fog begins to lift on the commercial real estate industry's path to recovery post-pandemic, LightBox's outreach to investors, brokers, lenders and due diligence professionals reflects a mix of growing optimism and concern about the stresses on commercial real estate wrought by the health crisis and prolonged business shutdowns. Based on interviews with commercial real estate professionals conducted for this report, the immediate and severe impacts of COVID-19 in the second quarter of 2020 were followed by slow, steady improvements in the third and fourth quarters that have continued into early 2021. The near-term forecast is clouded by several significant areas of uncertainty; namely the effectiveness of the new government stimulus package, and the unknown timing of widespread vaccine distribution.

Based on those surveyed and interviewed for this report, the industry is looking ahead to unique challenges and opportunities, buoyed by such positive factors as widespread availability of debt and equity capital and strong property fundamentals in certain asset classes and metros. Commercial real estate professionals expect to see a gradual, continued improvement in the market over 2021 as vaccine distribution expands to more segments of the population and the economy returns to full operation in the latter half of the year.

"There is a unique sense of energy in the marketplace as deal flow improves and many investors and brokers focus on repositioning assets and companies for growth in 2021. There's an incredible amount of equity stocked up and ready to be deployed at the right time yet the unknown impact of distressed assets looms large. There is renewed confidence due to the vaccine distribution but also many questions about the effectiveness against the various strains of the virus and what that will ultimately mean for opening up businesses and fueling additional investment momentum."

Tina Lichens, Senior Vice President, Broker Operations, LightBox

Key Findings of the LightBox Investor Sentiment Report 2021 Outlook

- Most-favored asset classes remain industrial and multifamily given the strong reliance on e-commerce during the pandemic and the continuing housing shortage.
- The LightBox Market Confidence Index reflects significant improvement since 2Q'20.
- "Compassionate capitalism" held typical levels of distress at bay that will likely begin to surface this year.
- There is no shortage of capital, particularly from opportunistic investors, waiting to chase property investment as the market recovery takes hold.
- Continuing COVID-19 infections, uncertainty of the timing of herd immunity cloud the forecast.
- Adaptive reuse will be a strong long-term trend in the wake of the pandemic.
- Investors and brokers expect the 2nd half of 2021 to be busier than the first.
- Lenders, coming off PPP-focused work, are ramping up originations but through a new lens and tighter underwriting that focuses on the impacts of the pandemic on property values.

Modest Optimism for 2021...*(cont'd)*

At the mid-point of Q1 2021, investors were actively pursuing new property acquisitions but with concerns and uncertainty about the long-standing impacts the pandemic-led shutdown could have on occupancies, valuations and the overall economy. Much will depend on what federal stimulus packages are approved - and when and at what level of funding.

"In the third and fourth quarters of 2020, the market stabilized somewhat, but is still way off. There are so many aspects of commercial real estate that are not good." Jay Olshonsky, President & CEO, NAI Global.

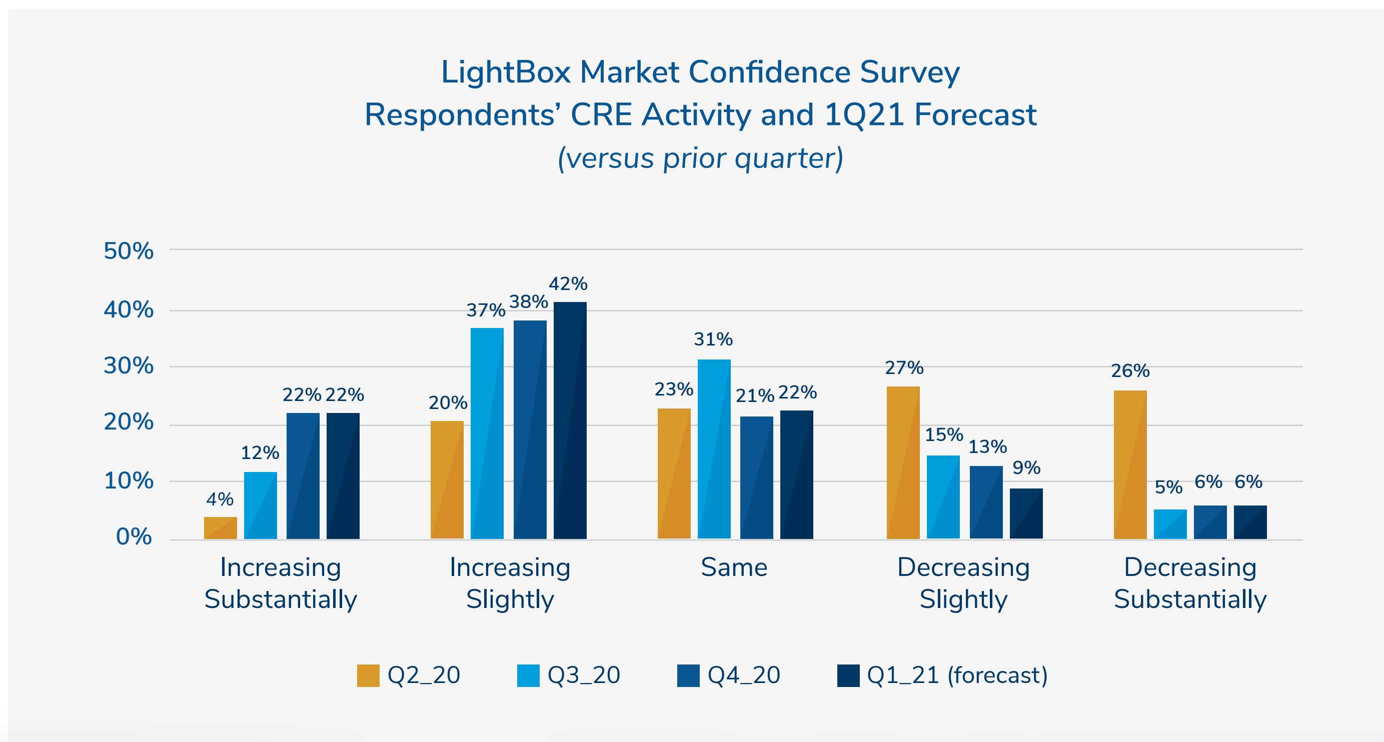
"What we have in this recession that we haven't traditionally seen in previous ones is a significant amount of capital - both equity and debt. This means that good assets, no matter what they are, can sell today. A seller could have a well-performing hotel and, though hospitality is the worst-performing class, it would probably sell."

