Real Estate NJ’s 2023 Market Forecast

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Editor’s note: This is part of a special advertising section appearing in Real Estate NJ’s January issue.

After finding its footing in the pandemic, the commercial real estate market was back on its heels by late 2022 thanks to fast-rising interest rates and fears that the worst is still to come. Developers, investors and other industry stakeholders in New Jersey are now bracing themselves for more uncertainty in 2023, as they also prepare to seize the opportunities that often come with economic distress.

You can read all about it in our 2023 Market Forecast, which features predictions and insights from some of the state’s leading voices in commercial real estate.

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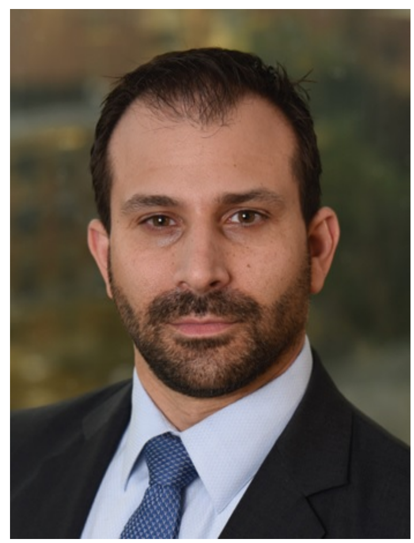
Vice President & Regional Director, NJ/PA Development



Coming off a strong industrial real estate cycle, 2022 was a transitional year for the market. Occupier demand continued to be strong. However, it has softened compared to previous years. Interest rate increases ultimately impacted asset valuations which were previously at a peak, causing a disconnect between buyers and sellers. We expect interest rate impacts to continue into 2023, stabilizing in the second half. Ultimately, buyers and sellers will be aligned with market valuation and, although occupier demand will be strong, lease absorption timing will increase compared to the past two years. Demand for goods will likely be impacted by economic conditions, which will slow imports and ultimately occupier decisions. Despite longer lease periods, rents will continue to grow but not with the same continued growth rates previously seen. Functionality, design and a flight to quality will continue to become more important to occupiers and investors in 2023.

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The glass is half-full, from our perspective, as the CSG Real Estate team is cautiously optimistic heading into 2023. While we're coming off a record year, there's no denying uncertainty is the enemy of transactions. We've all felt the impact of rising interest rates on deal underwriting and execution. That being said, the Garden State continues to boast strong fundamentals, many equity sources have significant dry powder and lenders are willing to lend — albeit at higher rates. In speaking with clients and industry friends, we see a desire to shift from neutral to drive before end of Q1 2023. With industrial, multifamily and mixed-use leading the way, and grocery-anchored retail and select office product gaining interest, we're expecting pent-up demand to show itself by winter's end. Once interest rates stabilize and sellers adapt to pricing reality, that pent-up demand will translate into renewed deal and development activity.

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In mid-2022, the sharp rise in interest rates chilled what had been a white hot year for transactional real estate.

With the decreased spread between interest rates and the cap rates on industrial properties, the transactional outlook will unlikely improve significantly in the first half of 2023. Purchases and sales will probably remain sluggish and mortgage refinances will occur only when necessary. Moreover, inflation, high sovereign debt levels and energy shortages threaten the economies of Europe, which could adversely affect the leasing of logistical space by European companies.

The rate of inflation may decline if ongoing supply chain issues are resolved and the divided Congress is unable to enact inflationary spending bills. This could cause the Federal Reserve to reconsider the tightening of monetary policy.

On the positive side, rental rates for industrial space should continue to increase.

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This past year has been a momentous time in our industry as we emerge from the pandemic and adapt to new ways of collaborating.

In some of the largest commercial markets, landlords will need to add new, unique amenities to their buildings and revitalize aging assets as the flight to quality trend continues.

We also expect to see increased ground-up residential and mixed-use development to accommodate the needs of hybrid and remote workers and solve the current housing shortage.

In addition, the warehouse and distribution sectors will thrive significantly as online shopping increases. Simultaneously, the need for retail spaces within residential areas will increase as hybrid work allows people to spend more time shopping in their own neighborhoods. For businesses to support new technologies, we predict a continuing boom in data center construction.

In 2023, JRM will continue focusing on these emerging sectors and our core markets — corporate, retail, hospitality, health care and core and shell.

