



2023

TOP TEN ISSUES AFFECTING REAL ESTATE®

The Counselors of Real Estate®

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The Counselors of Real Estate has identified the current and emerging issues expected to have the most significant impact on all sectors of real estate—each determined through polling, discussion, and debate among the broad Counselors’ membership. As the commercial real estate industry faces an unprecedented era of uncertainty, the influence of inflation and interest rates is the leading concern this year of the 1,000-member organization. Geopolitical risk and the implications of hybrid work round out the top three.

Now in its 11th year, and with many of the issues interrelated, the 2022-23 Top Ten Issues Affecting Real Estate can be grouped into three general categories: Economy & Markets, Government & Regulatory, and Change & Risk Management. Historically, the compilation has reflected several recurring themes that have become constants over the last decade, including infrastructure, macroeconomics, demographic trends, housing, technology and, more recently, sustainability, logistics, and the global pandemic. The goal this year is to identify the Top Ten Issues, how they have evolved, and what their subsequent impact is on commercial real estate’s various professional disciplines.

1. Inflation and Interest Rates
2. Geopolitical Risk
3. Hybrid Work
4. Supply Chain Disruption
5. Energy
6. Labor Shortage Strain
7. The Great Housing Imbalance
8. Regulatory Uncertainty
9. Cybersecurity Interruptions
10. ESG Requirements Forcing Change



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1. Inflation and Interest Rates: Some Clarity To Mixed Macroeconomic Signals

By Timothy H. Savage, Ph.D., CRE®

“An economic slowdown is already underway and the greatest recession risk to real estate is whether rising unemployment and lower household income cuts demand for residential and commercial property.”

Having focused on its mandate for maximum employment, the U.S. Federal Reserve is now singularly focused on inflation. Combined with sustained geopolitical risk and vanishing fiscal stimulus, tightened monetary policy will place upward pressure on cap rates and market volatility. Real estate transaction volume will, however, likely remain vibrant for the next year. The proximate threats to continued economic growth remain the COVID-19 pandemic and policy error at the U.S. Federal Reserve.

2019 and Pre-COVID

When teaching an honors finance course in fall 2019, I told my students that an inverted yield curve probabilistically predicted an economic recession in the next 12 to 18 months. In early September 2019, the curve stood at -50 basis points (bps). It had been negative since late July and would remain negative until early October. The Fed was also intervening in overnight lending markets. Simply put, the U.S. economy's longest recorded economic expansion was ending before COVID-19 entered the lexicon.

The Impact and the Response

Initially a demand shock, COVID-19's impacts persist. First-time claims for unemployment insurance (UI)

skyrocketed, and between early March and early June 2020, over 40 million Americans filed first-time claims. The unemployment rate quadrupled between March and May 2020. By the end of Q2 2020, real output was contracting by nearly 10%. During the pandemic, market volatility exploded to levels not seen since the global financial crisis.

The magnitude of the crisis drove a substantial policy response. Fiscal policy included extended UI payments, the 2020 Paycheck Protection Plan, and the 2021 American Rescue Plan. Focusing on direct cash infusions to support consumption, this response amounted to a quarter of annual U.S. GDP. The Federal Reserve lowered its overnight lending rate to zero and more than doubled its balance sheet with asset purchases. The 10-year U.S. Treasury fell to an historic low of 54 bps in March 2020, and the average 30-year fixed residential mortgage fell to approximately 270 bps.

Durables Drive Inflation and the Pivot

Given complex international supply chains, the pandemic was also a supply shock with a substantial inflationary impact. Supported by federal policy, overall consumption recovered rapidly but was distorted relative to its pre-pandemic levels.

Basically, consumers substituted dining out (non-durables consumption) with buying furniture (durables consumption). By April 2021, durables consumption was nearly 40% higher than its pre-pandemic level, while non-durables consumption was only 14% higher. Shipping costs associated with durables increased substantially and remain substantially elevated. These pandemic supply shocks have driven inflation well above the Fed's stated policy of two percent. By one standard measure, inflation is at levels not seen since the early 1990's. The ten-year break-even inflation rate remains well above 200 bps.

With the Fed's dual mandate of maximal employment and price stability, its initial focus was labor markets, which have largely recovered. It has now turned to price stability, signaling substantial rate increases in the medium term, including the recent increases in the FFR. It has also announced a "run-off" in its balance sheet. Both policies will place upward pressure on long-duration Treasuries, as well as cap rates (absent an offsetting increase in demand).

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2. Geopolitical Risk: Political, Capital Markets and Real Estate Uncertainty

By Constantine “Tino” Korologos, CRE®

“Continued geopolitical uncertainty provides significant headwinds to the economy. The longer it takes to moderate, the greater the negative implications for real estate.”

