Investment market insights

What’s ahead in 2023?

Avison Young | South Carolina

Capital Markets

AVISON YOUNG

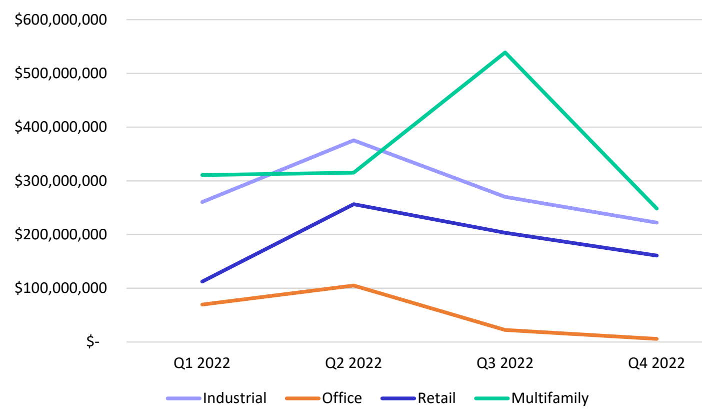
OVERVIEW

Inflation & interest rates: when will they peak?

Many business owners are pondering how to manage their businesses for growth in 2023 and beyond. Supply chains remain an issue for many industries, and availability of properly trained labor remains a major challenge. For most, the BIG questions are, "will inflation be brought under control in 2023?" and "when will interest rates peak?" Inflation and the attendant interest rate hikes by the Fed have affected all industries including the real estate sector, and have caused many investors to hit pause in terms of any significant investment (or capital) decisions. That response is typical when uncertainty in the market exists. The almost unprecedented rate of increase in the interest rates last summer and fall lead many to simply "put their pencils down".

As a result, commercial real estate investment activity declined nationally anywhere from 35% to 70%, depending on asset class, during the latter half of 2022 compared with the same period in 2021. The Upstate has historically shown greater resilience than most secondary markets to economic headwinds. The overall sales volume across all major asset classes went from $3.8B in 2021 to $3.48B in 2022, which was just a 9% decline. Q4 2022 was the slowest quarter at 27% below the quarterly average

Sale volume ($)



for calendar year 2022. So, as expected, we experienced some deceleration on the transaction side, but not as severe as many other similar size markets.

One can likely expect a subdued investment climate over the next couple of quarters relative to the record-setting last couple of years. We believe the Upstate market will remain active especially in the industrial and multi-family sectors: this is due to the continued in-migration and ever-increasing demand for distribution and warehouse space to service the expanding inland port in Greer and the rapidly expanding southeastern region, which is served so effectively from South Carolina.

South Carolina is reaping the benefits of a renewed focus on onshoring, especially in the automotive and aeronautic industries. We are also seeing a significant push towards expanding the state's burgeoning life science sector. It's noteworthy that the Palmetto State saw record corporate capital investment of $10.27M in 2022, which was more than double the trailing 5-year average. BMW's $1.7B manufacturing expansion was the largest in the region and second largest in the state in 2022. The total number of new projects announced in 2022 was 120 with a projected 14,083 new jobs to be added statewide.

Sales by quarter (Upstate Region)

	Q1 2022	Q2 2022	Q3 2022	Q4 2022	2022 Total
Industrial	$ 260,659,863	$ 375,371,796	$ 269,948,380	$ 222,106,843	**$ 1,128,086,882**
Office	$ 69,512,949	$ 105,185,516	$ 22,453,569	$ 5,662,450	**$ 202,814,484**
Retail	$ 112,605,466	$ 256,567,775	$ 203,404,125	$ 161,011,113	**$ 733,588,479**
Multifamily	$ 310,786,102	$ 315,062,184	$ 538,898,416	$ 248,315,517	**$ 1,413,062,219**
Total	**$ 753,564,380**	**$ 1,052,187,271**	**$ 1,034,704,490**	**$ 637,095,923**	**$ 3,477,552,064**

