ACEC Private Industry Brief

Commercial & Residential Real Estate

Fall 2019

Market Scope

The **commercial and residential real estate market** is "vertical" in nature and contains a variety of commercial and residential real estate property types, including: office, industrial, retail, multi-family residential (including student and senior housing), hospitality, and health care. Clients are typically developers and owner-users, such as large retailers. A wide range of engineering services are provided to these clients, including mechanical/electrical/plumbing (MEP), structural, site-civil, surveying, geotechnical, and environmental services. Land development-focused firms also include residential home builders as major clients.

Top Development Firms

According to *Commercial Property Executive's* annual rankings, the current Top 10 Development Firms (measured by square feet under construction) and the property types they specialize in are:

1. **Trammell Crow Co.** (O, I, R, M, H, He, X)
2. **Hines** (O, I, R, M, H, He)
3. **Related Cos.** (O, R, M, H, X)
4. **Tishman Speyer** (O, M)
5. **Duke Realty** (I)
6. **The Related Group** (R, M)
7. **Lincoln Property Co.** (O, I, M)
8. **Majestic Realty Co.** (O, I, R, H)
9. **The Wolff Co.** (R, M)
10. **Liberty Property Trust** (O, I)

Property types key: O=Office, I=Industrial, R=Retail, M=Multifamily, H=Hospitality, He=Health Care, X=Other.

5 Current Market Trends

- **1. Cities and States Lead on Climate Change:** State and local governments, which generally have a more direct impact on regulations concerning the built environment than federal agencies, continue tackling sustainability by setting ambitious climate goals and enacting new legislation that directly affects building codes. According to Urban Land Institute's *Greenprint Performance Report* (Volume 10) more than 31 cities have set energy benchmarking policies for buildings and 287 U.S. cities and counties signed the *We Are Still In* pledge to remain in the Paris Climate Accord. New York City, the District of Columbia and California have enacted particularly challenging mandates for limiting buildings' energy usage and carbon emissions. These challenges are also opportunities, particularly for engineering firms providing MEP design services.

- **2. Industrial Gets Urban:** For the sixth straight year the industrial/distribution market is named the top-ranked property sector for investment and development in *Emerging Trends in Real Estate 2019* (PwC & ULI). According to commercial real estate firm Newmark Knight Frank (NKF), e-commerce spending is expected to grow 60 percent by 2023, with an increasing consumer expectation for same-day delivery. Understanding how to solve "last mile" delivery challenges is a primary focus, with urban warehouses

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What facility types are growing?

1. **Warehouse**
2. **Fulfillment**
3. **Senior housing**
4. **Medical office**
5. **Moderate income/workforce apartments**

Source: PwC & ULI

1015 15th Street NW, 8th Floor, Washington DC 20005-2605 P: 202.347.7474 | F: 202.898.0068 | E-mail: acec@acec.org