Understanding the direct implications of geopolitical risks attributable to real estate can be challenging to measure. These risks, both global and domestic, generally materialize as volatility due to uncertainty about the future impact on economies and financial markets. Whether a conflict like the war in Ukraine, additional production shutdowns due to elevated COVID infection rates in China, or local politics surrounding rent regulations and sustainable development and renovation requirements, they are difficult to isolate and measure. Additional complexity surrounds these risks when they occur in an environment of increasing interest rates and inflation levels at a 40-year high. When you add in the complexities around supply chain stress, an improving but still unresolved pandemic hangover and energy costs, the lines between these risks become more blurred. While the focus is on the most visible geopolitical risks, the Ukraine and Russia war and the most recent lockdowns in China, these are not the only political risks affecting the broader markets.

Commodities Pricing, Supply Chain, and Inflation

Inflation and supply chain challenges are affected by factors outside of political risks, but some of the impact is being elevated because of it. Russia is one of

the largest exporters of energy and food commodities, with Russia and Ukraine exporting 30% of the world’s wheat, a key product in the world’s food supply. Wheat futures rose 40% year-to-date and 57.8% over the last 12 months. Russia and Ukraine also produce a third of the world’s ammonia and potassium exports, which are essential ingredients in the production of fertilizer. Much of the impact is already being felt in less affluent nations, in addition to the U.S., spurring concerns of a global food crisis. Other key commodities like steel and nickel had seen 30 and 45% increases, respectively, between early 2022 and late April, although prices have come down a bit.

China’s zero-COVID policy and the related lockdowns have driven production and port activity to levels not seen since the beginning of the pandemic. Sectors like the automobile industry and electronics manufacturing haven’t recovered from the initial phase of the pandemic, and these new challenges are adding to the stress. When you add the impact of other commodities involved in automobile manufacturing such as aluminum, copper, and nickel coming out of Russia and Ukraine, more inflationary pressure builds.

Higher energy costs, especially over an extended period, can also have a negative effect on real estate.

High prices at the gas pump can affect consumer sentiment and spending, potentially hurting an already weakened retail and hospitality market. As the probability of an extended conflict increases and possibly taking us into the winter months, this could mean higher heating costs on top of the growing gas prices.

Globally, the availability of products challenged by traditional distribution has countries focused on reconfiguring their supply chain management strategies, particularly sourcing. Terms like “dual sourcing”, “near shoring”, and “friend shoring” are being used to describe collaborative efforts to manage the challenges. In the short term, the challenges will likely grow before beginning to recede.

Cyber Risk

Cyberattacks have increased and continue to impact global stability as they target critical infrastructure. The Center for Strategic International Studies reported that on February 24, the date of the Russian invasion, cyberattacks increased significantly including disruptions to Ukrainian military communications, power grids, and telecommunications. These attacks are expected to continue, and resources are focusing on the protection and mitigation. With increasing investments into smart buildings, granular building infrastructure also becomes susceptible to cyber risk.

Consumer Confidence and Real Estate Considerations

All the challenges mentioned above have a direct effect on consumer spending, be it product cost, availability, or even how the products are purchased, online or in person. Higher-priced necessities could limit consumer spending, including retail, travel, and services. Central banks, looking to manage inflation with interest rates, have a narrow lane to land the planes on to avoid a recession, or worse, stagflation. If inflation is exacerbated by geopolitical volatility, something that interest rate policy can't manage, then the impact of that volatility becomes more significant.

With continued political uncertainty providing significant headwinds, the ultimate impact on commercial real estate will be greater than if the political risk didn't exist. The longer it takes to moderate, the more the accretive impact can have negative implications for the industry. We pray for bloodshed and the loss of life to end. Then we can hope for market stability and leaving the pandemic and financial effects behind.

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3. Hybrid Work and the “Great Decentralization”: A Correction Towards Resiliency?

By Cassandra Francis, CRE®

“Current decentralization pressures and the potential for property devaluation are sure to keep the entire financial sector on guard during the evolution of the next few years.”

In the aftermath of the pandemic, one thing everyone can agree on is remote work is here to stay, sending a clear message to employers as they struggle to retain workers and rethink their business models. Most also agree that COVID accelerated trends that were already emerging, including remote work, online retail, and migration to warmer climates and tertiary urban markets. However, an unexpected shift, the “Great Decentralization”, took many by surprise in the wake of this latest global disruption. Reversing decades-long flow of people and resources to large dense urban areas, this new trend towards geographic and organizational decentralization has changed most regions, with bracing effect on specific real estate markets and sectors. In the aftermath, government, businesses, and individuals now find they must adapt and evolve in light of this de-concentration, while addressing the increasingly underutilized built environment concentrated in urban areas. This will be particularly challenging given the array of concurrent social, economic, and existential shifts that include inflation, rising interest rates, wage growth, climate change, crime, geopolitical crisis, and wealth divergence. But will these new decentralized development patterns and socioeconomic structures provide the legacy of resiliency that better weather future disruptions and the next pandemic?