INDUSTRIAL MARKET

Sale-leaseback expected to heat up

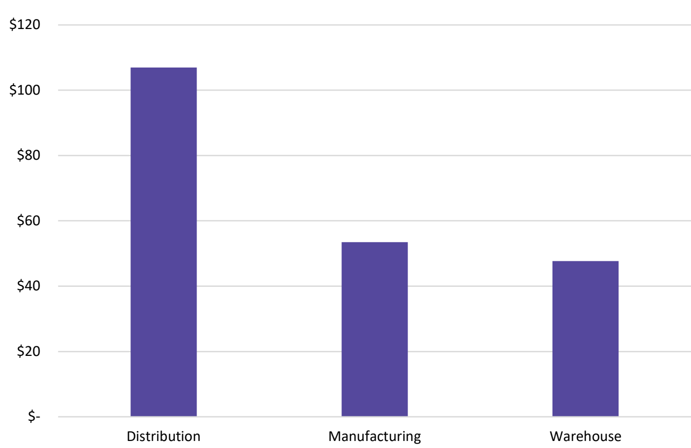
The Upstate industrial market was red hot in 2022. Slightly more than 10% of the total inventory (20.7M sf) in the four-county region traded hands during the year. Industrial sales volume fell 18% from Q3 to Q4. This was the smallest decline of the 4 major asset classes. Pricing hit record levels during 2022 with manufacturing averaging over $53 per SF and warehouse space trading at an average of nearly $48 per SF. The overall average across all industrial categories was $55.82 per sf. It should be noted that the average sales' price for distribution buildings was skewed dramatically by four transactions (newly constructed properties) that sold for a combined total of $285M ($110.55 psf).

Significant trades included 1700 Old Grove Road (Piedmont) that sold for $38.8M ($129 psf) to GIC Real Estate as part of a bulk/portfolio sale; also in that portfolio sale was 250 Wilson Bridge Road (Ft. Inn), which sold for $24.1M ($110/sf). Eastgroup Properties, Inc. acquired the 350 Old Laurens Road Building III located in Access Point (Simpsonville) from Hughes Commercial Properties for $21.1M ($71/sf) in July. Additionally, several sale-leaseback transactions occurred including the Orion Rug facility in Anderson (2415 N Highway 81) that sold in October for $15.7M to Sage Park and the 2-building portfolio STORE Capital (now GIC/Oak Street Capital) acquired from Elevate Textiles at 30 & 40 Emery Street (Greenville) in May. The properties total 560,000 sf and traded for a combined $33.1M ($59/sf average price).

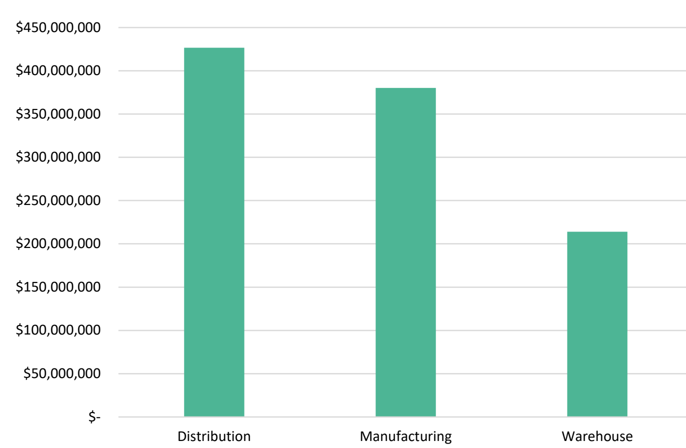
With the significant rise in the cost of capital for financing corporate investment, we anticipate a significant increase in the sale-leaseback market (bond rates are up nearly 200 basis points). Companies that previously had to access cheap financing via the bond market will be looking for alternative financing vehicles. The most obvious one, when there is significant CRE equity on their balance sheet, is to sell and lease back corporate owned real estate since the spread between BBB bond rates and (real estate) cap rates has diminished. It is well known that companies often look to sale-leasebacks as an additional capital source to finance investments that require significant capital such as facility or production line expansions, new manufacturing and warehouse facilities, or company acquisitions.

