

## THE LATEST TRENDS FACING THE COMMERCIAL REAL ESTATE WORLD

The most prevalent trend in the commercial real estate world as of recently is the dramatic rise in lumber costs. As you can imagine, the rise in lumber costs affects commercial and residential real estate, as well as any other type of construction project. Peter Grant from the [Wall Street Journal](#) tells us that unfortunately, "apartment-building developers have to pay 83% more for some types of wood than they did a year ago". According to [CoStar](#), the increase in general construction materials cost including steel and fuel is the highest since at least 1988. This new development comes with several unique challenges.

The WSJ article expresses that due to rapidly rising construction costs, some developers in the middle of year-long projects are running out of funding before their project completions because their initial budgets did not account for the dramatic rises in lumber. This is giving developers the incentive to race against the clock to finish projects before costs get any higher. The WSJ article also explains that due to commercial construction projects slowing down, subcontractors are charging lower margins for their services in order to win more projects. This trend offsets the rise in price of lumber in some cases.

### Generic Lumber Price

USD per 1,000 Board Feet



Source: Bloomberg LP and Wells Fargo Securities

Another sector of retail that was profoundly affected by the coronavirus pandemic is the movie theater industry. Movie theaters weren't performing at their best financially even before the pandemic, making the events of last year absolutely devastating for the industry.

The good news for theaters is that now that most are starting to open up, customers are enjoying themselves now more than ever. A recent Fandango.com survey tells us that out of 4,000 ticket buyers, 93% said that they were satisfied with their experience and 87% mentioned that they felt safe despite the pandemic. The three largest theater chains in the country, AMC, Cinemark, and Regal have opened up close to 100% of their existing locations (AMC and Cinemark have opened 98% and Regal 97%) and are ready to start releasing blockbusters again.

The newest blockbuster, A Quiet Place, is receiving raving reviews and according to Vulture, has "set a Pandemic-Era record at the box office". This Vulture article reports that A Quiet Place 2 has earned a \$57 million opening weekend which is roughly the same amount that Tenet made the entire time it was in theaters. Tenet's unimpressive theatrical run was disappointing news for the movie industry, given that studios were using Tenet's release to gauge if audiences were ready to come back to theaters.

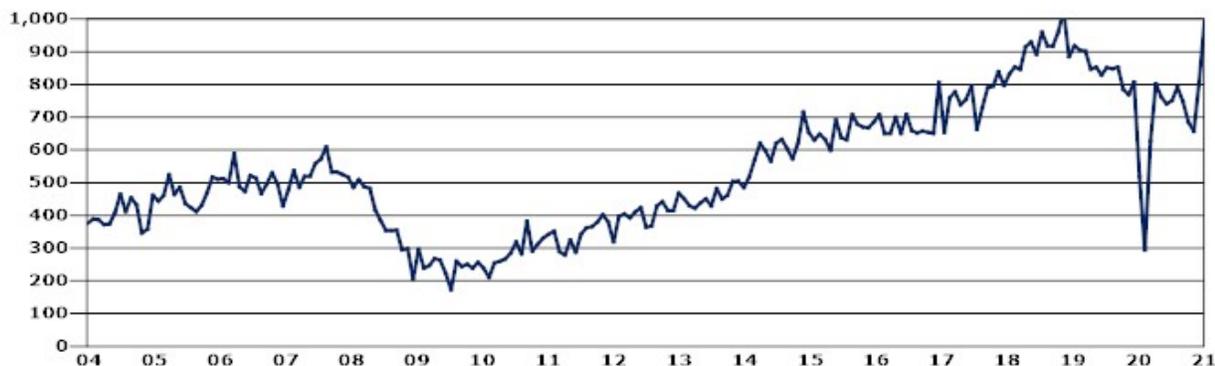
Here's how this connects to commercial real estate: Along with being a huge success for Paramount, A Quiet Place 2's impressive box office performance also represents a victory for movie theaters and in-person entertainment retail spaces in general. AQP2's success shows that audiences in general are as of recently becoming more comfortable with gathering in enclosed spaces with other people, which is a victory for all in-door based businesses and retail stores.

Restaurant:

While customers are coming back to restaurants and eating inside in most states, restaurant owners are facing a new challenge: employee shortages. The National Restaurant Association reports that as of May 2021, 72% of restaurant operators indicated that recruiting and retaining employees is their top operational challenge. To sum it up, there is an abundance of job openings, but a shortage of workers willing to fill the roles.

### Job Openings in the Restaurants & Accommodations Sector

Seasonally-adjusted monthly data (thousands)