Despite pleas from politicians and employers that employees return to the “workplace” to restore normal operations and reinvigorate downtowns, only 40% of workers in larger American metropolitan areas have returned to the office. Remote and hybrid work is favored by almost 80% of U.S. employees who want to work from home at least one day per week. With the onset of the pandemic, the closure of offices and the quick adoption of digital mechanisms to support work from home modality provided employees with new freedom to work away from large urban employment centers, allowing them to move to suburbs, exurbs, second homes and destination locations. Workers sought more living space at lower housing costs, moved closer to family or to more natural and socially distanced environments, all which contributed to an increase in quality of life and work/life balance. This movement of people and resources has caused many of these further-flung areas to flourish, drawing energy and economic activity from downtowns.

Workers are now accustomed to these benefits and a return to the office would mean potentially much longer or impossible commutes, less time with family, less flexibility and privacy, and increased costs and complexity, particularly with inflation and rising gas prices.

Despite reports of isolation, loneliness and burnout associated with remote work and blurred boundaries between work and private life, on balance workers appreciate the autonomy remote work provides. Now as workers confront the resurgence of COVID moving into the summer of 2022, they appear to be even more reticent to return to work given what they believe are viable remote work alternatives.

In today's competitive labor market, companies must retain existing or attract new employees by accommodating remote and hybrid work, at least in the near term. The Great Resignation hit hard, and worker mobility is on the rise. Apple employees and more recently Google Map subcontractors sent a petition to company leadership to urge a continuation of their ability to work remotely after being ordered into the office. Most surveys indicate that the majority of workers favor approximately 2.5 days per week in the office with a strong preference for Mondays and Fridays at home. Employers are eager to have a return to the office to get the most out of their employees and to cost-effectively utilize their office footprints. Many offices have been reduced in size, mothballed, or are in some state of transition, having expanded technology, improved ventilation, implemented more stringent cleaning protocols, and added attractive new amenities, all which have likely increased CapEx. As long as workers have leverage in this tight labor market, companies with a "office-first" mentality, requiring a majority or full return to the office, may need to lighten up, pay more, or suffer the consequences of employee departures.

As a movement to the suburbs, exurbs, smaller municipalities, and destination locations continues, other externalities have compounded workers' desires to work on a hybrid basis. Current inflation, rising interest rates, rapidly increasing housing prices and rents, and uncertainties around schooling and childcare reinforce demand for hybrid working scenarios. Further, the decimation of employment center restaurants and retail, increased crime, increasing taxes, and visible homelessness in once-bustling downtowns heightens concerns about working and living in urban centers when less dense, more livable options exist.

As companies consider a reduction in their footprints in response to emboldened employees' desires, the key will be to adapt offices for mid-week peak occupancy rates while trying to incentivize employees to spread the peak so reduced space can be better utilized. Employers will need to triage different work functions to specific locations, scheduling office meetings during the middle of the week while pushing phone and computer-based activities towards the shoulders of the week when workers prefer to stay home. Companies may look to invest in less expensive satellite units or shared and co-working spaces as they try to predict their future office needs once work lifestyles normalize and their leverage increases as the labor market stabilizes.

Some employers have found they can add amenities while reducing overall space and travel costs, resulting in overall savings. Curating an appealing, experiential office culture with a focus on interpersonal socializing will become even more important to draw workers to the office, as will prime office locations. Balanced collaboration between asset owners and managers and employers with a focus on the long term will be crucial to provide flexibility in the game of musical chairs that is underway across real estate sectors. A company's ability to expand, contract, sublet and terminate early, while rapidly providing more attractive flexible/shared workspaces, may ultimately correlate with its ability to survive, especially as energy, fuel, tax, and labor costs rise.

Proptech and smart building companies can expand their data-collection focus supporting optimal conditioning, cleaning, and maintenance operations to include more precise occupancy, space type utilization and movements of users' data with sensors to help companies reevaluate their changing real estate needs. Architects and designers will also be center stage in physically and culturally adapting spaces in unexpected ways.

A recent study from Columbia University and NYU estimates a tremendous devaluation of U.S. office buildings resulting from the rise in hybrid work. The study estimated a 32% decline in the value of US office buildings in 2020 and an anticipated 28% decline in the long term in response to structural changes surrounding a shift to more remote working practices.

These estimates were extrapolated from the detailed study of the New York City office market where they estimated a \$49B value declination by 2029. Higher-quality and newer office buildings would fare the best relative to the rest of the office inventory, and there is significant concern about the viability of adapting older office buildings with larger and deeper floorplates to residential uses and whether there will be enough future demand to backfill these altered spaces. This level of possible property devaluation, combined with rising inflation and interest rates, and a potential recession, is sure to keep private lenders, public finance and policy makers, and the entire financial sector on guard during the evolution of the next few years.

There are other real estate sectors which may face similar pressures in response to hybrid work including education, health care, hospitality, and entertainment industries as demand is reduced in employment centers. Like the anticipated reduction of office space that may occur if remote work continues longer term, it is anticipated that colleges and universities may reduce their real property as more online delivery and remote work makes large campuses obsolete; some institutions may fail altogether. Other sectors will likely invest in labor-reducing technologies in this expensive labor market including automation, robotics, and lesser but very effective mechanisms including QR code restaurant menus, telemedicine, contactless hotel check-in, and greater use of chatbots to fulfill customer service needs, all of which may increase efficiencies and reduce repetitive and lower-wage work functions.