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The outlook for commercial real estate in 2023 is interesting. Health care and life sciences markets will likely remain strong with the industrial sector cooling. Adaptive reuse has become a very practical solution for many of today's commercial real estate properties. With post-pandemic vacancies still currently on the market, large commercial footprints can successfully be transformed into facilities that are in higher demand. Since these properties exist, in some instances they can offer more sustainability by reducing the amount of materials needed to renovate. In turn, there can be a cost savings, sometimes significant, to execute. Throughout the recovery from the pandemic, many existing buildings have been transformed into different use types more reflective of current market demand. With thoughtful design and execution, efficient engineering systems for adaptive reuse projects can be achieved. However, real estate owners should recognize that not every building is a good candidate for a cost-effective adaptive reuse transformation.

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Buying opportunities are coming. The Fed-induced recession is here. Many loans that are now coming due have no option other than a sale because the pricing their sponsors underwrote to is long gone. I am just starting to see deals come across my desk that have pushed their loan into extension. As construction slows because deals simply can no longer pencil out, trades and suppliers are no longer going to be as busy as they once were, and we are going to see pricing come down. All of this has not happened just yet, but in the next six months it will be in full swing. Fortunately, or unfortunately, we all needed this reset. Maybe landowners will finally come down to earth, and you can find a deal at a great basis? They may not have a choice. I believe 2023 will be a year of great opportunity.

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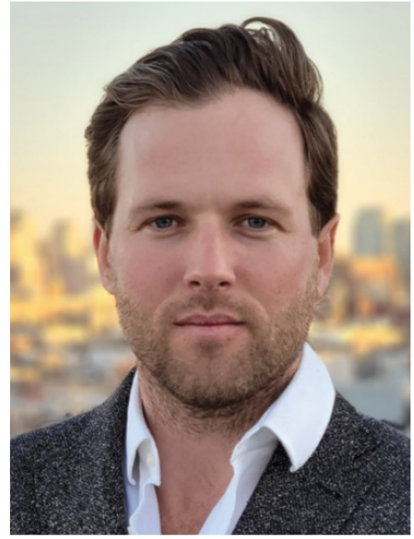

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Life is all about progress and evolution. Massive suburban office campuses are no longer at the forefront as a post-COVID world has revealed their continued use is insignificant. Remote working has paved the way toward a life without the rising costs of securing a physical space in an office building. In fact, according to commercial real estate firm JLL, 57 percent of suburban office space across the nation is so old it is considered “functionally obsolete.” Let that sink in.

As the housing crisis rages onward, real estate developers have realized the only way to put people back in homes is to create more of them. Hence, the suburban office parks of yesteryear are paving the way for adaptive reuse opportunities that include mixed-use spaces with apartments, townhomes, on-site amenities, retail opportunities and so much more.

Case in point — PARQ Life Reimagined. By taking an old, outdated industrial office park in Parsippany and turning it into a placemaking opportunity, we are creating a new, authentic neighborhood for the community to enjoy.

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At the end of 2022, the leasing and capital markets in New Jersey diverged with leasing remaining strong while capital markets stalled. Industrial vacancy in the market remains near historic lows, around 3 percent, with competition for the limited available space pushing rents higher. New Jersey typically doesn't see a high volume of investment sale trades, so the impact on existing building prices is unknown as buyers and sellers try to understand the correct bid. With respect to land, prices have decreased with South Jersey seeing the highest impact. Signs point to a development slowdown as construction and capital costs increase, and developers will have to navigate legislation aimed at limiting industrial development. These factors will only heighten demand for existing product. Lastly, today's customer wants more than four walls and a roof. Customers are willing to pay more for spaces equipped with sustainable features like, solar and EV charging.

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We have been through many market cycles and, if there is one certainty in real estate, it is change. For the last several years until mid-2022, investors were in bidding wars to purchase properties, especially multifamily, at low cap rates. Change came with rising inflation, interest rate increases and uncertainty that slowed the market. However, we continue to do business as we have since 1906. We are out knocking on doors, building relationships and providing our clients with market information, guidance and service when they need it.

The investment real estate market is resilient and relatively healthy. As stock market volatility and economic uncertainty continue, more investors are seeking the safe refuge of investment real estate. The multifamily market continues to be the strongest commercial real estate market and the multifamily rental market remains strong. Other types of investment and commercial properties in desirable locations also remain in demand.

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The installation of solar renewable energy generation systems on commercial, residential and government-owned properties should increase in 2023 due to the infusion of generous tax benefits from the recently adopted Inflation Reduction Act of 2022 (IRA) and New Jersey's continuation of robust subsidies in the form of a new solar renewable energy certificate program. The IRA, which includes almost $400 billion in tax incentives, is the United States' largest financial commitment to fighting climate change by reducing carbon emissions and is expected to be a game-changer for renewable energy investment. Under the IRA, solar generation or energy storage projects may be eligible for an investment tax credit (ITC) in excess of up to 50 percent of the project's cost. Significantly, the IRA permits investors that do not have a tax appetite to sell their ITC to third parties. This is particularly attractive to real estate investment trusts (REITs), public entities and non-\profits that have not been able to benefit from the ITC.