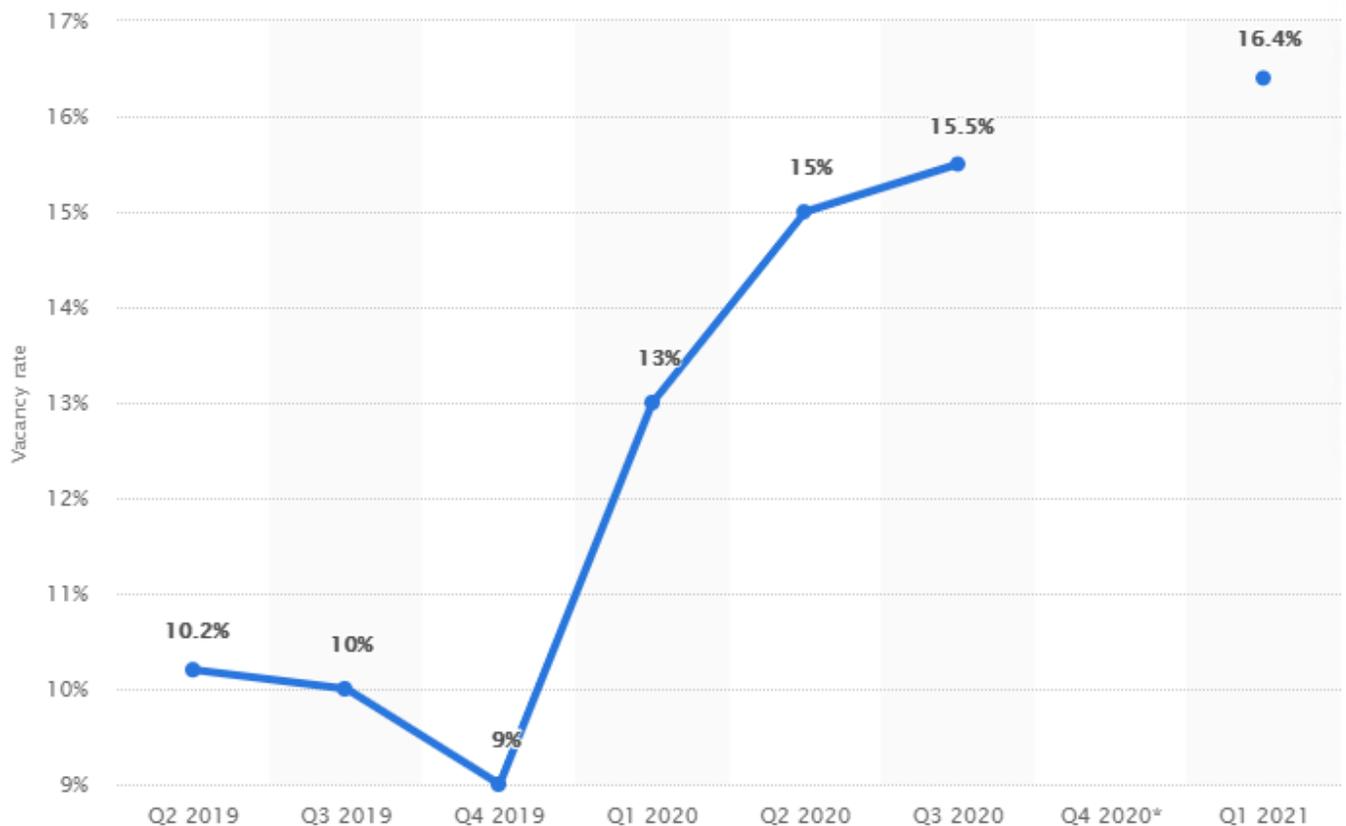


Sources: Bureau of Labor Statistics, National Restaurant Association

Note: Job openings represent vacancies on the last business day of the month

## Boardrooms to Bedrooms – How Covid-19 has affected office spaces

The pandemic has left many office spaces empty as working from home has become more popular. As pictured below, the shift in the number of vacant office spaces from 2019, 2020 and to the beginnings of 2021 is shocking. With this increase of vacancy, building owners are finding themselves asking what they can do with their existing space. The trend of redeveloping office space into housing has been the answer to their questions.



The reduced need of office space reduces leasing revenue which in turn reduces the buildings' market value. This decrease in value not only affects office owners, but investors and lenders as well. To avert this new problem, building owners are beginning to redevelop office spaces to a new use: housing.

Changing office spaces into housing can be tricky and there are several hurdles that need to be jumped over, but to these owners, the possibility of increased revenue is worth it in the end. One of the first hurdles is the entitlement process, which could include several hurdles of its own.

To better understand what this is, we define this as the process of getting all the necessary government approvals for your project to move forward. This process would include seeking approval with local municipalities for a conditional use permit, variance, or rezoning.

The city's requirements vary for this process, but most of the time to approve this new land use, landowner's will be required to submit a land use pre-application along with a preliminary site plan, an environmental information assessment that will look into the history of the parcel

of land to evaluate whether it may be contaminated with hazardous material, and a variety of other studies including parking or traffic studies.

As more and more landowners go through this redevelopment process, they are seeing that office spaces are requiring some basic building modifications to enable an area suitable for living. Some of these modifications include new insulation, windows to provide more and better lighting, and even mini courtyards. These are all aspects to give former office buildings a more “homey” feel versus the original office space feeling. Some other changes that may be made are adding in fire-protected exits, elevator shafts, adding in staircases and spaces that can accommodate plumbing and HVAC ductwork. These are necessary as the number of restrooms, air conditioning and access to water will increase when switching from an office space to residential housing.

Transforming what was once a space for people to work from nine to five to a suitable living space for someone 24/7 requires some creative solutions to incorporate those living necessities. These can include a washer and dryer unit, restrooms, living room space, storage, and a kitchen area. Partnering with a good developer and architect will be key to finding the best creative solutions.

One excellent example of a redevelopment that incorporated these living necessities is [the 20 Broad in New York](#). The developers of this building have done a great job of transforming what was once an office building into luxury living. They transformed this office space to have 553 rental units across their 30 floors. Within these units the developers were able to add individual courtyards to allow an outdoor space for their future tenants, something many complexes do not offer. They were also able to utilize the high ceiling in the previous building, which many see as a huge bonus in complex living. Looking at their spaces, you would never have guessed it was once a place for someone’s nine to five job.



Overall, redevelopment seems to be a product of Covid-19 in the commercial real estate realm. If you happen to find yourself in this situation we recommend looking into the highest and best use of your land so that you can reduce these vacant spaces and increase your net operating income and overall ROI!