Beyond the decline of downtowns, the decentralization of people and resources outward from employment centers poses other problems. It places great pressure on suburbs, exurbs, and in geographic regions that may not be able to properly serve the influx of demand for infrastructure and services. It also potentially complicates achievement of equity goals. Remote work potentially widens the digital and economic divide, causing a need for re- and up-skilling of lower tech workers. Women and minorities lead in prioritizing remote working, which may cause these groups to miss out on face time that may better support promotions that would fulfill corporate diversity goals. Mixed-presence collaboration may also lead to “presence

disparity” which could also limit career advancement for remote workers.

Economists estimate that, as a legacy of the pandemic and decentralization, 50% of the workforce will work remotely or in a hybrid manner in the future . This de-concentration of workers will cause government and businesses to pursue resource deployment models that support a more dispersed economy while repositioning and backfilling the existing built environment designed around now-less-relevant constructs of centralization. However, despite the urban exodus, downtown employment centers are expected to continue to draw residents seeking abundant urban amenities even as these centers become less pronounced as employment hubs. This is demonstrated by record high residential sales and opportunistic office space users who are betting on a return to these amenity rich environments. Urban and regional planners will need to follow the arc of the pendulum between regional centralization and decentralization as the homeostasis is increasingly impacted by future disruptions. Planners, government staff, and elected officials will face renewed pressure for new and upgraded Infrastructure and increased need for services in more decentralized locations which are often the most expensive and difficult areas to service.

At least in the short-term, it is possible that continued decentralization of our employment and economic systems may help support enhanced resilience against additional future disruptions. Decentralization is credited for building redundancies and spreading out system footprints while building talent diversification amongst system participants, all which could be advantages when faced with future pandemics, severe weather, and other system stressors. The COVID disruption and the resulting shift to remote work may well be the bellwether for future resilience, forcing a move toward a more decentralized, diversified, and adaptable built environment and geographic land use pattern across all regions.

Accompanying benefits of less traffic, cleaner air, improved access and mobility, more flexible and full employment, higher quality of life, better work/life balance, higher productivity, and potentially cost savings will further support the continuation of this new hybrid work trend at least in the short term.

Employers who move from “business as usual” to “business as evolutionary” will benefit as disruption and change inevitably accelerate.

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4. Supply Chain Disruption

By John Viggers, CRE®

“Impacting nearly every aspect of real estate, delays will continue to raise costs and cause realignment in supply chain strategies and warehousing.”

It may not come as a surprise that supply chain issues made The Counselors of Real Estate’s Top Ten list again. It’s a frustration we are all dealing with personally from the grocery store to the home improvement centers to our automobiles. In the real estate sector everything from routine repairs and maintenance to property improvements to new construction are greatly impacted. Delays in deliverables, rising costs, shortage of labor and lack of materials are influencing nearly all companies and their related real estate.

Basic economics, as we’ve learned, is the creation of equilibrium between supply and demand to create economic harmony. Since humans first started trading, those with goods and services in demand adjusted their business to produce more to support growing demand. Thus, creating the earliest forms of trade and business.

Today, many factors impact the supply and demand tug-of-war, and the best supply chain systems run on flexibility. Most would assume this is all a COVID-19 side effect, which is only partially true. Many experts believe this started well before COVID-19 and may last longer than our vaccine and boosters. We all witnessed the back-up of cargo ships in the port of Los Angeles and the bottleneck caused by the cargo ship “Ever Given” in the Suez Canal.

What has become profoundly clear is this is not a U.S. problem, but a global one. As the world’s economies have grown and prospered through greater efficiencies, we’ve become more reliant on others’ ability to maintain supply chain harmony.

In the past, warehouses held large inventories just in case. This antiquated system created excess and waste. As the world became more efficient and practiced just-in-time production, warehouses held less product to increase efficiencies. Once the need for those products stopped and production ceased due to a global pandemic, reserves were not prepared for the rush of demand as e-commerce erupted across the globe. We also realized how dependent we were on the efficiency of production from China. As China shut down, the world effectively shut down.

Other contributing factors include the weather and climate disasters. Materials shortages such as wood, steel, computer chips and electrical supplies all influence commercial real estate decisions today. Labor shortages are stressing nearly all areas of U.S. business, and commercial real estate is not exempt. According to recent research, 88% of contractors report moderate to high levels of difficulty finding workers and 35% have turned down work due to labor shortages.

As commercial real estate practitioners, we've been tasked with the challenge to adjust how location decisions are made. Critical site selection has driven decisions across the U.S. in unprecedented ways. Delayed supply chain concerns are an unknown factor for developers, who are adding several months to their schedules. They're trusting vendors to get the labor and materials and meet construction deadlines, risking added costs and unmet contractual obligations.