David Schwartz
CEO and Chairman, Waterton

Market Confidence Rose to its Highest Point in Pandemic

Interviews conducted for this report mirror the results of the latest LightBox Market Confidence Index, which is based on a broad-based survey of nearly 500 commercial real estate professionals across the U.S. A solid 60% of respondents reported a "slight" or "substantial" increase in their own organization's commercial real estate activity, up from 49% in the previous quarter and only 24% at the start of the pandemic in the second quarter.

There is a growing sense from respondents that the market turned a corner in late summer as property listings increased and motivated investors moved ahead with deals. The deployment of multiple vaccines points to light at the end of the tunnel, but the recovery trajectory is decidedly uncertain. It is worth noting that, despite the unknowns, when asked to forecast what they expect in the new year, 22% expect to see their activity increasing substantially, a more significant 42% expect a slight increase over 4th quarter activity, and only 15% expect a decline.



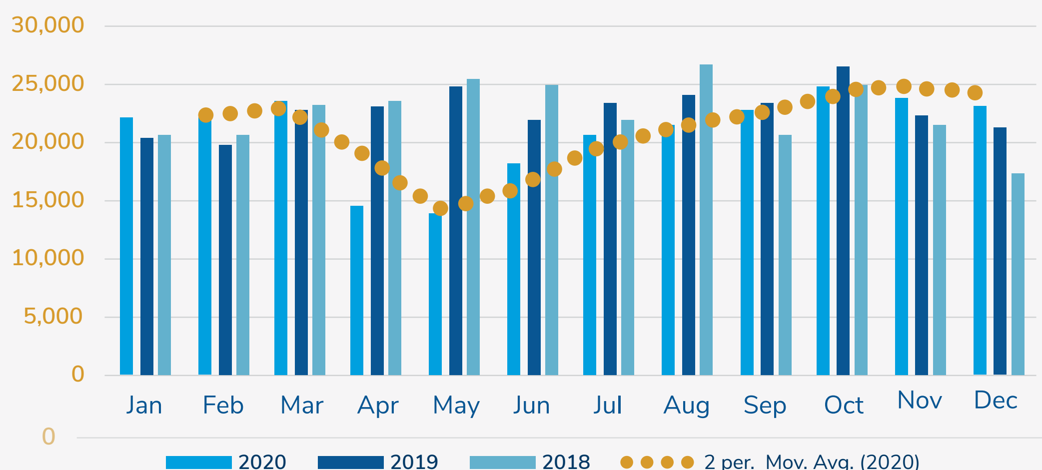
LightBox Market Monitor: Rebound in Listings and Due Diligence Underway

The pandemic's impacts were abruptly felt across the commercial real estate sector in April and May—from listings activity to due diligence to deal closings. LightBox tracks two commercial real estate market indicators that point to the third quarter as a turning point in the market's recovery.

Trends in commercial property listings by brokers and investors using the LightBox RCM platform to buy and sell commercial real estate tell an interesting story about the recovery taking root. After bottoming out in April, the volume of property listings began a steady rebound trajectory in May that continued through year-end.

"The number of offerings we launched in September and October were down only 8 to 10% below 2019 levels. The pent-up demand to bring deals to market that were put on hold back in April and May surfaced and while we saw the expected surge, it didn't pull back and continued through November." Brian McAuliffe, President of Capital Markets/Multifamily, CBRE.

The LightBox ScoreKeeper model tracks trends in the volume of environmental due diligence, another leading indicator of where commercial real estate investment activity is ramping up. Phase I environmental site assessment activity over the past year illustrates just how far the market has come. Shelter-in-place directives in April and May triggered dramatic 30-40% drops in ESA activity that erased the growth of a relatively strong first quarter. Since then, each month has been another step closer to normal. By September, the market was performing at monthly levels more consistent with the early months of 2020, and by November and December, 2020 volume was above the corresponding months of both 2019 and 2018.



"Compassionate Capitalism" Keeps Distress at Bay

One of the characteristics of this downturn thus far that has kept distress levels low is the willingness of lenders to meet borrowers halfway by exercising forbearance and extending or restructuring loans to offer relief to struggling borrowers.

> *"We're seeing only early signs of distress, but nothing really trading so far on the poorly-performing assets. The reason for that is we're dealing with a societal health crisis this time, so we saw **compassionate capitalism** from lenders giving leeway to borrowers and landlords providing latitude. At some point that ends, and we will start to see distress surfacing, but it could be a few years."*
>
> David Schwartz, CEO and Chairman, Waterton

The widespread regulatory changes enacted after the Great Financial Crisis left banks in a stronger position to protect themselves against losses, but given the long duration of the shutdown, a day of reckoning could be ahead. As forbearance periods expire and business closures continue to take a toll, it is likely that more landlords will struggle to make payments and lenders will be forced to make decisions about nonperforming assets. Recent high-profile foreclosure proceedings like Chicago's historic Palmer House Hilton made headlines. The moratoriums on foreclosures and evictions in several states including New York limit the options of lenders and landlords, but foreclosures are already rising in areas like the Southeast U.S. that do not have such protections in place.

