



HOULIHAN LAWRENCE
COMMERCIAL



Commercial Market Report

WESTCHESTER COUNTY | SECOND QUARTER 2020

Executive Summary

SECOND QUARTER 2020

Q2 2020 Westchester Real Estate Market Report:

Operating in and Surviving Uncharted Waters

All hands on deck to weather the uncertainties and to identify a route to recovery.

Uncertainty and change have never engulfed so many people and businesses at the same moment in time. Few across the world have been untouched by the COVID19 pandemic. Many are fighting for their own health, their jobs or the survival of their business.

The path forward is unclear and important decisions are made more difficult because a new reality is just emerging as the “sharing economy” has given way to the “distancing economy”. In many ways, we are all trying to build new foundations on still unsettled ground. The road back is uncertain, but we must choose to embrace necessary change and quickly adapt.

While facing challenges and sharing in the widespread economic pain, the Westchester Commercial Real Estate business is in the early stages of benefitting from consumers and companies desire to live and work in areas that offer lower population density and access to open spaces, along with great services, excellent infrastructure and a highly educated work force.

Jobs reports test positive — but will it hold?

The July 2nd jobs report painted a hopeful picture for the economy as the Bureau of Labor Statistics (BLS) reported that the US added 4.8 million jobs during June and the unemployment rate dropped to 11.1% from 13.3% in May (June marked the second month of employment recovery). However, jobs are still being lost as the pandemic drags on and many businesses are forced to make hard decisions required to survive. The longer this crisis lasts, the more likely it is that consumer and business behavior changes will become permanent and the impact on Commercial Real Estate assets – and other segments of the economy – become long lasting. We envision possible winners and losers due to the impact of consumer's adaptive behavior.

Private employers in New York City are making accommodations to employees' desire to feel safe. Given the apparent success of work from home protocols, many are evaluating a rolling office presence, for which they need less office space, and/or alternative locations. Bound by lease contracts, reductions in office footprint are likely to be slow and take place on the margin. Westchester and Fairfield, CT stand to benefit from these trends as smaller business re-locate out of NYC and larger businesses seek to establish an outpost in these suburban less densely populated areas. Over the long term, lower employee density at core locations and work location flexibility are likely to become engrained in corporate cultures.

Accommodating distancing, retrofitting building ventilation systems, or hedging team health with an alternate location, are among the reasons we are hearing as companies seek short and long-term office space in Westchester.

“Hvac” – heating, ventilation, and air conditioning – takes center stage

For the office, residential and some retail segments of commercial real estate, air quality is becoming one of the most important areas of discussion between landlords and tenants. Landlords will have to demonstrate that their building's ventilation system provides the appropriate air volume circulation, filtering and purification capabilities to gain tenant's confidence. New air purification techniques and other wellness protocols are likely to emerge as a differentiating factor in buildings seeking to attract strong tenants and top of the market rents. In New York State, Governor Cuomo has indicated that it is possible that retail malls may only be allowed to open if they install virus-blocking air filters.

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SECOND QUARTER 2020

The on-going transformation of the Retail sector has been catalyzed by the Pandemic. Consumers have found ways to shop for almost everything they need on-line and retailers have had to invest in their on-line platforms to accommodate transaction volume and customer data security. As a result of pandemic fears and e-commerce success, dense, multistory retail buildings are being challenged. On the other hand, strip centers and well-located street retail, with access to parking, are likely to continue to show resilience. Southern Westchester is not over-retailed and while malls will have to re-invent themselves, demand for in-line space in well-located strips in Westchester has been surprisingly resilient. Rents are likely to re-set lower but at levels that are better than initially expected.

Multifamily owners are trying to manage tenant rent deferral petitions, higher operating costs, lower cash flow and debt servicing — all while continuing to keep their buildings running and healthy. Banks have been inundated by forbearance requests and are managing their own balance sheet and liquidity. Government programs have provided the means for many residents to make rental payments, but as those programs expire, a number of families and landlords will face difficult decisions.

Industrial properties have experienced a high collection rate during the pandemic and continue to be the most resilient real estate market segment, driven by e-commerce applications. This is the case in Westchester as well as other parts of the country. New demand sources have emerged for smaller industrial spaces during the pandemic adding to the overall health of this segment of the market.