If there is an upside, nearly everyone is affected by these challenges, and we are adjusting our expectations. Vacant retail stores are being repurposed as last-mile warehouses. Older buildings are seeing new life and leasing opportunities. However, the challenges continue as modern logistics experts are racing to keep up with demand, shifting how products enter ports and how transportation systems are utilized to get the products to end-users.

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5. Energy: Sustainability, Affordability & Availability

By Maureen Ehrenberg, CRE®

“Some of the practical consequences of what building owners and business owners are facing and need to consider in their business continuity and resiliency planning include rising insurance costs and increased investment in on-site energy resilience.”

The COVID-19 pandemic sparked a surge of awareness in the scientific research and findings behind healthy buildings and workspaces. Return to office preparedness and planning by companies and building owners further emphasized the importance of health and wellbeing in the workplace for productivity and employee attraction and retention. As a result, building operators follow the guidelines recommended by ASHRAE and the CDC to reduce infection risk from air-borne viruses and improve cognitive function for building occupants by increasing the percentage of fresh air the ventilation system is circulating throughout the building.

Increasing daytime lighting levels and upgrading acoustics have also been recommended for improving health and wellness. Space design and planning are bringing more daylight into workplaces and increasing the size and number of open areas for collaboration and coworking. Lighting controls are being installed to compensate for window shading required to reduce the glare and the heat gain from bright outside light, increasing the use of artificial lighting. White noise machines are being installed to mitigate the noise levels in the open areas to eliminate distraction and stress. These health and wellness actions can almost

double the energy needed for lighting, sound, and other experiential elements being introduced to create healthier workplaces.

In the short term, the tradeoff for these health and wellbeing operational improvements is a significant increase in building energy consumption for common areas and tenant spaces, along with a corollary increase in greenhouse gas (GHG) emissions. HVAC and lighting tend to be the largest contributors to energy consumption in office buildings. With the increase in energy consumption to provide more focused, healthy, and productive workplaces, real estate owners and operators are embracing smart, connected buildings. Sensors in lighting, HVAC equipment and managing temperature controls, and occupancy sensors that determine the demand for space and utilization provide actionable insights to offset energy cost increases by automation and improving the efficiency of managing space and energy consumption. IoT, Artificial Intelligence (AI), and Machine Learning (ML) eliminate the need to trade off health and wellness in buildings for increased energy costs.

The National Oceanic and Atmospheric Administration (NOAA) estimates the sea level will rise one foot by 2050, which is when the Paris Accords will require that energy consumption must have adapted to meet net-zero carbon. The NOAA mapping forecasts the sea will slowly encroach on and engulf the current coastal communities between now and then. This is forcing building owners and operators to invest in measures to protect their assets from things they have not needed to consider previously, such as a rising cost of traditional fossil fuel-based energy sources and increased demand for renewable alternative energy solutions.

Some of the practical consequences of what building owners and business owners are facing and need to consider in their business continuity and resiliency planning include:

- Property & Casualty insurance costs will rise quickly, according to multiple studies;
- Increased needs for energy resilience on-site (cleaner backup power, co-gen/battery) to ensure critical building functions continue to run and the business owner's critical operations are not impacted when the grid is down (sump pumps, elevators for evacuations, emergency lighting, HVAC);
- An increased number of people working from home also increases demand for an unplanned increase in the residential demand for constant power and uptime.

Energy conservation, including reform, sustainability, and renewable energy, has been an ongoing topic in real estate for over 50 years. What is different now are organizational commitments for Environmental, Social, and Governance (ESG) that have resulted in a sudden and unprecedented rise in demand for alternative energy, changes in practices and expectations for healthy buildings and operations, and climate change informing location preferences, etc. The result has been sustainability initiatives that address energy consumption, demand management, renewable energy, clean energy, and carbon reduction. The real estate industry must continue to meet these challenges.

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6. Labor Shortage Strain: Where Have All the Workers Gone?

By Andrew J. Nelson, CRE®

“The implications for property markets are mostly indirect but potentially significant. Occupiers will lease less space if they lack the workers to run their businesses.”

In the immediate aftermath of the pandemic lockdown, many communities began to see a most unusual sight: “help wanted” signs sprouting up on storefronts in the middle of the sharpest economic contraction in modern times. A growing number of employers began to report difficulties in finding the workers they need to operate their restaurants, shops, and other businesses.

The origins of the worker shortage are clear. Many workers initially were afraid to re-enter the workplace for fear of contracting the coronavirus. Plus, the government’s generous supplementary unemployment benefits and pandemic checks provided ample incentive for workers to remain on the sidelines.

But the COVID benefit programs ended long ago around the time that COVID vaccines became widely available, yet the worker shortages have only grown. The number of job openings tracked by the Bureau of Labor Statistics (BLS) is higher than they’ve ever been – both absolutely and relative to the total number of jobs in the economy – since BLS started tracking job availability more than two decades ago.

More problematic for employers: There are almost twice as many unfilled positions as unemployed workers to fill them, equating to a shortfall of more than five million workers. In the prosperous year prior to the pandemic there were about 20% more open positions as

unemployed workers, and the ratio had never reached 25%. Now it’s over 90%!