Refis Boost 2020 Lending Activity, Modest Originations Forecast for 2021

Just one quarter after record-high commercial real estate lending in the fourth quarter of 2019, the onset of the pandemic triggered a widespread slowdown in originations. The market got a boost from robust refinancing activity that helped compensate for the slower pace of transactions. Lenders also channeled efforts into processing PPP loans from the first round of stimulus under the CARES Act. With the new stimulus about to unfold, lenders will pivot again to support the market's urgent need for relief through a second influx of PPP loans.

The latest data from the Mortgage Bankers Association reported that commercial and multifamily mortgage loan originations in 3Q'20 remained subdued and were 47% lower compared to the third quarter of 2019. It is worth noting that originations backed by industrial and multifamily properties saw smaller declines than other property types, supported by loans made for Fannie Mae, Freddie Mac and FHA. Notably, however, third quarter volume increased 12% above the second quarter, consistent with debt markets adjusting to market conditions and once again becoming active, with loan underwriting standards conservative to reflect the as yet unknown length of the pandemic.

Preliminary data from the MBA shows that commercial property lending in 2020 was 30 percent lower than in 2019, with all asset classes in decline. The most significant impacts were in the hard-hit hotel and retail sectors, down by 77 percent and 69 percent, respectively. Although 4Q'20 originations were 18 percent lower than a year earlier, volumes were up significantly from a very low 3Q'20, which could signal a return to stronger lending in 2021.

Given the uncertainty over rent payments and the unknown impact of the pandemic on property valuations, banks are being more selective about originations on properties perceived as high-risk, like hospitality, retail and office, with a stronger preference for the relative safety of multifamily and industrial property loans. The MBA is forecasting an 11% increase in commercial and multifamily lending in 2021 to $486 billion, but with significant variation by asset class and location.

"The lenders I'm talking to have production targets they're trying to meet. This means they're first trying to replace any loans that are rolling off, and then they're focusing on trying to grow their portfolios overall."

Tom Fink

Managing Director, Trepp, LLC

Ramping Up Risk Management in the Face of Uncertainty

Though debt is available, the economic disruption is dictating stricter underwriting, higher costs of capital and selectivity about financing assets in hard-hit categories. As fears of potential bankruptcies and loan defaults intensify, risk managers are shifting their focus and implementing stricter underwriting.

"Regulators have been hands off during this recession and allowed banks to be accommodating. In anticipation of a day of reckoning as the true impacts of the pandemic surface, banks appear to be positioning for bulk distressed loan portfolio sales instead of re-establishing REO and workout teams." CCIM Institute's Chief Economist K.C. Conway.

Lenders are assessing each borrower's situation uniquely. Some borrowers would be struggling even in good times while others are temporarily struggling due to pandemic-driven changes in the market. In the end, lenders may need to foreclose on some properties or opt to sell off some nonperforming loans, while holding onto others whose borrowers are expected to recover post-pandemic.

The good news is that there is no shortage of debt capital in the market. Although lenders are more conservative, lending in the third and fourth quarters began a slow recovery from the second quarter decline. As lenders adjust their strategies, so too must borrowers to ensure that they are proactively preparing given the uncertainty in the forecast.

> "My advice to property owners and asset managers is: Don't borrow more than you need and borrow it for as long as you can get it. The last thing you need is a liquidity crunch where you need to refi but there's something going on that's going to stop you from doing that. If you're going to borrow money to invest in commercial real estate, you need to be an active manager of your debt the same way you manage your property. Stay in touch with your lenders, talk to them regularly and send them the financial reports they ask for so they know you're a good borrower."
>
> Tom Fink, Managing Director, Trepp LLC.

Strategies that lenders are adopting in 2021:

- Requiring borrowers to bring second sources of funds to the table in the case of future default.
- Scrutinizing assumptions about a property's operating expenses, tenants' ability-to-pay, vacancy rates and projections on rental rates and cash flow.
- Turning a critical eye to their loan portfolios to identify those most at-risk of default as they prepare for distress, dispositions and foreclosures.
- Staffing up experienced workout personnel.
- Paying more attention to environmental due diligence to avoid lending on a property with contamination in a market where valuations could fall.

A Market Bracing for “True” Distress

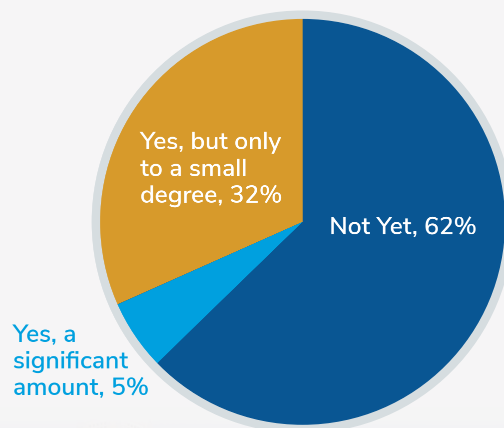
The rapid influx of record-high federal stimulus last spring, coupled with lenders’ forbearance efforts, delayed the typical distress that the market might have otherwise faced after months of sporadic lockdowns of varying degrees around the country. As the new year begins, the commercial real estate market is bracing for a wave of distressed assets as the impacts of the pandemic make it harder for tenants to make rent payments and borrowers to pay off their loans.