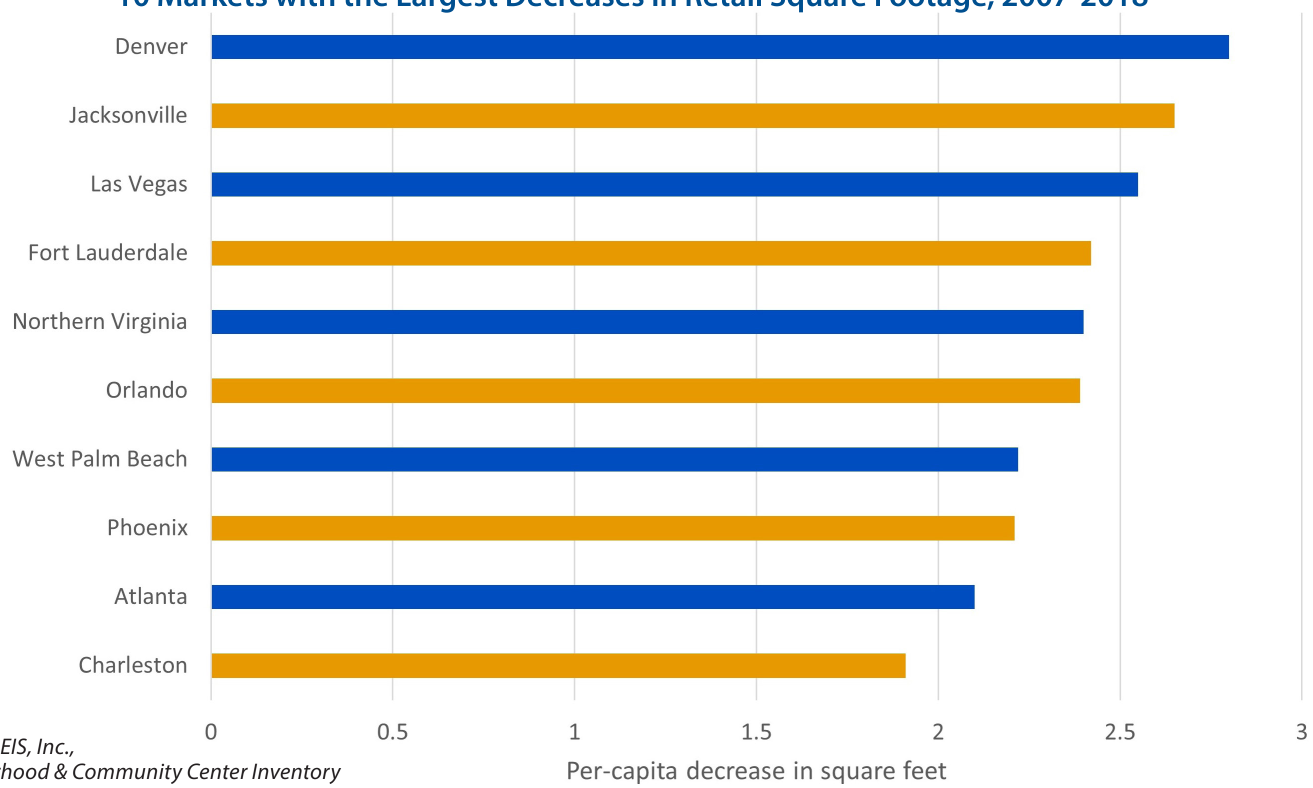
as one solution. NKF estimates the average distributor spends 50 percent of overhead on transportation and only 4 percent on real estate, so there may be room for a shift to more expensive, close-in facilities. In September 2019, developers of the first multi-story warehouse in the U.S. (in Seattle, built as a speculative project) announced the two tenants to occupy the facility, Amazon and Home Depot Inc.

- **3. Opportunity Zone Anticipation:** The opportunity zones program is the first new, national community investment program in 15 years. It gives investors the flexibility to develop and redevelop a variety of commercial and residential project types, from much-needed workforce housing to metro-located brownfield sites. Incentives give investors significant tax breaks in exchange for investments in census tracts designated by each state's governor. There are 9,000 communities designated as Qualified Opportunity Zones, including many in transit-oriented, urban locations. Commercial real estate firms have begun creating funds and targeting opportunity zones. For engineering firms, connecting with state and local organizations working to attract development—and exploring with clients potential sites—are good moves to pre-position for future work.

- **4. Retail Re-imagined:** Although e-commerce is booming, most sales still take place in brick-and-mortar stores. However, these stores are changing, with a focus on designing smaller spaces that highlight consumers' experiences. The U.S. has long supported retail-space-per-capita levels that are multiples of what exist in other developed countries, and experts see this pullback as a recalibration (see chart below). At the same time, traditional malls and other retail centers are re-purposing vacant spaces to focus on services and entertainment, including urgent-care medical facilities, health and fitness providers, and restaurants.

- **5. Growth in '18-hour' Cities:** Real estate investors have long touted the benefits and stability of developing projects in 24-hour cities; but the new buzz is about "18-hour cities." Generally seen as having similar attributes of a 24-hour city—without the density or round-the-clock vibrancy—18-hour cities have urban amenities, access to mass transit, and walkable neighborhoods. What is largely attracting residents, including aging Millennials, is a lower cost of living. *Emerging Trends in Real Estate 2019* (PwC & ULI) notes that 17 in the top 20 of its growing real estate markets fall into this 18-hour category, with growth expected to continue, "The projected average annual population growth over the next five years in the 17 markets is 1.3 percent compared with 0.7 percent for the United States as a whole."