So where are all the workers? The vast majority are already back on the job. The economy has regained all but about a million of the 22 million jobs lost during the initial lockdown. The number of unemployed workers quadrupled during the recession but is now under six million, on par with the level on the eve of the pandemic.

Second, there is often a mismatch between the open positions and the workers available to fill them. This takes two forms: geography (the available workers don’t live within commuting distance of the open jobs) and qualifications (many of those idle workers don’t have the experience or credentials required for the jobs available). However, this mismatch problem is hardly new and there’s little evidence that it’s gotten worse.

Lastly, there’s been a profound change in how workers view their employment status. For various reasons, the pandemic prompted many workers to reassess what type of work they want to do, under what conditions, and for what pay – or even whether to work at all. As a result, firms are finding it increasingly difficult to retain their workers who are quitting jobs in record numbers in search of better pay or opportunities.

As with job openings, BLS is reporting an unprecedented number and level of workers (as a share of all workers) quitting jobs each month. The two are related, as most jobs left behind when an employee quits must be backfilled with another worker, thereby creating another job opening. Economists generally view high quit rates as a positive sign that workers have enough confidence to leave one job for another. However, the current churn of workers is amplifying the overall worker shortage. The quit rate is now fully 25% higher than before the pandemic.

On top of all those supply-side constraints, demand for labor is remarkably strong. Labor demand, which is measured by the sum of both filled and open positions, typically takes several years to recover after a recession. It took over six years for labor demand to reach its prior peak after the Great Financial Crisis of 2008, for example, but less than two years after the pandemic recession. Labor demand is now slightly higher than before the pandemic. All this helps explain why so many firms cannot hire all the workers they need, even though the size of the labor market is virtually back to its pre-pandemic level, down less than 1%.

Worker shortages are not spread equally across industries, however. Both job openings and quits are concentrated in lower-wage sectors, as workers have been taking advantage of tight labor markets to upgrade their positions. The hospitality and restaurant sectors have seen some of the largest increases in quits and job openings, whereas worker shortages and turnover are much lower in better-paying sectors such as business services (e.g., attorneys and accountants) and financial services (e.g., banking, and real estate brokerage). Logistics, manufacturing, and health care have also experienced above-average increases in job openings.

These shortages are compounding even more acute supply-chain shortages that emerged in the earliest days of the pandemic. With factories, mines, and processing plants shut for extended periods in different parts of the world, firms scrambled to find new suppliers for their operations.

It all adds up to a situation normally seen only during wartimes: Worker shortages and supply bottlenecks so

severe that many businesses have been forced to cut back on production, despite ample consumer demand. Restaurants and stores close early or remain closed on slower days. Factories cut shifts or go on hiatus, magnifying the supply shortages.

The implications for property markets are mostly indirect but potentially significant. Occupiers will lease less space if they lack the workers to run their businesses.

Another indirect impact may prove even greater: With wages and the cost of other inputs rising due to shortages, the Federal Reserve has undertaken aggressive monetary actions to tame inflation. So far, the consensus view among most economists is that no recession is imminent, but any action sufficient to temper wage and price growth will surely cool the economy. As discussed elsewhere in our Top Ten report, a slowing economy would reduce all types of real estate transactions, from leasing to lending to sales, impacting all commercial real estate professionals whose business depends on transaction volumes.

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7. The Great Housing Imbalance

By Paige Mueller, CRE®,
and Paula Munger, CRE®

“Markets that have not been able to provide lower-cost housing have experienced ongoing out-migration and risk stressing infrastructure capacity as renters are driven further out to the exurbs.”

It is no secret that housing in the United States has been underbuilt for decades. In the 1970s and 1980s, one new housing unit was created for every 1.2 jobs, on average. By the 2010s, that figure had become completely out of balance to just one unit for every 2.6 jobs.

Numerous factors contributed to the shortage of new supply in the last decade: land availability; increasing costs for land, labor, and materials; an increase in regulatory barriers, by way of fees, or longer and more complicated entitlement processes; and community opposition to development, also known as NIMBYism, particularly for larger apartment developments.

The pandemic and its aftermath had outsized impacts on housing demand. According to Pew Research, in July 2020, during the height of the pandemic, many young adults (52%) resided with one or both parents, the highest level since the Great Depression. By Q2 2021, when vaccines were becoming widely available and the economy more fully reopened, those young people contributed significantly to new household formations.

On the supply side, multifamily completions in 2020 and 2021 in properties with 5 or more units were at their highest levels since the late 1980s.

Single-family completions, on the other hand, were still running just shy of their long-term average of one million units per year, and well below the peak 1.6 million pace of 2006.

Stronger multifamily construction levels have not kept up with demand, however. According to RealPage, Inc., Q1 2022 demand as measured by absorption, was more than double new deliveries and at 713,000 units annualized, the highest level of absorption since RealPage started tracking the data in 2000. Low vacancy rates have been driving up rental rates by a double-digit pace.