> “In terms of distress, we haven’t seen it yet in multifamily. The capital stack and ownership have been patient because they can still meet their debt obligations due to lessons learned in the Great Financial Crisis.”
>
> Brian McAuliffe, President of Capital Markets/Multifamily, CBRE

Asked whether they are seeing distressed assets hitting the market in their area, 62% of the nearly 500 respondents to the LightBox 4Q Market Confidence Index survey selected “not yet,” and another 32% are seeing distress but “only to a small degree.” Looking ahead, the volume of potential distress is not insignificant. Real Capital Analytics estimates that the sum of actual and potential distressed debt is close to $150 billion, or one-fourth of the average annual deal activity seen from 2015 to 2019.

Are You Seeing Distressed Assets Hitting the Market in Your Area?

(Source: LightBox Market 4Q Market Confidence Survey, 477 respondents)



Opportunistic Investors are Mobilizing

Last year gave rise to the industry's next great distressed cycle, although the contours of that process remain to be seen. One of the biggest unknowns as we head further into 2021 is the timeline for distressed assets to surface as willing buyers amass capital and wait for opportunities. For the majority of survey respondents, the expectation is that higher volumes of distressed properties will be put up for sale in the second quarter of 2021 (46% of respondents) while another 28% believe it will be sooner. Given the wide range of impacts and the variance by property type and geographic area, distressed situations will likely evolve slowly over the course of 2021 and into 2022.

Before then, the market will go through a "discovery phase" of determining just how deep the pandemic-driven property value declines will go. The highest levels of distress are expected in the hardest-hit hospitality and retail sectors. Early data show that the value of the collateral for CMBS has been written down by 27 percent on average based on the new appraisals done as loans move into special servicing. Hotel properties experienced the sharpest drop in value, followed by retail.

"What will likely emerge are two types of distress starting in the first quarter of 2021. One is what I'd call 'true distress' in retail and hospitality since they were the sectors most heavily impacted in terms of net operating income and rent collections. The second will be an effort by investment managers to rebalance their portfolios toward other sectors with a more stable profile. For instance, some may decide to sell still-decent malls, retail properties or hotels that aren't technically distressed, but are in a tough spot near-term. In urban centers like New York City & San Francisco, opportunistic investors will move in even if it's not at a steep discount just to get a foot into areas they couldn't previously afford."

Ben Breslau, Chief Research Officer, JLL

As the new round of federal stimulus makes its way into the market, the first quarters of 2021 will be very telling in terms of whether the volume of nonperforming loans increases significantly. When distressed opportunities present themselves, there will be no shortage of capital from investors waiting to buy at a discount.

Stark Differences by Asset Class

One of the defining elements of this downturn is the sharp differentiation of impact across major asset classes. At year-end, Real Capital Analytics reported that December's deal volume had nearly recovered, narrowing the gap between activity from the corresponding month of 2019 to only 7 percent. Final year-end data shows that transactions were down 32 percent across all property types. In terms of dollar volume, 2020 transactions were led by apartment deals ($139 billion), industrial ($99 billion) and office ($86 billion), while retail and hotel continued to lag.

"In multifamily, most of the trades are in the strong suburban Sunbelt markets and gateway urban markets where there's evidence of valuations at pre-COVID levels or even above. We're seeing very little price discovery on valuations in major gateway metros like New York City and Chicago to date," said David Schwartz, CEO and Chairman, Waterton.

Below the surface of these broader trends, however, lie important distinctions in sub-classes that are largely the result of the pandemic-accelerated trends that had already been years in the making. At the time of our last Sentiment Report in early 2020, market conditions were aligned to deliver another strong year. Now, commercial real estate is sorting through the disruptions, adjustments and protocols necessitated by the COVID-19 pandemic.

> "Although the rising rate of infections is concerning, the capital is still there and investors have long-term obligations and money they need to invest so, for them, it's a matter of looking for the right opportunities. Transactions are being done. Pricing still hasn't quite settled down. There's still a bid-ask spread when it comes to buying and selling properties, but I think that spread is compressing. If you're in the retail business, I think there's still a long way to go, and in the lodging sector, you have an even longer road back given the uncertainty of when business travel will return in any sizable amount."
>
> Tom Fink, Managing Director, Trepp, LLC

Essential E-Commerce Keeps Industrial in Top Spot

One of the most pronounced impacts of the COVID-19 pandemic was that it cemented industrial's status as most-favored asset class. Shelter-in-place guidance and closed non-essential stores intensified the growing reliance on e-commerce and at-home delivery. As a result, industrial currently has the strongest fundamentals and investor interest—in both transactions and new development—a trend that is not likely to abate anytime soon.

Essential E-Commerce (cont'd)

Prologis estimates that accelerated e-commerce adoption and higher inventory levels have the potential to generate 400 million square feet or more of additional demand for industrial space over the next two to three years. Demand is strong for infill warehouse space, especially in and around urban centers, like Denver, Dallas, Houston, Las Vegas and Phoenix. Investor attention is focused on property deals in logistics, last-mile distribution, data centers and cold storage as a substantial portion of grocery sales moved online, and now, more urgently, to meet the need to disseminate vaccines quickly. Given the shortage of attractive industrial properties to meet demand in some growth areas, developers are looking to repurpose retail space into industrial uses.

"Logistics companies and the industrial real estate sector generally outperformed the market in 2020. The pandemic has also brought supply-chain disruptions to the fore. A significant rethinking of just-in-time supply models is underway and real estate in port cities, regional distribution hubs and other e-commerce centers will be adapting in ways that are at variance—perhaps sharply so—from the trendlines describing the overall economy."

Hugh Kelly, PhD, Principal of Hugh Kelly Real Estate Economics

"Chips Will Fall" in Multifamily Sector

In terms of investor interest, behind industrial sits multifamily which has benefited from strong demand for space given the national housing shortage. Despite the overall strength of fundamentals, there are significant differences by metro and sub-asset class.