> *We expect the composition of the Upstate (SC) industrial investment market to shift in 2023 as US based institutional capital becomes more patient (and cautious) while sovereign wealth funds and private equity continue to seek places to invest for capital preservation and consistent cash flow, respectively. In 2022 we saw the continuation of a four-year trend of significant foreign capital inflows and an outflow of local capital (and to a lesser degree national capital).*
>
> **– Gary Lyons, Principal,** SC Capital Markets Lead

Industrial price per sf



Industrial sales volume ($)



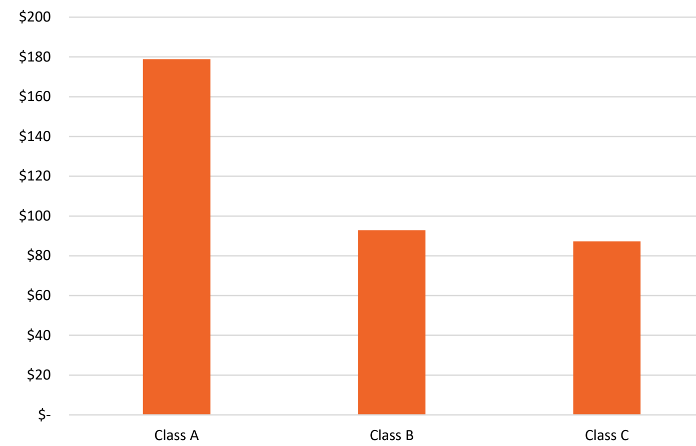
Silver linings lie in absorption and rent rates

The Upstate office market was hit the hardest with a decline in deal velocity as lenders pulled back significantly due to the Feds aggressive moves, the lingering uncertainties created by the pandemic, and the new work-from-home culture. Cap rates held steady in 2022 at 7.2% having peaked at 7.9% during the pandemic while average deal size declined with many smaller buildings trading in 2022 ($1.32M average price).

However, several silver linings exist for the office sector including absorption---Q4 held steady (no additional loss of occupancy), office development was largely muted, and asking rents rose 1.9% in Q4. In addition, the share of remote office job postings in the market is nearly 37% less than the national average, likely indicating that the general attitude in the Upstate is, “let’s get back to the office” and make something positive happen.

Canal Insurance made a bold move last summer when they executed a long-term lease for 62,372 sf at the 101 N. Main Street building in downtown Greenville.

Office price per sf



“Debt sources for office deals are getting harder to find unless the asset offered is owner-occupied or has a stellar rent roll with a substantial WALT [weighted average lease term]. Even seasoned investors with strong credit, and a long track record of successful investing, are having to get creative with their debt partners. Local banks remain one of the better sources of capital, albeit at lower LTV’s and significantly higher rates than a year ago. As loans approach maturity we expect owners will get more realistic about the higher interest rate environment.”

-- **Ned Reynolds, Vice President**
Office & Investment Services

Notable sales transactions

Address	Sale date	Building size (sf)	Sale price	Sale price psf	Buyer
701 Millenium Drive Greenville, SC	May 22	210,227	$53,500,000	$254.49	Angelo, Gordon & Co
301 N Main Street Greenville, SC	Jun 22	357,752	$25,250,000	$70.58	College Street Partners
15 Brendan Way Greenville, SC	Apr 22	38,816	$6,600,000	$170.00	15 Brendan Way, LLC
400 Brookfield Pkwy Greenville, SC	Mar 22	74,881	$4,878,000	$65.14	Greenville Classical Academy
8 Memorial Drive Greenville, SC	Nov 22	20,680	$3,800,000	$183.75	Harvard Investments