Commercial real estate lenders are beginning to warm up to new deal underwriting. Banks and other lending sources were unwilling to consider new business in the early days of the Pandemic, with the possible exception of well-sponsored multifamily deals. In general, we expect very cautious underwriting and loan pricing/terms that reflect higher risk buffers and lower loan-to-value ratios (LTVs). Transaction volumes in Westchester have been low and recent transaction terms reflect deals that were on-going prior to the crisis. Valuation across market segments is still very uncertain.

Westchester's high performing multifamily sector holds steady

According to data collected by COSTAR, Westchester multifamily average rents have remained stable. Occupancy is down close to 1% as compared to the same quarter in prior-year. However this drop precedes the pandemic and reflects new apartment deliveries. Take up of apartments units in Westchester, South of I-287 was positive during Q2, 2020.

In Westchester, like in other areas of the Country, tenants now prefer low-rise garden apartments over denser high-rise buildings. Most of new construction projects in Westchester are the latter format, and pricing may have to become compelling to attract tenants and stabilize these new projects, once delivered.

Westchester office statistics stable during q2

COSTAR data for Westchester offices, South of I-287 reflect a relatively stable market with positive take-up of office space. Statistics do not yet reflect changes brewing due to the pandemic. Some of the positive absorption may have been as a result of early relocations from NYC. Rental pricing for Westchester offices showed a slight improvement that appears driven by deals in higher-end offices and locations. Close to half of the leasing volume observed during the quarter were sublets, which are more prevalent in better quality buildings.

Retail vacancies not showing up yet

The Pandemic business pause has exerted severe financial pressure on some retail tenants, in particular, restaurants and fitness centers. These tenants are currently working with their landlords and financing partners to try to emerge from the pandemic as viable businesses. It is too early for retail occupancy statistics to reflect which businesses may fail and have to abandon their current locations. For the time being, COSTAR data reflects stable retail occupancy and rents from prior quarters.

Industrial data reflects stable market and stable pricing

Anecdotally, Industrial properties are in high demand. However, tenant turnover friction may be higher, at times, due to the fact that requirements tend to be more specific for industrial tenants. Overall, we expect this segment of the market to be stable and vacancies to be filled briskly.

CRE investors staying in “wait-and-see” mode

Purchaser and seller pricing expectations are still wide apart and the weak investment sales trends that we have observed over the last two quarters is likely to remain in place until financing availability improves, re-opening efforts gain traction, and pandemic trends reach a level of stabilization. Many purchase and leasing deals that have been put on hold may never take place, at least not as initially conceived, and the environment is highly uncertain. We expect that investment cash deals will be more prevalent in these initial phases of market “thawing”. Purchasers are likely to increase their underwriting scrutiny as tenant cash flows – and rent paying ability – may have changed substantially during the pandemic. Should attractive discounts to replacement value become available, we envision a burst of activity in the investment sales markets.

In general, we are observing that owner-users, with immediate real estate needs to house and grow their business, are the most likely buyers in these early days of returning to activity.

Houlihan lawrence is here for our clients

In this very fluid and difficult situation, we are ready to help with advice, ideas and market intelligence.

Please reach out to us with your questions and concerns. We will help you navigate these markets. We are continually following all Executive Orders issued by the Federal Government, NY State Government, and the advisories provided by our state trade association, NYSAR.