Going forward, rental demand will be nuanced, a reflection of the following trends, according to a report recently released by the National Apartment Association and National Multifamily Housing Council:

- As the population ages, the 55+ cohort will account for a large portion of rental demand over the next decade, particularly in slow growth markets. The younger renter base will decline in many of these markets.

- 40% of net new demand through 2035 will occur in just three states: Texas, Florida, and California. Secondary cities offering a mix of high quality of life, relatively lower costs and/or job generation such as Boise, Austin, Raleigh, Orlando, and Phoenix are also expected to grow by at least double the national pace.
- The tenant base will become more diverse, with growth dominated by the Hispanic population as growth in the White segment of the population is highly focused in the 65+ age group.
- Affordability continues to be a growing and widespread issue which has been amplified by recent double-digit price increases in both the owned and rented segments of the market. More than 6.95 million owned housing units priced less than \$200,000 were lost between 2015 to 2020 as were 4.7 million rental units with rents less than \$1,000 per month. This segment of the market is critical to provide housing to a significant portion of the U.S. workforce. Markets that have not been able to provide lower-cost housing have experienced ongoing out-migration and risk stressing infrastructure capacity as renters are driven further out to exurbs.
- The housing market overall remains highly fragmented in terms of ownership, and new approaches to provide housing continue to develop. For example, while institutional ownership of single-family rentals (SFR) continues to rise, only 2% of SFR are currently owned by institutional investors.

Overall, more than 4 million new rental units will be needed by 2035. The U.S. is in dire need of both rental and for-sale housing in locations where people want to live. Businesses, local leaders, and policymakers need to come together to create an environment conducive to building a variety of housing units at all price points.

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8. Regulatory Uncertainty

By David Waite, Esq., CRE®

“The emerging conflict between state preemptive legislation and local control over land use, and the litigation that has emerged from these conflicts, will create additional regulatory uncertainty for some time to come.”

Among the goals of a commercial real estate owner, developer, or financial partner is a clear, stable, durable, and predictable regulatory environment. Real estate owners and operators seek to plan, develop, and operate real estate assets in a regulatory environment that is largely free from rapidly changing regulatory compliance requirements and development standards. Changing regulations can add substantial time, risk, and cost to completing development projects and can also impose new and often burdensome operating restrictions on existing properties. The current regulatory environment at all levels of government—federal, state, and local—throughout the United States increasingly lacks the desired clarity, stability, durability, and predictability that is important to real estate owners and operators. Not surprisingly, this year’s survey respondents identified “regulatory uncertainty” as a Top Ten issue.

The source of regulatory uncertainty at the federal level is not only a function of the changing administration politics, policies, and priorities, but also reflects the continued expansion of the breadth and depth at the administrative level of the continued proliferation of federal regulations addressing all manner of real estate, land use, and environmental priorities. New regulations at all levels of government proliferated and, in some

cases, remain in effect in response to the COVID-19 pandemic. These include important health and safety regulations including mask mandates, social distancing, and vaccination requirements focused on limiting the community spread of the virus. Many regulations adopted during the pandemic—directly impacting the real estate industry—are intended to provide financial support to those who have been adversely economically impacted by the pandemic. Residential and commercial tenant eviction moratoriums at the federal, state, and local level, as well as limits on rent increases proliferated throughout the pandemic. Many of these restrictions will remain in place throughout 2022, and in the case of Los Angeles County, the residential tenant protection laws will remain in effect through June 2023.

Other recent notable examples include ongoing changes to Environmental Protection Agency (“EPA”) and the United States Army Corps of Engineers (“Corps”) regulations pertaining to waters of the United States (“WOTUS”) under the Clean Water Act (“CWA”). The CWA requires the EPA, the Corps, and states that have permitting authority to regulate the discharge of pollutants into WOTUS. This includes CWA Section 404 “dredge and fill” permits issued by the Corps. Development projects have struggled for decades with the uncertainty of WOTUS as applied to wetlands,

streams, and similar seasonal water features.

These regulatory shifts at the federal level are also impacting the implementation and enforcement of the Migratory Bird Treaty Act (MBTA), Endangered Species Act (ESA), and the National Environmental Policy Act (NEPA). These changes reflect a pivot away from the Trump administration's relaxation of regulatory red tape.

The federal government's response to global climate change is also presenting new regulatory challenges. The federal government is rapidly developing new requirements in response to climate change for a variety of real estate development projects, uses, and operations. At the same time, many companies are seeking to embrace these changes not only to gain a competitive advantage by voluntarily adopting pro-active development and operational changes that can reduce greenhouse gas emissions ("GHG"), but also to make a demonstrated commitment to social responsibility. These measures include participation in carbon emission credit trading programs, adopting new green technologies and building standards, and adopting and implementing Environmental, Social and Governance ("ESG") policies and priorities.

At the state and local level, there continues to be a proliferation of new regulations—often initiated in coastal states such as California—intended to address water quality and availability, GHG reductions and "net-zero" emissions mandates, wildfire hazard, wetlands regulation, sea-level rise, clean energy mandates and fossil fuel regulation, rapid transportation legislation, and the production of much-needed market-rate and affordable housing. Many of the new regulations are intended to shape land-use patterns and encourage the production of housing in urbanized areas where transit-oriented and other higher-density affordable housing development is encouraged and incentivized through regulation.