10 Markets with the Largest Decreases in Retail Square Footage, 2007-2018



Source: REIS, Inc., Neighborhood & Community Center Inventory

Government Affairs Action

- **Energy Tax Incentives:** ACEC is advocating for extensions of the Section 179D energy-efficient commercial buildings tax deduction, an incentive for the installation of energy-efficient lighting, HVAC and building envelopes, and the Section 45 production tax credit (PTC) for renewable energy. These energy tax provisions, along with a number of other tax measures, expired in December 2017 and were one of the key advocacy issues during the 2019 ACEC Annual Convention and fly-in. In addition, ACEC submitted comments in support of extending Section 179D and Section 45 to the Senate Finance Committee. The Council and industry allies are urging Congress to include the tax extenders in an expected year-end budget bill.
- **CWA Section 401 Clarification:** ACEC supports a proposed rule that would provide discipline to states authorized to certify that projects comply with Clean Water Act (CWA) Section 401. Projects such as natural gas pipelines have been economically threatened by delays, resulting in utility restrictions on residential and commercial developments. The proposed rule would reduce time delays and limit the scope of state reviews on certifications. Included in Section 401 of the CWA are requirements concerning effluent limitations and standards for performance for new and existing discharge sources, water quality standards and implementation plans, and toxic pretreatment effluent standards. The CWA provides up to one year for states to certify projects, however some states have abused their authority with time delays and requirements beyond the scope of the CWA.
- ***Additional ACEC Advocacy Efforts Related to the Commercial & Residential Real Estate Market*:**

  √ WOTUS Redefinition: ACEC is advocating for the repeal (which was announced by the U.S. Environmental Protection Agency and Dept. of the Army on September 12, 2019) and subsequent revision of the 2015 "Waters of the United States" (WOTUS) definition, which expanded what was considered a wetland and would have caused needless complications in permitting processes.

  √ Permitting Improvements: ACEC supports the White House Council on Environmental Quality's proposed rulemaking that proposes efficient, well-informed and timely federal decision making.

  √ More Funding for Superfund & Brownfield Redevelopment: ACEC supports stable funding so properties can be restored for productive commercial development.

  √ Support for the NFIP: Long-term reauthorization and reform of the National Flood Insurance Program (NFIP), including expansion of private-market protections, is important since flooding is the most impactful natural disaster type in the United States.

Business Development Insight

Mass Timber Market Growth Means New Opportunities and Challenges

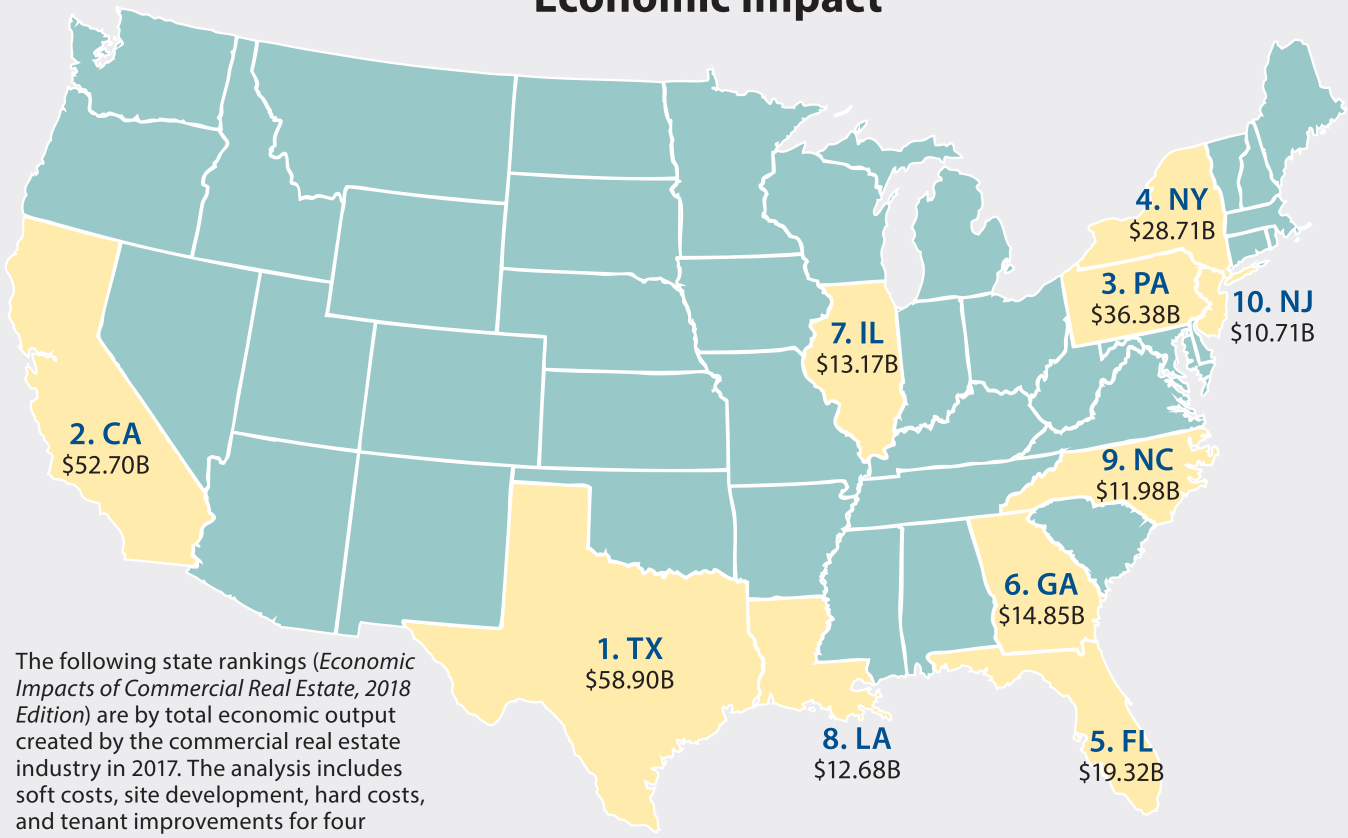
A combination of factors, including code changes, a growing carbon-consciousness, and an appreciation for the warmth of wood, are stacking up to make mass timber structures the mid-rise building of the future.