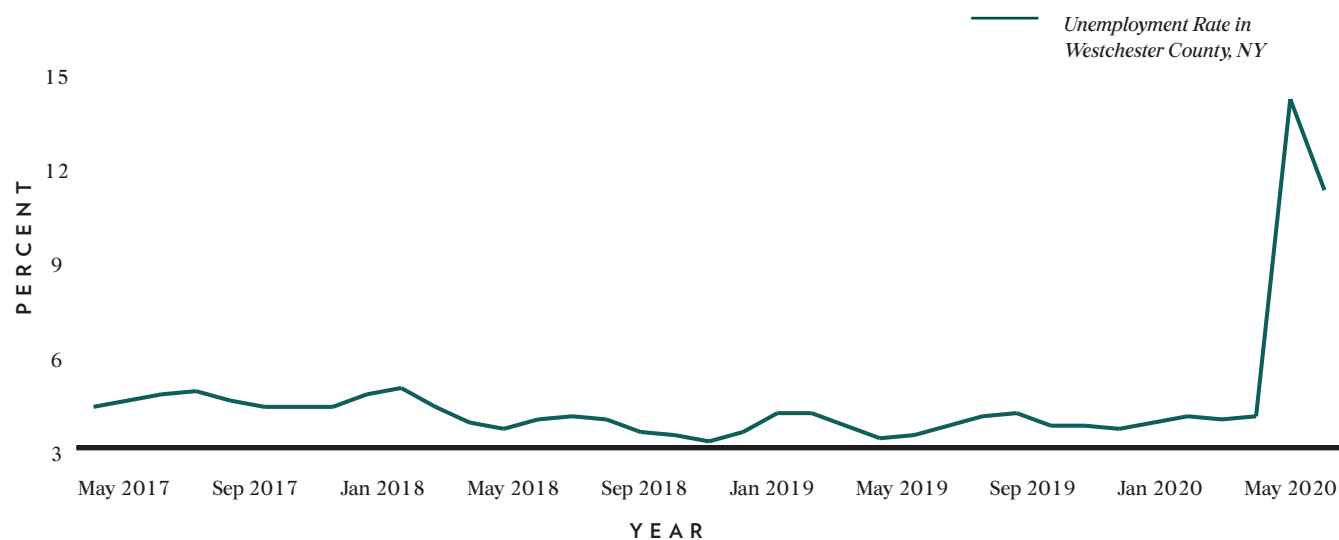
Stay well. We are a call away.

COVID-19 Significantly Changes Employment Fundamentals

WESTCHESTER COUNTY AND NATIONAL UNEMPLOYMENT STATISTICS

Westchester's employment trends were solid at the outset of the COVID 19 pandemic. In fact, Westchester's unemployment rate had remained under 5% for more than three years.

However, the pandemic has deeply affected most sectors of the economy, in particular, service sector employment. As of end of May, last available data indicates that Westchester County's unemployment is over 11% but lower than the 14% recorded in May and consistent with National trends.



Sources: COSTAR, Trepp, US. Bureau of Labor Statistics, Unemployment Westchester County (Not Seasonally Adjusted), NY. Real Estate Employees Data is Seasonally Adjusted. All data retrieved from FRED, Federal Reserve Bank of St. Louis; June 2020.

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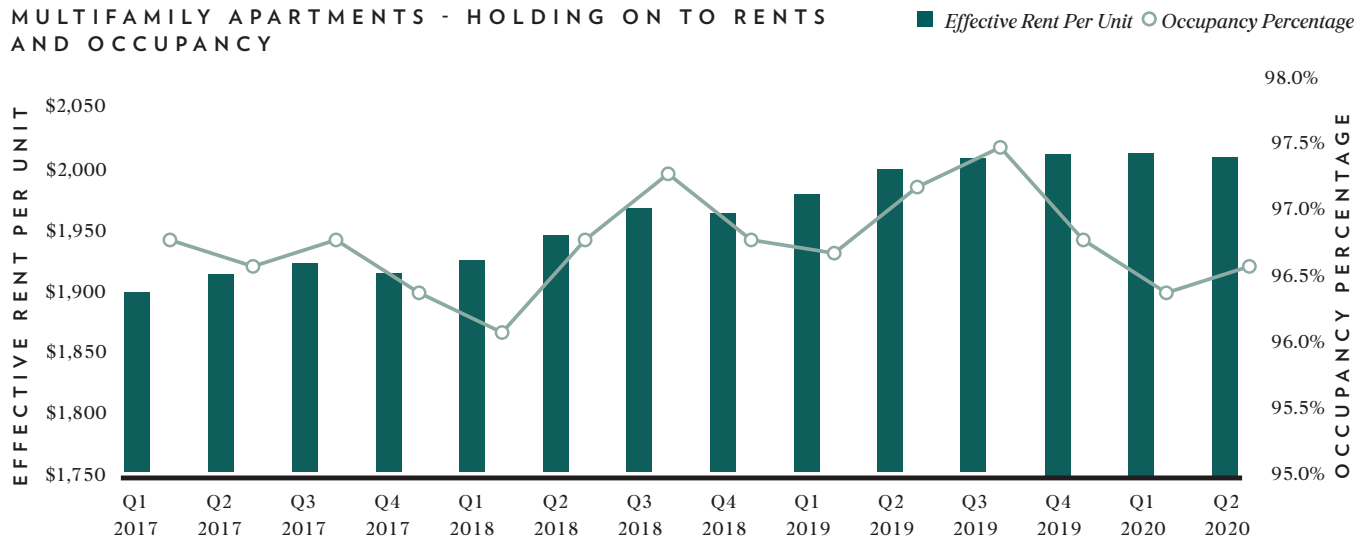
Multifamily Assets: Stellar fundamentals may be interrupted