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The International Union of Operating Engineers Local 825 closed out 2022 on a high note of full employment for its nearly 8,000 members. Looking ahead, it sees continued demand for its operators.

Fueled by a $12.3 billion infusion of infrastructure funding, Local 825's heavy equipment operators are building, repairing and maintaining roads, rails and bridges while continuing to work on water mains, cleaning brownfields and prepping for wind energy projects to come.

The Hoboken Connect project, which broke ground in October, will restore the city's historic transit terminal, build infrastructure upgrades and construct new development that will provide nearly 10,000 construction jobs over the life of the project. Major highway widening has been approved for New York's Route 17 and New Jersey's Atlantic City Expressway. In Hudson County, a $10.7 billion New Jersey Turnpike expansion leading to the Holland Tunnel is on the drawing boards.

Our members are usually first on a job, preparing each site for the construction to follow. Each member is highly trained and experienced and ready to start work "day one."

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Multifamily and industrial are still the preferred asset classes for institutional and private investors alike. Investors who were largely on the sidelines during the second half of 2022 will be motivated to deploy capital in 2023. All-time high rents in New York City, coupled with rising mortgage rates, pose continued challenges for first-time homebuyers and we anticipate sustained renter demand for suburban multifamily product. Given its proximity and seamless connectivity to New York City, northern New Jersey is well-positioned to capture this demand. Transit-oriented developments (TODs) should benefit as companies continue to call employees back to the office, compelling renters to seek shorter commutes.

Cap rate expansion over the past several months due to rising interest rates has created an excellent investment opportunity for those seeking quality assets at a highly attractive basis. Stabilization of the debt markets will give many investors the confidence to get more aggressive with their underwriting, which will lead to greater deal activity.

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As property managers and multifamily investors, we believe the returns we all enjoyed over the past couple years are done. The old tenets of investing in quality products in good locations and implementing your value-add/development plan with a close eye on expenses with multiple exit strategies will be the recipe for successful investments in 2023.

Most forecasts call for a peak in mortgage rates around 7.5 to 8 percent in early 2023, then gradually coming down over the course of the year to 5.5 to 6 percent. Drastic increases in rates will bring opportunities to buy at a discount as one- to five-year mortgages due to reset in 2023 at higher rates will force selling. Prudent investors that have been on the sidelines will finally be rewarded.

Multifamily rents nationwide have fallen for the past four months as per CoStar data, but in New Jersey we haven't seen rents decreasing. Rents have stabilized and automatic increases on renewals and turnovers we implemented throughout 2022 will slow down. The ROI of keeping a tenant at the same rent is better than raising their rent and losing them to other buildings offering incentives.

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From a macroeconomic perspective, we can expect 2023 to be a challenging year. After several years when many businesses experienced record profits, we are entering a period of "survival of the fittest." With interest rates, core inflation and labor costs at their highest levels in many years, we can expect new construction to slow down. As with the Great Recession of the late 2000s, however, the strongest players in the marketplace will further solidify their position and grab share from weaker players. Our clients are primarily well-capitalized, long-term investors. We anticipate helping them take advantage of opportunities that might not have existed prior to this ongoing Fed tightening cycle. So, although we are likely to see a moderate downturn in new construction, we will see an uptick in acquisitions of vulnerable, less well-capitalized entities, as well as an uptick in project approval for when rates and costs stabilize.

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The multifamily, mixed-use market in New Jersey is strong, even in the midst of uncertainty concerning interest rates and rumors of recession. Our clients are moving forward with existing projects and looking to acquire new sites.

With entitlements taking one to two years on average, then design and bidding taking another six months and construction duration of one and a half to two years, most new projects will not be coming online for three to four years. Knowing this, most developers believe that the market may be considerably different at that time.

The current residential rental market has been bolstered by higher mortgage rates prohibiting first-time buyers from purchasing homes, thus keeping them in rental housing. Another source of demand in New Jersey is that the extremely high rental rates in Manhattan and

Brooklyn have forced renters over the Hudson River to lower rents in New Jersey.