Strong demand for STNL's to continue

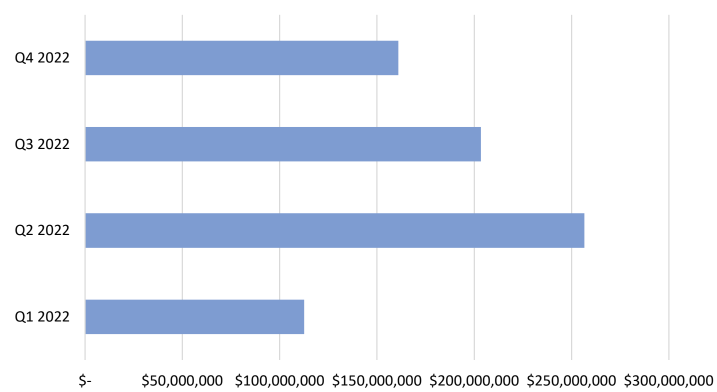
Notable sales transactions

Address	Sale date	Building size (sf)	Sale price	Sale price psf	Buyer
Walmart Anderson, SC	Jun 22	183,211	$17,400,000	$95.00	Blackstone RE Investments
850 E Suber Rd Greer, SC (Riverside Crossing)	Apr 22	58,358	$13,900,000	$238.00	Kingsbarn Realty Capital
4 Market Point Drive (Whole Foods Outparcel)	Sept 22	14,676	$8,700,000	$595.00	DDR-SAU Green-ville Point, LLC
1818-1846 Woodruff Rd Greenville, SC	Sept 22	69,722	$10,700,000	$151.00	Agree Eastern, LLC
120 E. Blackstock Spartanburg, SC (Lowe's)	Sept 22	159,150	$14,500,000	$91.00	Agree Central, LLC

The resilience of the Upstate retail market has been extraordinary. Transaction volume dipped only slightly in the fourth quarter while pricing has continued to climb since the pandemic (11.3% YOY increase). Cap rates, meanwhile, have reached a bottom of 6.9%. Price appreciation stalled in Q4 at $123.57 psf, which is still well below replacement cost.

National investors dominated the picture in 2021 & 2022 with nearly 80% of the transactions involving a national investor or operator. In both years, the national investor and owners had a net positive acquisition's posture, compared with local investors who were net sellers. Interestingly, the most active submarket in the region was the Anderson County/I-85 corridor which saw nearly $60M of retail CRE transact at an average cap rate of 7.3%. The Wade Hampton corridor in Greenville saw $39M in transaction value with an average cap rate of 6.7%. With absorption rates healthy again, new deliveries constrained, and in-migration of new residents with significant spending power, we expect the Upstate retail market, especially in the prime corridors and top zip codes, to do extremely well in the next several years in spite of the softening economy. Strong demand should continue for STNL properties, multi-tenant strip centers, and well-positioned, grocery anchored centers so long as they don't contain excessive shop space.

Retail sales volume (sf)



"The Upstate region's retail market continues to hold strong through the recent changes in the capital markets. The steady population growth and consistent national accolades make Greenville an ideal market for a wide array of investors (public & private) and national retailers while still leaving room for local retailers."

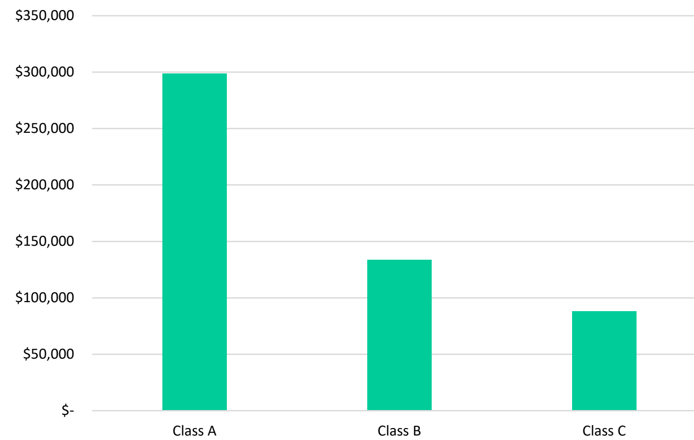
– James McKay, Senior Associate
Retail & Investment Services

Demand red hot for multi-family

The Upstate's multi-family sector was once again the top performing sector in 2022. This is based on a transaction volume perspective as it came in at slightly over $1.4B for the year and was highlighted by the June sale of the DECA Camperdown complex to Raia Capital Management for $125,000,000 (576K/unit). Transaction activity in the sector peaked in Q3 at $539M and declined significantly in Q4 to $248M, a 54% drop.