SOUTH OF I-287

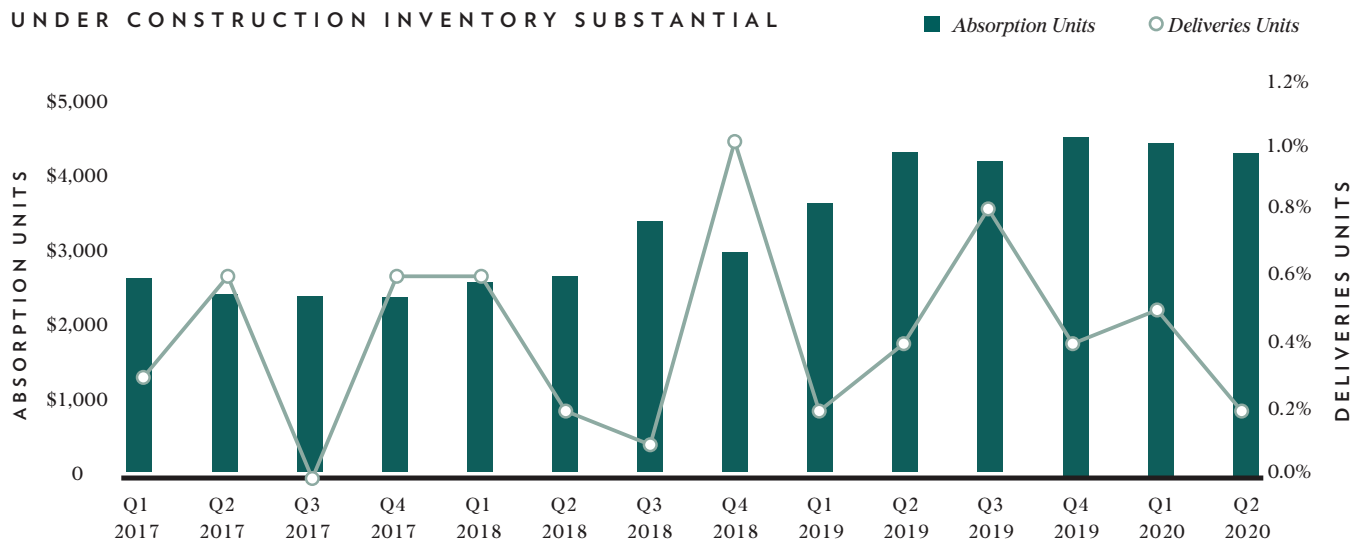
Multifamily Classes B and C are enduring rent deferrals and missed payments. Government programs have helped tenants in these building continue making rent payments.

Multifamily A properties and luxury units are likely to experience occupancy challenges and competition from new developments in certain areas. The speed of economic recovery will dictate how this segment of the market performs over the next few months.

MULTIFAMILY APARTMENTS - HOLDING ON TO RENTS AND OCCUPANCY



UNDER CONSTRUCTION INVENTORY SUBSTANTIAL



Sources: COSTAR, Trepp, US Bureau of Labor Statistics, Data Reflects Fundamentals for Westchester County Area South of I-287. Price Index for Westchester retrieved from FRED, Federal Reserve Bank of St. Louis; July 2020.