"Multifamily does well in growth markets and in the historically less volatile ones. While the Midwest is not considered a growth market as far as our transactions activity, properties in the region have performed extremely well due to the stability of the employment base and the economy, except for Chicago. Phoenix is the most active, desirable market in multifamily with values above pre-COVID levels. The Texas market and Southeast region have generally done well while the Northeast and West Coast regions are expected to struggle."

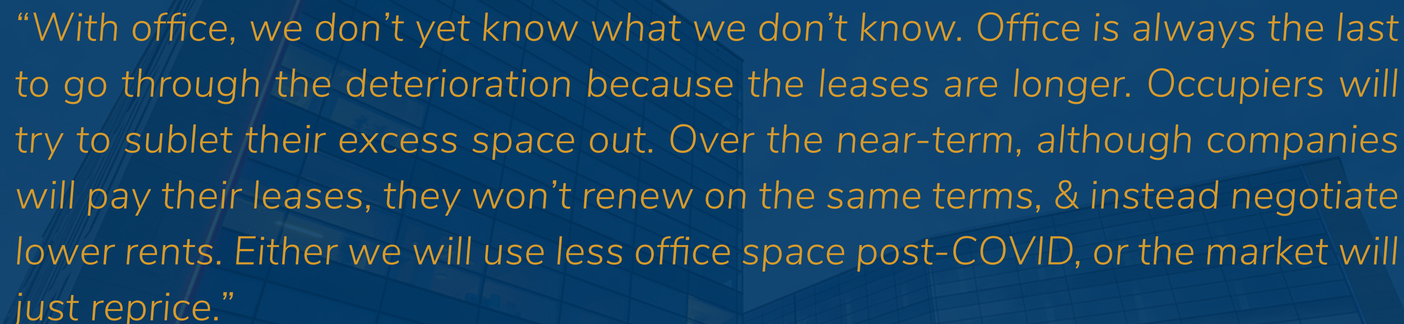
Brian McAuliffe, President of Capital Markets/Multifamily, CBRE

“Chips Will Fall” (cont’d)

Rent relief in the federal response to the pandemic helped this sector avoid the repercussions of rent nonpayment and tenant evictions, but the market is anticipating some fallout as the true impacts take shape in the coming quarters.

> “Multifamily is doing well so far, but the chips will fall. For the first time ever, there’s a nonfinancial issue in the market that’s causing multifamily occupants to not pay their rent. We will see some pain emerge in multifamily in some areas like Manhattan, Florida and Vegas that depend on travel and tourism. There are also a lot of markets with construction of new Class A multifamily development underway. In some of these areas, vacancies are going up, so it’s not accurate to make a blanket statement that multifamily won’t get hurt.”
>
> Jay Olshonsky FRICS, SIOR
> President & CEO, NAI Global

While harder-hit metros could struggle with declining rents and higher vacancies as residents flee big cities for smaller, suburban areas, overall investor and lender appetite for multifamily is still strong as is refinancing activity. RCA reported that sales in multifamily in 4Q’20 were even with prior year levels, and for the year fell by 28 percent in 2020 vs. 2019.



> *"With office, we don't yet know what we don't know. Office is always the last to go through the deterioration because the leases are longer. Occupiers will try to sublet their excess space out. Over the near-term, although companies will pay their leases, they won't renew on the same terms, & instead negotiate lower rents. Either we will use less office space post-COVID, or the market will just reprice."*
>
> K.C. Conway MAI, CRE Alabama Center of Real Estate (ACRE)
> Director of Research & Corporate Engagement, CCIM Chief Economist

Office: "We Don't Know Yet What We Don't Know"

The dramatic transition to remote working during the pandemic directly impacted office, which was already suffering from oversupply in many urban areas prior to COVID-19. After months of managing a work-from-home staff, there's not a CEO out there who's not considering flexible work options and strategic changes to their office space footprint post-COVID, especially if they are not planning on having 100% of staff in the office full-time. Some may pivot to a "hub-and-spoke" model with a smaller downtown headquarters supported by new satellite space in smaller offices in suburban, low-rise Class B and C properties. Others may keep the same footprint but reconfigure to provide less density and offer employees more flexible work options. Longer-term, the aggregate long-term effect could be a decline in office space demand, but these changes will take time to materialize.

Wait-and-see is the current mood in office as companies with leases expiring are opting to renew for a shorter period until market conditions become clearer. Office space is already experiencing falling rents as vacancies rise in many metros. As businesses rethink their need for office space, there will be demand for the design of flexible workspaces that accommodate new pandemic-related protocols and a trend toward smaller spaces outside of central business districts. In certain metros, an oversupply of office will eventually be repurposed into new uses like housing, vertical warehouses and e-commerce fulfillment centers, and meeting/event spaces.

The story for 2021 will be one of gradual re-entry to the office, with a preference for suburban assets over urban, and a slow path of return to pre-pandemic investment levels. Urban areas hit hard by the health crisis, like San Francisco and New York City, will recover more slowly than smaller metros that benefit from strong employment growth and a technology focus like Austin, Dallas, Phoenix and Seattle.

Retail/Hotel Remains Challenged But Nuanced

Prior to COVID-19, the retail sector's struggle against e-commerce was well told, but its challenges were brought to the surface by the health crisis as consumer reliance on e-commerce became a necessity rather than a preference. Retail is where the market will likely see the greatest pain and the greatest potential. Not only have the owners of non-essential stores had to cope with extended closures, but an even broader swath of the population now routinely shops online, making the environment for brick and mortar stores that much more challenging. Retail tenants are struggling to pay rent, and lenders are reluctant to extend capital for retail investment given the continued bankruptcies and store closures.