The apartment sector also continued to hold the record for the lowest market cap rate among all asset classes coming in at 4.8%, which was roughly 100 basis points lower than the historic average cap rate for the region. Record low cap rates, rising rents and nearly full occupancy (98.2% average at time of sale) resulted in a record price/door of approximately $190,000 (an increase of $60K/door since 2019). The class A sector dominated the transaction landscape and drove the cap rates down due to the favorable financing and flush capital sources in pursuit of large deals. Class A pricing averaged $298K/door while class B came in at $133K/door and class C at $88K/door. Nearly half of the Greenville market transaction volume occurred in the Greenville/Mauldin and Eastside Greenville submarkets. While their volume totaled $334M and $221M, respectively, these submarkets only accounted for 18 of the 55 recorded transactions. The average sales' price in these red-hot submarkets was nearly $31M.

Multifamily price per unit



"The Upstate, and more specifically the Greenville multi-family market has been a darling of secondary market investors for many years. Our region has offered investors consistent investment returns, which has come as a result of consistently high occupancy levels realized from steady in-migration as well as a diversified and skilled workforce well-suited for apartment living. The appeal of this region has accelerated since the pandemic as we have seen a larger pool of affluent residents relocating to the Upstate for a superior quality-of-life."

-- **Gary Lyons, Principal**
SC Capital Markets Lead

Notable sales transactions

Address	Sale date	# of Units	Sale price	Sale price/unit	Buyer
DECA Camperdown 320 Falls Street, Greenville	Jun 22	217	$125,000,000	$576K	Raia Cap Management
The Lofts at Woodside Mill 1 E Main Street, Greenville	Aug 22	307	$100,600,000	$327K	Goldman Sachs
The Aster 101 McCaw Street, Mauldin	Sept 22	330	$81,500,000	$247K	Nicol
The Mills 1000 Oak Springs Dr, Greenville	Oct 22	304	$73,100,000	$240K	Blackstone, Inc.
Crescent Park Commons 401 Elizabeth Sarah Blvd, Greer	July 22	318	$71,500,000	$224K	Southwood Realty Company

CONCLUSION

Investors will find opportunity in...

2023 is already presenting new challenges and opportunities for owners and investors alike. The industrial and multi-family sectors will likely remain the “darlings” of the investor community, especially in dynamic markets like the Upstate of SC. We anticipate that pricing will continue to stabilize, and in some instances, may decline slightly however the abundance of fresh capital seeking new deals will likely keep pricing up even as spreads have narrowed substantially.

While multi-family occupancy rates are projected to remain in the mid-90% range as long as we avoid a deep recession, we don’t expect lease rates to climb like they have in recent years as most tenants are “tapped out”, given the impacts of inflation on their budgets.

Industrial, especially big box Class A space, may be in for a bit of a hit given the nearly 15M sf of new product available or being delivered in 2023. The balance of the industrial market is well-positioned to remain at/near full occupancy with the ongoing demand for affordable warehouse and manufacturing space remaining high. If construction costs moderate, we anticipate an uptick in smaller building (under 100K sf) development as there is a huge unmet demand for occupier buildings of this size.

The retail sector, much like multi-family, is entering 2023 in a healthy state. With constrained construction activity and continued population growth throughout the Upstate we expect all sub-types to perform well with the possible exception of the mall sector. Single Tenant Net Leased properties remain in high demand due to the appeal from a large swath of the 1031 investor community (i.e. baby boomers looking for “hands off” real estate investments). Strip centers populated primarily with service businesses and restaurants should continue to do well as will grocery anchored centers.

The office sector is projected to be the most challenging since we anticipate only moderate absorption and little to no rent growth except in select submarkets. Office investors should begin to see real opportunities later in 2023 as more owners face the decision to refinance or sell. Some percentage of office owners, hopefully a small percentage, may be forced to sell or recapitalize their property prior to loan maturity due to their 2023 valuation not being sufficient to meet the minimum LTV requirements in their loans.

Our team of professionals are ready to assist you. Please reach out to us with your investment real estate questions and challenges.

For more market insights and information visit **avisonyoung.com**

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