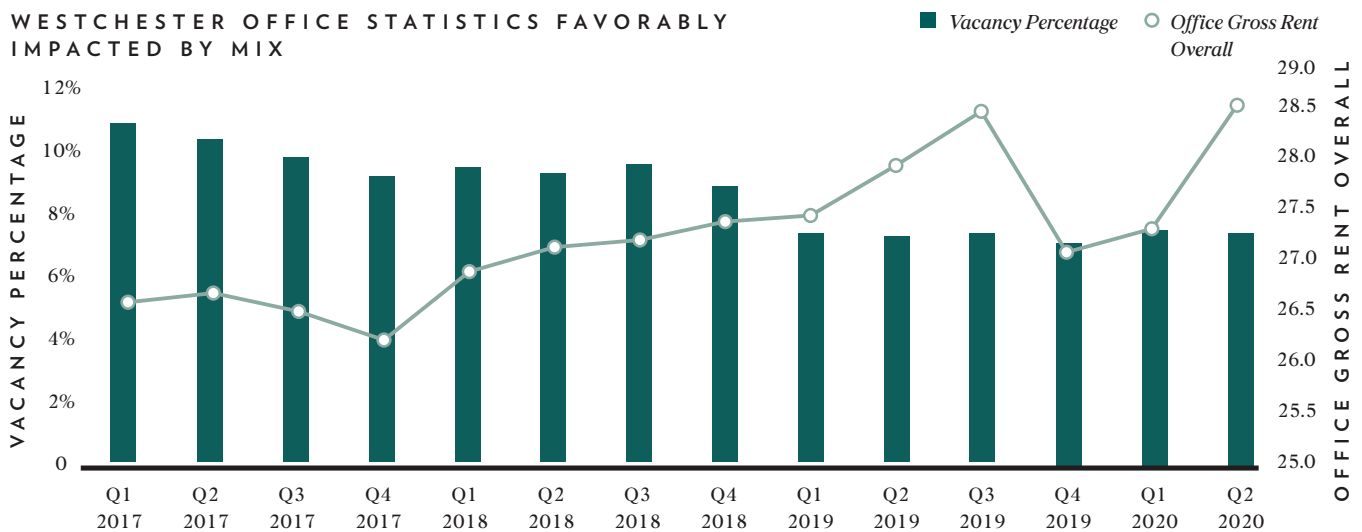
Westchester Office and Retail – Office and Retail Seeking Fundamental Stability

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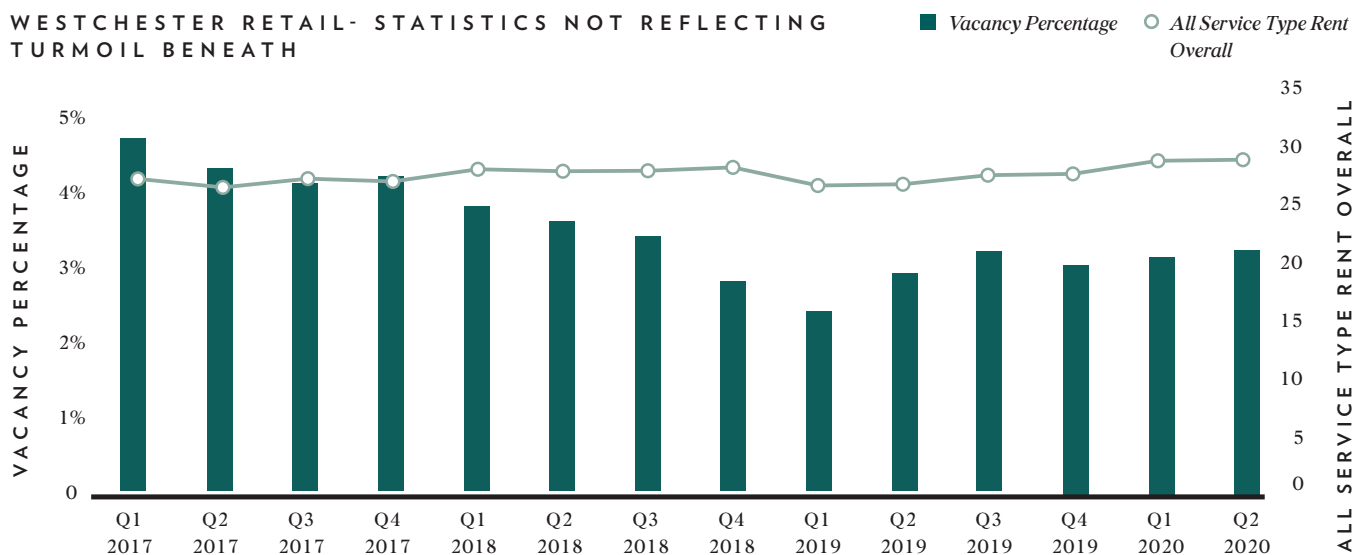
An increase in sub-let lease activity in the office space suggests that larger tenants are optimizing their space use and offering surplus space to companies that would like to have a beach-head or expanded footprint in lower Westchester

