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RealEstateMatters

In This Issue

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C&I Council: *2025 Real Estate Outlook*

The following are selected highlights of remarks by Mark Fitzgerald and the High Real Estate Group leadership team to the Lancaster Commercial & Industrial Real Estate Council at their 39th annual meeting in February 2025. You can download the slide presentation here: https://bit.ly/42tZq4b or by visiting highrealestategroup.com and scrolling through the "News" section halfway down the home page.

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Navigating the Complexities of Commercial Real Estate Partnerships

By: Tony Seitz – Vice President – Development, High Associates Ltd.

Investing in commercial real estate can yield significant rewards, but it also comes with substantial risks, regardless of the asset class. Whether it's an acquisition or a new development, real estate investments are capital-intensive and require specialized expertise throughout all phases of the process, from due diligence to managing operations. In order to mitigate risk and leverage talent and opportunities, commercial investors often "partner" on real estate projects.

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President's Message

Thank you to everyone who attended this year's Lancaster Commercial and Industrial Real Estate (C&I) Council meeting. For those who were unable to make it or are interested in learning more about this year's presentation, please visit https://bit.ly/42tZq4b to download the slides, or visit highrealestategroup.com and scroll through the "News" section halfway down the home page.

In this issue of Real Estate Matters, we cover the salient parts of my remarks at the meeting and those of our asset class leaders. As 2025 progresses, I am generally optimistic about the outlook for the real estate market, driven by positive economic indicators and strategic opportunities across various asset classes.

The economy continues to show resilience, with real GDP growth outperforming forecasts and a declining probability of recession. Inflation remains a concern, particularly in housing costs, but the overall economic environment is conducive to growth and stability.

The sentiment for acquisition remains strong, particularly in the industrial and multi-family sectors. The office sector is showing some early signs of recovery, which gives us optimism about the continued positive movement as more people return to the office. Cap rates are stabilizing, and underwriting criteria are adapting to market conditions, ensuring sustainable investment opportunities.

Lancaster's real estate market continues to outperform national trends. Our local office market remains resilient, with vacancy rates significantly lower than national averages. While the industrial and multi-family sectors are experiencing record levels of development, we anticipate demand will remain strong, absorbing the additional space as it becomes available.

The construction industry faces challenges with material costs and labor shortages, but we are confident in our ability to navigate these headwinds. By prioritizing domestic sourcing and diversifying supply chains, we are well-positioned to maintain our momentum and meet the growing demand for new developments.

Overall, the real estate outlook for 2025 is promising. We are committed to leveraging these opportunities to drive growth and deliver value to our stakeholders. Thank you for your continued support and partnership.

Mark

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A real estate partnership can take many forms, including joint ventures where ownership is shared, or joint developments where parties collaborate to deliver a project while maintaining separate ownership of the specific real estate assets within the development. An example of this is a land condominium where the partners jointly fund the infrastructure and entitlements, after which each partner is responsible for developing and owning their individual condominium units and the vertical construction thereon, with the condominium association owning the common elements.

A real estate partnership can be as creative and unique as the parties involved desire. Partners in a venture may be active, passive, or both. The motivation behind these partnerships typically includes sharing costs and risks, dedicating time and manpower, leveraging expertise, utilizing existing assets (such as when a party brings land it owns or controls to the table), and leveraging relationships.

This article briefly expands on a few of the pros and cons of real estate partnerships and offers some advice for structuring them effectively.

Pros of real estate partnerships:

1. **Shared Cost/Risk:** In times of rising costs, sharing the financial burden of acquisition or development can significantly reduce individual risk. Partners may also provide access to new sources of capital investment, including equity and financing options. The allocation of costs and capital calls within the partnership structure can be complex and often requires substantial negotiation.
2. **Expertise:** Partnerships are often formed to leverage the specialized skills each party brings. One partner may be a seasoned developer in a specific asset class, while another may have extensive local knowledge and relationships due to an extended presence in the market. In many instances, a passive partner may seek out a proven developer to form a joint venture, where the developer manages the deal and the passive partner provides most of the capital. High Real Estate Group, with its deep expertise in key real estate asset classes, integrated structure, proven track record, and access to High Construction and Greenfield Architects, is uniquely positioned to selectively leverage its expertise as it evaluates partnership opportunities.
3. **Existing Assets:** Parties often bring existing assets to the table, which can be crucial for entering a deal. Establishing some form of partnership may be the "price of admission" to a deal when the party with ownership seeks to remain in the project and leverage its asset. Additionally, the scope