All retail, however, is not created equal and the nuances by sub-asset class are pronounced. Investors are favoring grocery anchored shopping centers and those with pharmacies and medical facilities. The retail sector is also poised for a strong focus on adaptive reuse, particularly on the conversion of obsolete mall space. One-quarter of U.S. malls are expected to close within the next three to five years, and some will be targeted by investors looking for conversions to industrial fulfillment centers or logistics hubs to support healthy e-commerce. Others will be converted to myriad other uses like office space, medical care facilities, mixed use developments or experiential shopping spaces.

The hotel sector felt the most immediate impact from the pandemic as travel came to halt. The share of hotels with securitized mortgages that were delinquent on their loans was nearly 20% as of November, up from 1.52% a year earlier, according to Trepp LLC. Occupancies are expected to recover gradually as business/leisure travel and events activity resumes. In the meantime, some investors are buying struggling hotels for conversion into rental apartments in metros with strong population and employment trends.

Raw Land in Demand As Investors Scramble to Build Single-Family

Another asset class experiencing higher interest based on the LightBox RCM platform is raw land. Investors and developers have undeveloped land in their crosshairs as they look to acquire sites in well-located areas for future projects. One particularly active area is single-family home construction, which hasn't seen construction levels this high since 2007. To meet high demand for rental properties, institutional investors are acquiring raw land for the construction of build-to-rent houses in popular suburban locations.

Metro Focus: The Rise of the Secondary Metros

In terms of geographic trends, another key impact of the pandemic is an acceleration of the pre-COVID trend toward smaller metros. The shift to the suburbs was already happening pre-COVID due to demographic trends, but the pandemic gave some residents a reason to exit dense urban areas for more reasonably priced, less crowded suburban areas. Secondary and tertiary markets in the U.S. have been experiencing strong population growth since 2014, making them look more attractive to investors than certain gateway cities.

Cities that experienced lower infection rates or were less reliant on the hard-hit hospitality/travel sectors have a distinct advantage in today's market climate. Popular secondary metros on investors' radar screens include Austin, Boston, Charlotte, Columbus, Dallas, Denver, Dallas, Phoenix, Raleigh and Salt Lake City. Many of these metros are experiencing high rates of population growth, and offer a strong talent pool to employers, particularly for the in-demand technology sector. On a regional basis, the Sunbelt currently looks more attractive to many investors than the Northeast and West Coast markets.

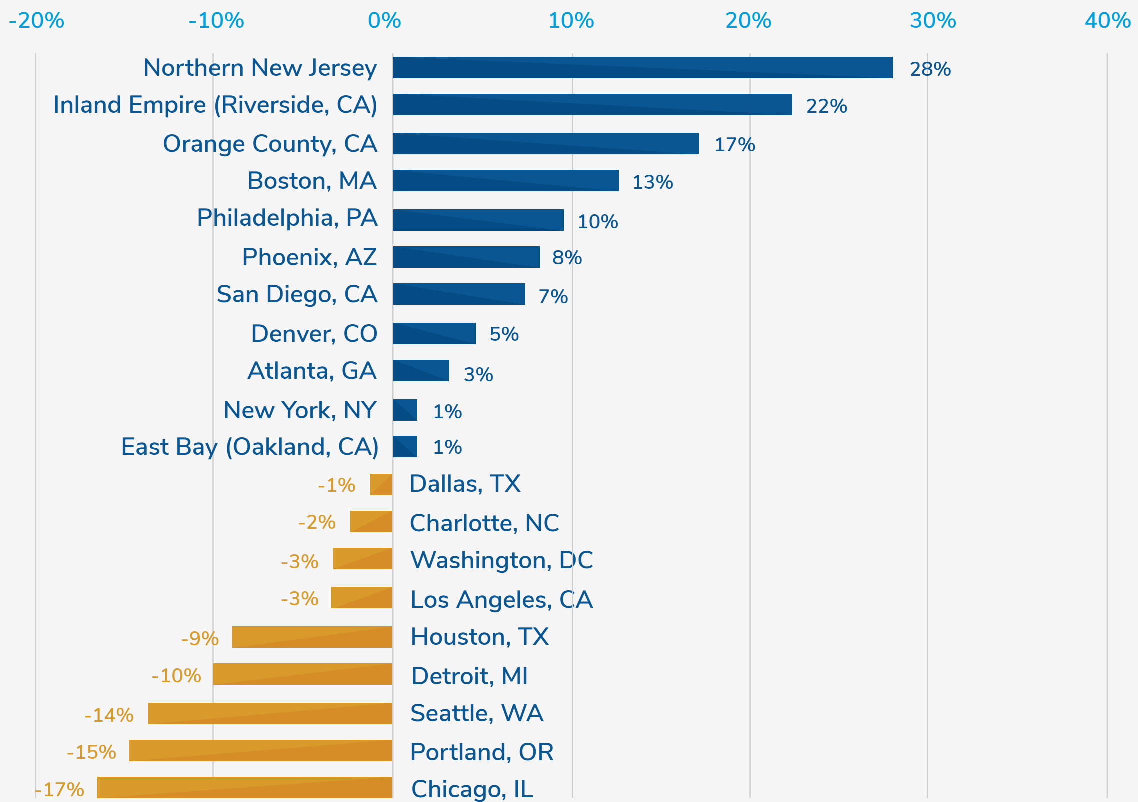
It is reassuring to see that after the sharp declines seen in April and May, commercial real estate activity is recovering to pre-pandemic levels in some U.S. markets. Trends in environmental due diligence conducted prior to most commercial property deals are an interesting predictor of where investor interest is rebounding most strongly. Of the 20 largest markets for environmental due diligence, 11 experienced 4th quarter volume that surpassed 4Q'19 levels based on the latest analysis of LightBox ScoreKeeper output.