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We have been tracking trends and conditions closely. There will likely be challenges for all of us in 2023. A few key performing markets, such as multifamily/mixed-use, will slow down. However, we are confident this will still be a solid year for us, with projects like The Crossings at Brick Church Station kicking off and others in the pipeline. The industrial sector will continue to lead the way in new construction. 2023 may be the year we see the multilevel warehouse market making its way into New Jersey. The traditional retailer is at a fork in the road. Look for grocers, QSRs and service-oriented businesses to make up most of this market. Hopefully, we will see this volatile market with high interest rates and inflation start to reverse if the Fed shifts its positions.

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The prognostication of the real estate market can be left up to the brokers and owners in our wonderful New Jersey real estate market. Instead, here is an update on the accounting firm landscape. The customer demand related to our services has significantly changed. As accountants, we're at the center of everything a customer does, and we credit our success to them. With that said, Wiss has poured back capital to invest and expand our service mix. Clients are demanding services such as data analytics, financial consulting, family office services (including wealth management and insurance), advisory, recruiting, IT implementation, automation services, trusts and estate, outsourcing and a deep tax experience in the real estate industry. The goal for firms is to become a one-stop shop for all our customers' needs. If you are not hearing these things from your firm, you should be asking why.

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The CRE industry will face challenges in 2023 — interest rates have risen, high inflation will impact property valuations and banks are faced with rate compression. All of this will impact real estate investment and development, and affect basic supply and demand fundamentals.

Prior to the Fed increasing interest rates some 300 basis points, capital to fund acquisitions and developments flew freely. Today, negative leverage has popped up in CRE investing and could slow down deal flow and developments. If inflation does get tamed and cap rates remain low, CRE investors will deploy their cash and banks will need to be there for their clients. CRE is still the best hedge for inflation and despite negative leverage, we expect more money to flow into real estate.

For more than 100 years, Peapack has provided superior banking solutions for our clients. As we enter 2023, we continue to be committed to serve our clients and the communities with the greatest needs.

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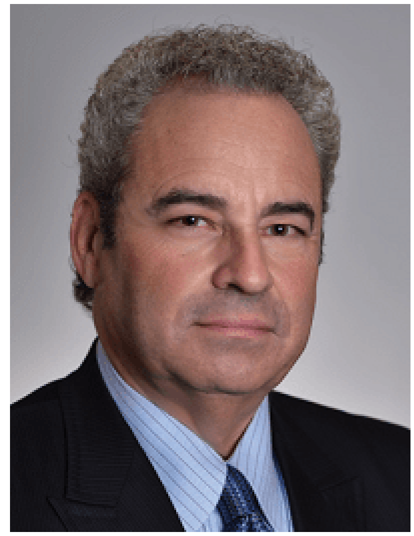
As the many schools of thought on the current and future state of the economy and interest rates continue to pull CRE investors in different directions, one thing remains clear: Multifamily assets are on solid ground entering 2023. Historically able to withstand the test of any economic cycle — even severe recessionary periods — New Jersey's apartment stock is continuing to demonstrate a level of stability steeped in its most-favored CRE investment vehicle status. While there is a 'normalization reset' in multifamily values and rents following a pandemic-fueled era surge of both, statewide occupancies are among the strongest in the nation. And, based on my 48 years in the business with Gebroe-Hammer Associates, the latter will be fortified by renewed economic growth that will in turn drive demand, particularly among existing properties in the value-add Class B and C sector. People can work and shop from anywhere, but they need a place to call home.



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Fear and uncertainty are dominating the market for real estate investment. There are several negative economic concerns which will affect the real estate industry in 2023. These concerns, despite strong balance sheets, have resulted in banks and equity sources delaying any commitments, causing illiquidity in the market.

Woodmont will continue to invest and build for long-term growth, as a holistic view of investment strategy should transcend any short-term dysfunctions in the markets, including a likely recession. Companies with strong track records and balance sheets will continue to attract capital sources. A seven-plus-year view of value creation provides a very attractive case for real estate investment today.

With long-term value creation at the heart of our operations, Woodmont will remain committed to the acquisition and development of properties in our core asset classes of multifamily, industrial and senior housing in New Jersey, Pennsylvania and Southeast Florida.

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Despite the rise of remote work, companies in 2023 will renew their commitment to physical office space that allows employees to connect, collaborate and be inspired. While most people perform best when they interact face-to-face, landlords have come to the understanding that not every company is ready to return to the traditional office space. Last year proved that a hybrid work model leads to the best productivity and work/life balance for employees, and come 2023, we expect to see more companies occupying a reimagined post-pandemic “office of the future.” These smaller, highly amenitized, collaborative workplaces will provide employees with the features needed to work effectively with colleagues both near and far. In addition to well-executed design, companies will be interested in flexible

lease terms for a space where they can expand or condense as needed, without compromising best-in-class features, to help them weather continued changes in the workforce and the broader economy.

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