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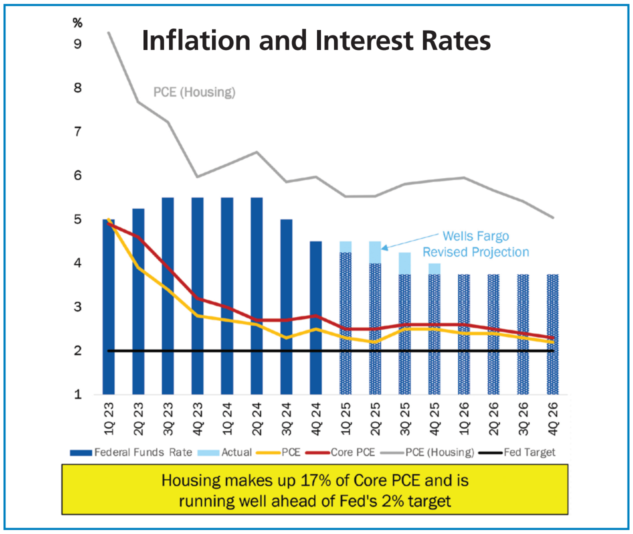
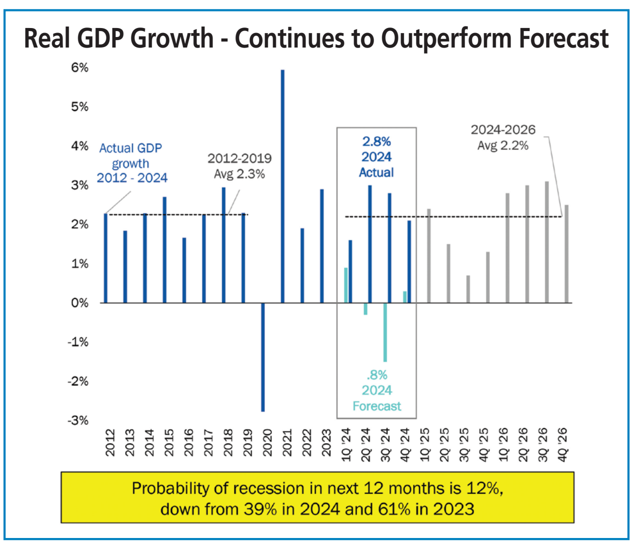


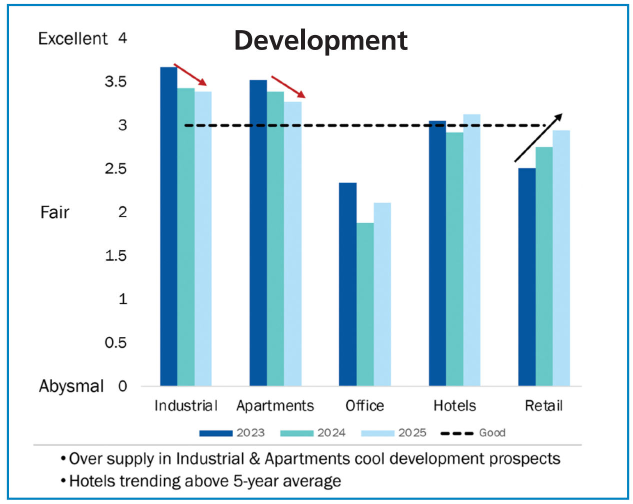
Source: Wells Fargo Annual Economic Outlook – 11/23 and 11/24; Bureau of Economic Analysis; Moody's Analytics Forecasted; Bureau of Labor Statistics; Wall Street Journal

Inflation and Interest Rates – Core Personal Consumption Expenditures (PCE) continued to decline gradually in 2025. However, housing costs, which constitute 17% of the Core PCE, are still significantly above the Federal Reserve's 2% target. After peaking at 5.5% in 3Q23, the federal funds rate declined to 4.5% in 4Q24 as the Fed attempts to balance economic growth while reducing the rate of inflation, aiming for an economic soft landing.