"I'm most bullish on the suburbs and secondary markets, adaptive reuse and logistics and supply chain developments. I'm most bearish on large, dense MSAs with high cost of living and tax burdens and dependency on mass transit, like New York City, Chicago and San Francisco that will continue to struggle."

K.C. Conway, MAI, CRE Alabama Center of Real Estate (ACRE) Director of Research & Corporate Engagement, CCIM Chief Economist

Metro Focus (cont'd)

The metros showing the strongest recovery in property due diligence activity were led by northern NJ, Inland Empire and Orange County. Cities were particularly hard hit by COVID-19 so it is not surprising to see that metros like Seattle, Chicago, LA and New York City are still struggling. A metro's recovery rate will not only depend on the severity of the rate of infections but also its vulnerability to the hardest-hit sectors of real estate. Metros with a heavy reliance on hospitality, travel, retail and restaurants will recover more slowly than ones that are a big draw for technology firms or industrial investors, for example. Tech markets like Denver and Atlanta are benefitting from stronger investment activity, along with industrial hubs like northern NJ, Phoenix and Atlanta.



Near-Term Uncertainty, Long-Term Optimism

Not surprisingly, near-term uncertainty is top of mind for many commercial real estate professionals. While activity in the 3rd and 4th quarters from LightBox's market indicators as well as outside sources points to a reassuring recovery from the market bottom in April-May, the CRE professionals interviewed for this report are concerned about the impact that continuing restrictions on normal business operations and travel will have on property fundamentals and performance moving forward.

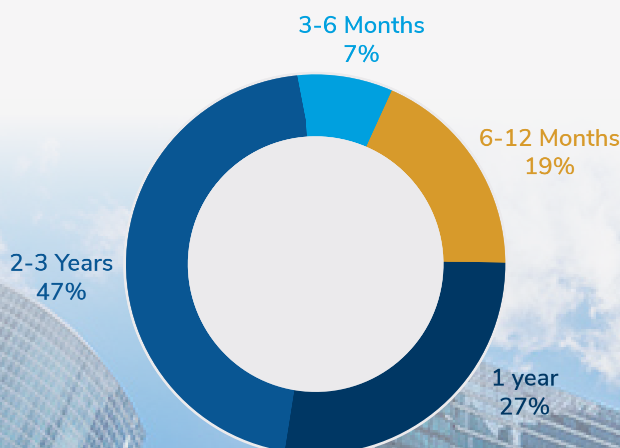
The LightBox market confidence survey of consultants, investors, brokers and valuation professionals reflect a similar near-term caution. Nearly half of respondents (47%) don't expect the market to return to pre-pandemic levels for another two to three years. Each metro and asset class is paving its own recovery path. As one respondent shared: "Hospitality will take years. Multifamily is in high gear right now. The effect of the pandemic on office has not yet hit, and industrial is absolutely on fire."

For some trends, like challenges of brick-and-mortar retail and the corresponding rise of e-commerce, the pandemic was a pace accelerator, as it was for the continued migration away from urban centers to suburban locations in many areas. In myriad ways that remain to be seen, the health crisis has triggered deep and impactful changes that will likely take years to unravel.

> "We could start to see properties coming back on the market in early 2021 due to cases where lenders will be forced into making decisions about properties where borrowers are already behind on their payments and the bank doesn't feel like it can wait anymore. One positive element is that the market has plenty of private capital so once distressed properties show up on the selling block, those buyers will come in at a discount and backstop any distress."
>
> Jay Olshonsky FRICS, SIOR
> President & CEO, NAI Global

Market's Expected to Return to Pre-COVID 19 Levels

(Source: LightBox 4Q Market Confidence Survey of environmental due diligence)



Near-Term Uncertainty *(cont'd)*

The good news from the last two quarters of 2020 is that commercial real estate investors are comfortable looking at properties again. Clearly, the market recovery cannot fully happen until the health crisis ends, but it's important to remember that COVID-19 exerted an external shock on an otherwise healthy market, and that fact alone bodes well for its recovery. The path forward will be uneven, but there is a tremendous amount of capital on the sidelines poised to pounce when pricing is attractive to buyers. Given the near-term uncertainty associated with the timing of vaccine distribution, coupled with the transition to a new Presidential Administration, it is likely the market will experience a busier second half of the year as the vaccines reach a broader swatch of the population and business activity slowly returns to normal.

> "We're still in a recession so obviously the pandemic is the main consideration. Business activity whether it's travel or conferences or restaurants won't be normalized, which means the market will still be struggling with high unemployment and low-demand environments. I'm expecting it to be a pretty tough year operationally, and worse in urban gateways."
>
> David Schwartz, CEO and Chairman, Waterton

The Urban Land Institute predicts 2021 CRE transaction volume will reach $400 billion, a 33% increase over $300 billion in 2020 as pent-up demand for deals chases a higher volume of properties being put on the selling block. As the market trajectory of 2021 unfolds, we can take solace in the fact that investor confidence is rising as they move off the sidelines, property listings are on a steady recovery track and property due diligence is now at its highest levels since the pandemic hit.

"The big question for investors post-pandemic is: Who are the winners and losers? We'll continue to see the pre-pandemic migration of millennials from urban to suburban areas. We'll also see opportunities for adaptive reuse of retail and hotel, especially if demand for business travel doesn't come back to previous levels." David Schwartz, CEO and Chairman, Waterton.

2021 Trends to Watch

Among the trends shaping the commercial real estate investment sector heading toward Q2 2021 are:

The Distressed Asset Wave is Coming

The market is bracing for a wave of distressed assets to hit the market, likely by Q3 of 2021. Multiple funds have been created to buy distressed assets in the office, retail, hospitality and multifamily sectors. Further, brokers are re-familiarizing themselves with auction platforms, which have been a preferred strategy for disposing of assets quickly.