Mass timber refers to composite-wood systems that combine multiple pieces of wood into larger structural elements. The strength and applicability rivals concrete and steel, and in most structures mass timber is considered to have the same fire and safety risks as buildings made of more traditional materials. In December 2018, the International Code Council voted to loosen the International Building Code's restrictions on structural wood. These changes allow for buildings up to 18 stories in height, effective in 2021. Current U.S. building codes limit structural wood to six stories in commercial structures.

The world's tallest wood structure (at 18 stories) was completed this past March in Norway, and was constructed using the popular composite cross-laminated timber (CLT) material. CLT was developed in the early 1990s and uses lumber from smaller trees that are glued together in perpendicular layers to form large, mass timber panels. Fabrication of these panels is done in factory environments before being moved to job sites. The CLT process decreases wasted material compared to more traditional construction methods. The CLT process puts the focus on the preconstruction and planning phases. Most CLT projects are done under a design-build or similar arrangement and are completed 10-30 percent faster, according to sources.

Many are enthusiastic about mass timber due to its purported environmental benefits. Unlike steel, timber is renewable and wood acts as a "carbon sink" drawing carbon out of the atmosphere as trees grow. That carbon stays captured for many years within the wood project. Mass timber proponents estimate that wood buildings may produce less than one-quarter the carbon emissions of steel or concrete—although environmental advantages are highly dependent on forestry management practices and where the timber is sourced in relation to the building site. However, the U.S. supply chain is gaining in options for mass timber. In 2018, the first CLT plant in the Eastern U.S. opened in Alabama. According to Woodworks (June 2019 analysis), 221 mass timber buildings are under construction or have been completed in recent years in the U.S., and an additional 378 are in the design phase.

Top 10 States with Greatest Commercial Real Estate Economic Impact



The following state rankings (*Economic Impacts of Commercial Real Estate, 2018 Edition*) are by total economic output created by the commercial real estate industry in 2017. The analysis includes soft costs, site development, hard costs, and tenant improvements for four kinds of facility types: office, industrial, warehouse, and retail/entertainment.

Source: NAIOP Research Foundation

Key Webinar

The Potential of Opportunity Zones for Your Project Pipeline

The new opportunity zone program provides developers the flexibility to pursue commercial, residential, and multi-modal projects on underutilized sites. Governors in each state designated 9,000 communities nationwide as Qualified Opportunity Zones. Learn about why this new program is creating such a buzz and how engineering firms can realize new business opportunities.

Webinar Presenters

Catherine Lyons, Manager of Policy and Coalitions with the Economic Innovation Group

Vanessa Sturgeon, President & CEO with TMT Development

On-Demand Link: http://bit.do/opportunity-zones

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Erin McLaughlin is ACEC's senior director of private market resources. She can be reached at: emclaughlin@acec.org

Further coverage can be found in Engineering Inc.'s regular column "The Private Side" as well as ACEC's quarterly economic reviews.