Source: Wells Fargo Annual Economic Outlook – 11/23 and 11/24; Bureau of Economic Analysis; Moody's Analytics Forecasted; Bureau of Labor Statistics; Wall Street Journal

GDP Projections – The gross domestic product (GDP) projections for 2025 indicate a positive economic outlook. In 2024, the actual real GDP growth was 2.8%, significantly higher than the initial forecast of 0.8%. Additionally, according to economists surveyed by the Wall Street Journal, the probability of recession in the next 12 months has dramatically decreased, from 61% in 2023 to just 12% in 2025.



Source: PWC; ULI 2025 Emerging Trends in Real Estate

Real Estate Investment Sentiment – The national sentiment for real estate investment remains generally positive in 2025. The office sector is showing early signs of recovery, with a slight bounce off the bottom in 2024. Retail properties, especially grocery-anchored neighborhood/strip centers, are experiencing significant positive movement for both acquisitions and development. Hotels are trending above the five-year average for development while showing a slight increase in acquisitions. Despite an oversupply in some industrial and apartment markets, the appetite for acquisitions remains strong, with a modest cooling for development. Overall, the outlook for real estate investment is optimistic.

US: Cap Rates Searching for Equilibrium

	4Q 2024 Range	4Q 2024 Average	Change from 4Q 2023
Apartments	4 – 6.25%	5.16%	43 bps
Industrial	4 – 7.5%	5.27%	4 bps
Suburban Office	5 – 9.5%	7.76%	104 bps
CBD Office	5 – 9.5%	7.23%	45 bps
Neighborhood/ Strip Centers	5.5 – 10.0%	7.25%	25 bps
Select Service Hotels	7.5 – 10.5%	8.94%	0 bps

- Cap rates decreased for apartments and neighborhood/strip centers
- Cap rates on all office continue to increase

Source: PWC Real Estate Investor Survey 3Q 2024

Cap Rate Trends – In 2024, cap rates for apartments and neighborhood/strip centers decreased compared to 2023, indicating strong investor demand and continued income growth expectations for these property types. Conversely, cap rates for all office properties continue to rise, reflecting ongoing challenges in the office market, including higher vacancies and negative rent growth. Suburban office cap rates experienced the largest increase of 104 basis points, while Central Business District (CBD) office cap rates rose by 45 basis points.

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Lancaster Market – *Key Observations by Asset Class*

Office and Industrial

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Office – Two new office projects were completed in 2024. There are three buildings proposed for development, and sublease availability is on the rise. While it was a softer year, Lancaster's vacancy is less than half of the national average. The "asking" rate for Class A is $27.87 per square foot and Class B is $18.85 per square foot. Net absorption for Class A space was 31,300 square feet, and vacancy rates increased slightly from 4.9% to 5.2%. Class B & C office space had negative absorption of 87,700 square feet, and vacancy increased from 6.8% to 8.1%. Net absorption for business centers was 400 square feet with a vacancy rate of 15.3%.

Industrial – Four new projects were completed in 2024, adding 952,749 square feet to the market. Four projects are under construction, totaling 1,096,402 square feet. Eight flex/industrial projects have been proposed with a total of 835,981 square feet. For industrial space, there was a positive absorption of 776,000 square feet in 2024, and vacancy increased slightly from 5.5% to 5.6%. The "asking" rate for industrial space is $8.52 per square foot. Flex space had a negative absorption of 18,000 square feet, and the "asking" rate for flex space is $10.51 per square foot.

Multi-Family

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For the second year in a row, Lancaster outperformed national rent growth, and it is projected to do so again in 2025. Lancaster's growth was 3.8% last year and is forecasted to increase by 3.6% this year. Apartment demand nationally stayed robust throughout the year. However, Freddie Mac estimates that the U.S. housing market faces a shortfall of about 3.8 million units of housing. Data suggests a strong year for the local multi-family industry. We expect to see a large uptick in supply hitting the market in 2025-2026, with an increase of approximately 1,200 units in Lancaster County. Owners are focused on cost-saving opportunities to generate Net Operating Income (NOI) growth through centralized leasing and maintenance.