Retail property markets are likely to experience the most pronounced negative impact from COVID disruptions. Larger retail boxes will be more difficult to lease until re-formatted, while smaller, in-line retail space in good locations continues to be in demand.

WESTCHESTER OFFICE STATISTICS FAVORABLY IMPACTED BY MIX



WESTCHESTER RETAIL- STATISTICS NOT REFLECTING TURMOIL BENEATH



Sources: COSTAR, Trepp, US Bureau of Labor Statistics, Data Reflects Fundamentals for Westchester County Area South of I-287. Price Index for Westchester retrieved from FRED, Federal Reserve Bank of St. Louis; July 2020.

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Industrial/Flex Properties

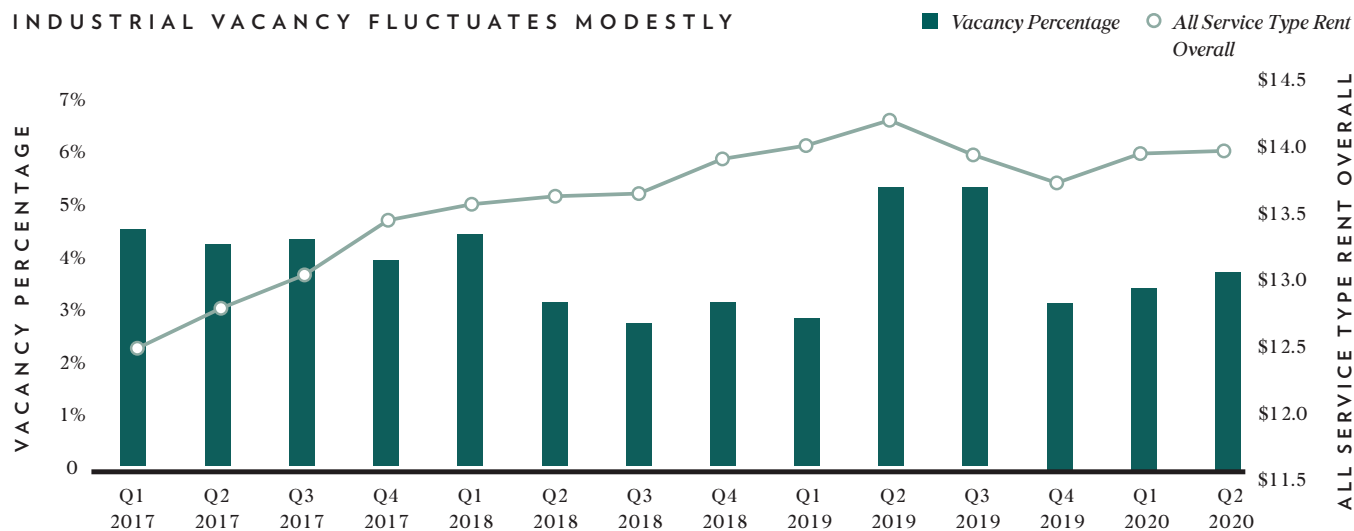
Price Stability and Expanded Uses

SOUTH OF I-287

E-commerce, already strong before the COVID-19 crisis, has continued to drive high demand for industrial and distribution related properties. However, no segment of the property markets will be immune during this crisis and there may be some fluctuations in industrial occupancy related to tenant turnover.