"The industry continues to anticipate a surge in distressed assets, with numerous funds popping up to leverage the situation," says Tina Lichens, Senior Vice President, Broker Operations, LightBox. *"While predictions for a tsunami-like wave may be overstated, there remain questions about the level of distress and what sectors and markets will be the most impacted. Also, are government initiatives to prevent massive financial stress having an impact or just prolonging the breaking of the wave?"*

Adaptive Reuse Expanding-- Retail to Industrial or Medical

Investors looking for additional growth opportunities are focusing on properties that can be repurposed into other uses. Vacant or obsolete retail spaces are being converted into medical office or industrial distribution or fulfillment sites, for example. Bricks and mortar retailers are also shifting some of their retail footprint into return or shipping fulfillment centers to improve efficiencies and reflect consumer demand. *"Assets that are thoughtfully repositioned or reinvented—embracing innovative concepts and reflecting market fundamentals and consumer trends—can potentially see a considerable increase in value,"* Lichens adds.

Trends to Watch (cont'd)

Net Buyer or Net Seller?

Due to increased competition for deals and aggressive capital plays, some investors that had planned to be net buyers in 2020 are switching to the sell side to capture the upside of market pricing. The bottom line is that smart investors who have both capital and property in high demand will need to be nimble and able to pivot 180 degrees depending on market conditions.

Follow the Moving Vans

The investment growth after the pandemic is likely to occur in markets with strong in-bound relocation. Research from U-Haul and others points to movement away from California and into Idaho and Arizona and away from New York and New Jersey and into parts of Florida, Tennessee and other areas. Many core coastal markets are seeing residents move inward to the Mountain West region and other places where the cost of living is lower. Investors are closely watching how this impacts pricing and the distressed assets sector.

Executive Summary

Fueled by a return to commercial real estate activity in the second half of 2020, market confidence is higher than it's been since the pandemic hit. Yet outreach conducted for this report suggests the growing realization that this was a quick decline, but the road out will be a slow recovery. The market can't ignore the significant uncertainties that will determine the health of the market in this new year.

Over the next few quarters, the commercial real estate sector will get more clarity in two key areas of uncertainty: how long it will take for widespread deployment of COVID-19 vaccines (and thus, the expected return to more normal business activity), and the pace of distressed assets hitting the selling block.

As federal assistance that protected property owners from the impacts of rent non-payment fade, foreclosures and the level of distressed assets in the market will increase. The market is mobilizing for distress, but no one knows when it will come or how bad it will be. Debt and investment funds are ready to take advantage of distressed opportunities at the right price, and there will likely be more reliance on auctions as an avenue for reaching prospective buyers to divest properties quickly and efficiently. The transition of political power to a Democratic Administration and only a thin majority control in Congress likely means that any sweeping federal policy changes won't be easy.

The next few quarters will be very telling in terms of where the buy opportunities will surface—and how deep COVID-led price reductions might cut. As market confidence improves, expect to see investors adjust their asset class focus, disposing of properties in retail and hotel, and strategically redeploying capital into other sectors.

As with any market recovery, there will be winners and losers. Our outreach for this report suggests that certain types of retail will continue to do well, including grocery-anchored shopping centers. Suburban office will outperform Class A space in big metros as companies downsize urban, CBD footprints. It's a safe bet that industrial will continue to lead the pack as our reliance on e-commerce creates unprecedented demand for warehouses, last-mile distribution centers, data centers and cold storage. Multifamily will also be a strong growth driver, fueled by demographic trends that support a robust rental market particularly in population growth centers.

Longer-term, the industry is entering an age of adaptation that will challenge owners, investors and developers to respond to the dramatic shifts in the evolving demand for space. The market is entering an important chapter of its evolution that will create new avenues of opportunity for real estate professionals to reposition, redesign and redevelop properties as certain properties lose their appeal and new uses emerge.

Acknowledgments

LightBox would like to sincerely thank the following individuals for participating in interviews to provide further insights into the U.S. commercial real estate market:

- **K.C. Conway, MAI, CRE**
  Alabama Center of Real Estate (ACRE) Director of Research & Corporate Engagement, CCIM Chief Economist
- **Tom Fink**
  Managing Director, Trepp, LLC
- **Hugh Kelly, PhD**
  Principal of Hugh Kelly Real Estate Economics
- **Brian McAuliffe**
  CBRE, President of Capital Markets/Multifamily
- **Jay Olshonsky, FRICS, SIOR**
  President & CEO, NAI Global
- **David Schwartz**
  CEO and Chairman, Waterton

About LightBox:

LightBox is a leading provider of CRE data and workflow solutions for marketing, prospecting, due diligence, risk management, and location intelligence that enable decision making for 50,000 CRE brokers, 1,100 banks and lenders, 2,000 appraisal firms, and 5,000 environmental consulting and engineering firms. By combining proven brands with innovative technology and data capabilities, the company is creating new solutions to facilitate transparency, efficiency and insight for real estate.

Through RCM, LightBox offers a global marketplace for buying and selling CRE and increases the speed, exposure, and security of CRE sales through a streamlined online platform. Solutions include integrated property marketing, transaction management, and business intelligence tools to unify broker-level and firm-level data and workflows. The company has executed over 72,000 assignments with total consideration in excess of $2.4 trillion. Approximately 50% of all U.S. commercial assets sold, over $10 million, are brought to market using the company's online marketplace annually. LightBox was established in 2018 and backed by Silver Lake and Battery Ventures. Learn more and follow LightBox at www.lightboxre.com, on Twitter at @LightBoxRE, or on LinkedIn.

LIGHTBOX

For More Information Please Contact:

info@lightboxre.com | 888-440-7261

www.lightboxre.com

© 2021 LightBox Holdings, L.P.