Retail

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Following the market volatility associated with COVID-19, materials costs stabilized in 2024. However, proposed tariffs on imported goods are anticipated to create supply chain confusion, and import tariffs may lead to higher prices. On the labor side, the aging workforce, combined with fewer young people entering the trades, has led to a labor shortage. There are 439,000 additional construction workers needed to meet the anticipated 2025 demand. Recent immigration trends have expanded the labor pool, but future deportation policies may limit ongoing availability. Construction backlog is down nationally, but contractor confidence remains high. Locally, we are poised for growth.

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of a project can expand when parties consolidate parcels and density/uses into a larger tract, making the combined effort more successful than independent projects.

4. **Relationships and Time/Manpower:** Closely aligned with expertise, the relationships and resources each party brings to the table can be a motivating factor to form a partnership. One party may have cultivated deep ties to a community, resulting in unparalleled relationships with governing bodies and regulatory agencies. Another might have the internal resources and manpower to dedicate substantial time to uncovering and executing real estate opportunities. The diversity of skills, talents, and resources, and the successful pairing of these attributes, make real estate investment dynamic and partnership opportunities potentially rewarding.

Con of real estate partnerships:

While the potential benefits are significant, there are also drawbacks to consider:

1. **Conflicting Ideas and Approaches:** Differences in development and operational strategies can arise, leading to erosion of trust and impeding execution. Although dispute resolution processes are stipulated, they are often imperfect and cannot resolve or smooth over conflicts in real time.
2. **Complex Partnership Documents:** The negotiations required to properly structure partnership documents are time-consuming and expensive. In the case of a public-private partnership (where one of the parties is a government entity), additional time and complexity are introduced due to the specific rules and regulations that bind government organizations.
3. **Reduced Returns:** While risk is mitigated, returns are often reduced in joint ventures, and development upside can be limited to one of the partners.
4. **Loss of Interest:** Despite the best of intentions at the outset, one party may lose interest, take a back seat, or even seek to exit the partnership.

Tips for Forming Effective Real Estate Partnerships:

Over the years, High Real Estate Group has successfully engaged in numerous joint venture and joint development projects across various markets and asset classes, always as an active investor-manager. Currently, High is collaborating with Audubon Land Development Company on an exciting new multi-family development project in Collegeville, PA. Both companies are well matched with shared values and a shared commitment to delivering quality projects.