Accelerated growth in logistic infrastructure will benefit larger assets the most while smaller format warehouses may need to be upgraded in order to capture higher segments of the tenant market.

INDUSTRIAL VACANCY FLUCTUATES MODESTLY



Sources: COSTAR, Trepp, US Bureau of Labor Statistics, Data Reflects Fundamentals for Westchester County Area South of I-287. Price Index for Westchester retrieved from FRED, Federal Reserve Bank of St. Louis; July 2020.

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Slower Investment Activity

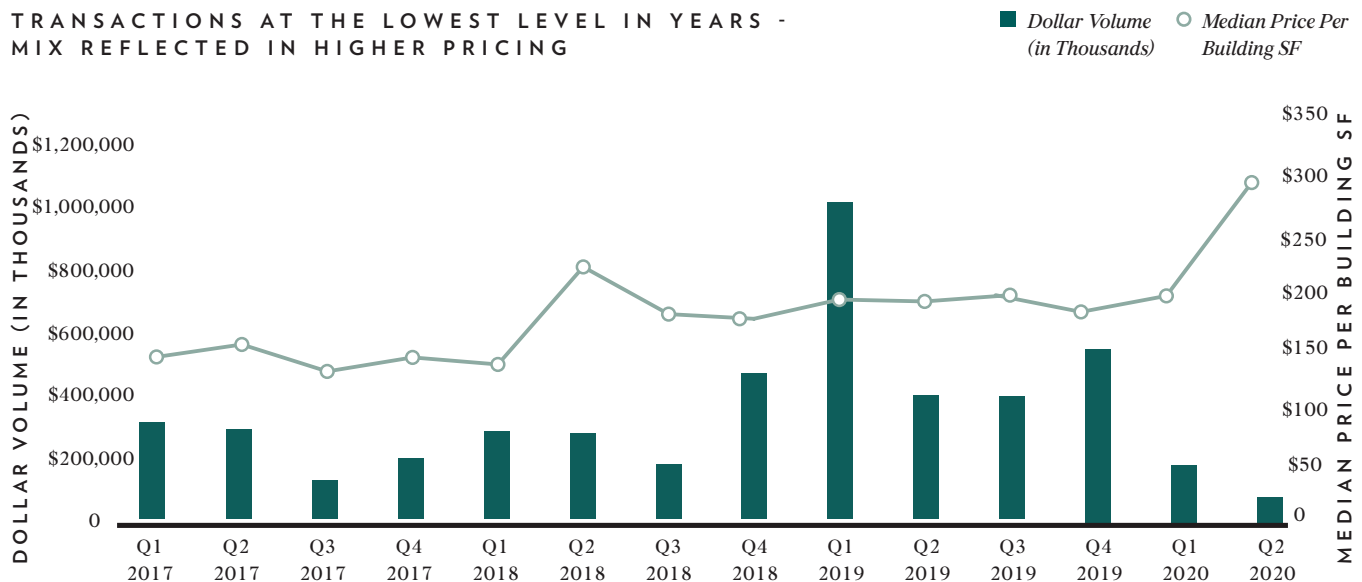
SOUTH OF I-287

As expected, Q2 2020 Investment activity was weak, reflecting the impact of the widespread business “pause” and investor hesitation due to the uncertain environment ahead.

The few transactions that were able to close reflected robust pricing. This is possibly the result of higher end buildings in the mix impacting median pricing.

In the next few months we are likely to see a continuation of low transaction volume as investors keep their powder dry until they develop more confidence in valuations.

TRANSACTIONS AT THE LOWEST LEVEL IN YEARS - MIX REFLECTED IN HIGHER PRICING



Sources: COSTAR, Trepp, US Bureau of Labor Statistics, Data Reflects Fundamentals for Westchester County Area South of I-287. Price Index for Westchester retrieved from FRED, Federal Reserve Bank of St. Louis; July 2020.

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