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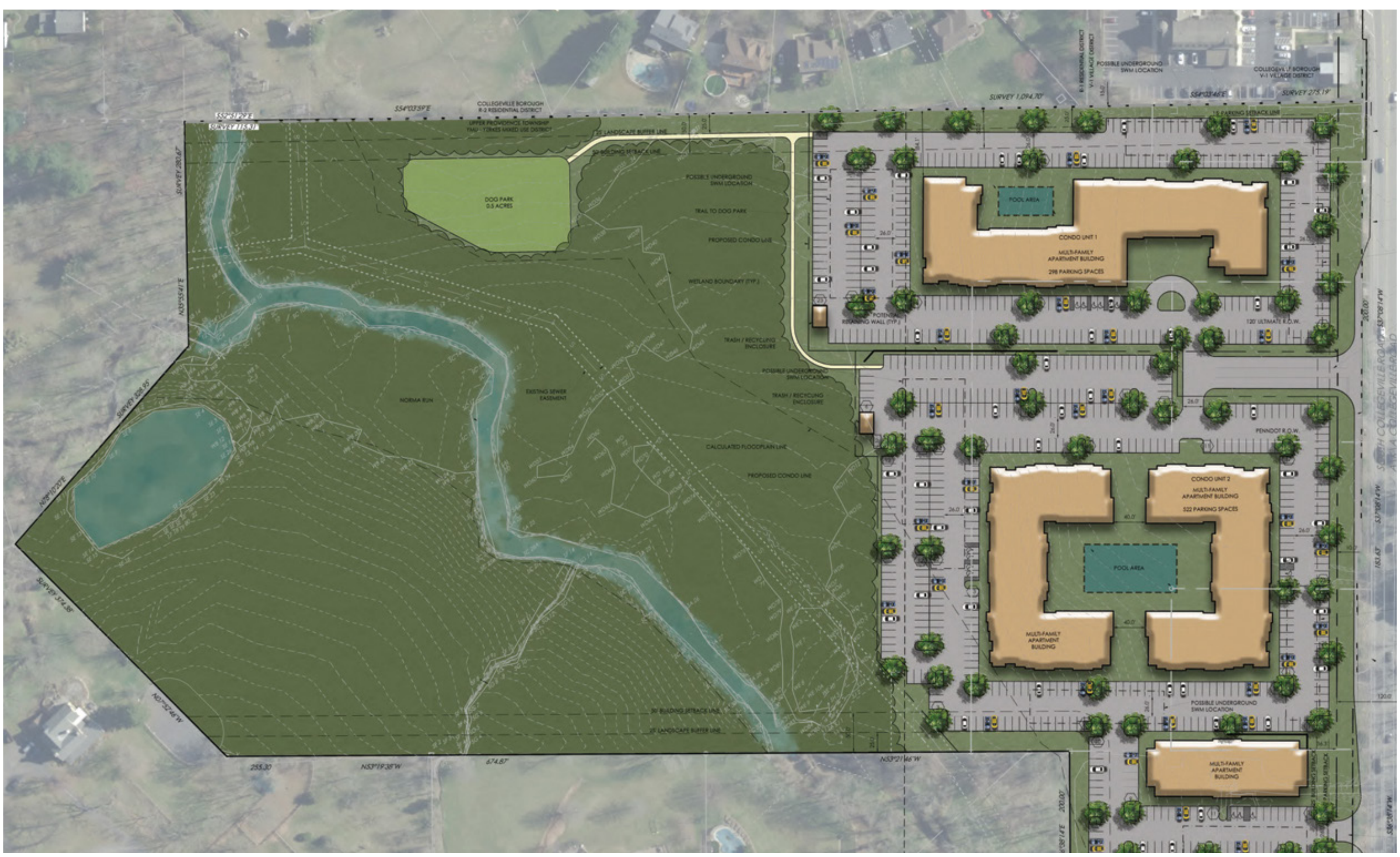

Navigating the Complexities of Commercial Real Estate Partnerships

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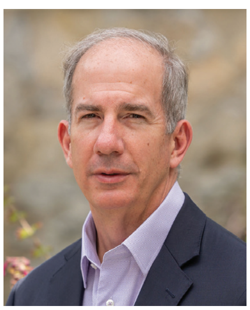
Below are a few tips for entering into successful real estate partnerships:

1. **Define Roles and Responsibilities:** Clearly outline the nature of the deal in a letter of intent (LOI) document. While typically non-binding, the LOI should serve as an effective guidepost during the agreement phase, defining the deal's parameters.
2. **Engage Qualified Counsel Early:** As noted earlier, document preparation is time-consuming and complex. Engaging qualified counsel for both sides early in the process is essential to structuring the partnership correctly. Consulting tax counsel early on is also advisable.
3. **Assess Suitability:** Be open, try to see both sides, and honestly assess at the outset how well-suited the organizations are to be partners. Any real estate deal takes time, and partners can expect to be engaged for years or even decades.



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Ground Breakers

1. Aqua in Chicago is a mixed-use building rising 859 feet for a total number of 85 floors. The first 18 floors are retail shops and office buildings. Floors 19 through 52 are apartments and floors 53 through 85 are for condominiums and penthouses.
2. The construction robots market is set to grow at an annual rate of 17.5%. Robots make construction work safer by replacing humans for the most dangerous and unpredictable tasks.

3. Completed almost 500 years ago, the Great Wall of China spans over 21,000 kilometers. The Great Wall is also known for being the second longest continuous construction project ever undertaken, with a total building time of approximately 2,000 years.

4. The steel industry employs over 8 million people which is about the population of the entire country of Switzerland.
5. The Tremont House in Boston was the first hotel to use electricity in 1889, installed by Thomas Edison himself.

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