The State of California has mandated that local governments must update their housing elements of their general plans to affirmatively plan for the production of housing to meet jurisdictionally

specified future regional housing needs.

California's SB-9 has largely eliminated single family zoning by allowing duplexes of up to 4 units on single family zoned properties. California has adopted a host of housing bills, including legislation to encourage the development of accessory dwelling units ("ADU's") on single family zoned property. These "preemptive" state laws and regulations conflict with many local land use regulations and represent a challenging shift from local control over land use planning and zoning to the imposition of state mandates to create more housing. Many states are also adopting certain regulations intended to grant density "bonuses" and streamline the approval of projects creating affordable housing. The emerging conflict between state preemptive legislation and local control over land use, and the litigation that has emerged from these conflicts, will create additional regulatory uncertainty for some time to come.

The proliferation of new regulation—at all levels of government—that will impact the commercial real estate industry remains a near certainty for the indefinite future.

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9. Cybersecurity Interruptions

By Tom Shircliff, CRE®

“This is not a so-called smart building or Internet of Things problem, which continues to stack up risks, but rather a 40-year build-up as our main systems require computers, networks, and Internet connections.”

We are in a new era of cybersecurity risks in commercial real estate, driven by decades of technological advances that impact all buildings’ physical and environmental functionality. There are material risks for investors, owners, operators, and occupants. Risks include insurance gaps relating to nation-state attacks and for-profit ransomware, as well as from ill-equipped building managers and contractors.

Insurance carriers and brokers increasingly deny cybersecurity insurance coverage. When you can get a policy, the premiums skyrocket, and there are gaps and exclusions in existing policies. Often, cybersecurity incidents in building control systems are not addressed in property and casualty (P&C), general liability, and cyber riders and can result in litigation as well as the aforementioned exclusionary language emerging notably in P&C. Directors and Officers (D&O) insurance is now rising in importance with some cybersecurity lawsuits against individuals and recent SEC Cybersecurity disclosure proposals.

This is not a so-called smart building or Internet of Things (IoT) problem, which continues to stack up risks, but rather a 40-year build-up as our main systems

(e.g., HVAC, elevator, lighting, access control, parking) require computers, networks, and Internet connections. These IT elements are necessary to provide building-wide control between devices and floors as well as remote maintenance and updates. Notwithstanding those multiple decades of technology inundation, there have never been suitable technology or cybersecurity skill sets in the entire CRE value chain from design to development and management. Therefore, the problem is systemic and pervasive throughout the entire industry, which is unfortunately now on full display in a global era of cybersecurity awareness.

More recently, there has been a steadily intensifying cybersecurity theme from state actors such as Russia (publicly) and Iran (in secret documents) and for-profit hackers that all target critical infrastructure in the West. This is not only power plants and dams but also commercial real estate and all non-single-family use types. In one specific instance, Russian malware was recently discovered in REIT HVAC systems only one week after the US government warned of the malware by name and country of origin. Iranian documents mention specific system and manufacturers of HVAC, lighting, and metering systems when stating their malicious intentions for commercial real estate.

These real estate targets include corporate office properties, banks, schools, hospitals, public venues, and more. The Boston Children's Hospital HVAC contractor was ransomed by international hackers and created intense concerns.

Consequences can include life safety issues, equipment replacement, unmitigated access to corporate networks, full-building downtime, and significant brand damage. We are entering the perfect storm from the confluence of decades of tech buildup, lack of skill sets, cultural ignorance, savvy bad actors, and a dependency on commercial real estate as critical infrastructure. This impacts all stakeholders but can be influenced most broadly by investors and owners as their policies and requirements can be mandated downstream to asset managers and property managers for assessments, policy enforcement, and active monitoring.

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10. ESG Requirements Forcing Change

By Deborah Cloutier, CRE®

“These requirements are also instigating much innovation in the design, development, and construction of new buildings as well as renovation of existing stock with long lifespans ahead of them.”

Government regulators around the world are increasingly passing laws, rules, and ordinances regarding the performance and disclosure of real estate assets according to environmental, social, and governance (ESG) criteria. These requirements are forcing real estate investors to measure and report – and in some cases publicly disclose – their assets’ energy and water use, waste, carbon emissions, and climate change risks. It is these fast-paced developments in the regulatory landscape that will likely support the adoption of policies and practices toward low-carbon economy change over the next few years. These requirements are also instigating much innovation in the design, development, and construction of new buildings as well as renovation of existing stock with long lifespans ahead of them. Regulators are taking this stance because they are being demanded by the marketplace and the next generation of consumers and politicians to address climate change.

In the real estate industry, ESG risk assessment and mitigation initiatives are becoming essential components of real estate investment. In 2021, the U.S. Securities and Exchange Commission (SEC) acknowledged the growing demand by investors for ESG and climate-related disclosures. In March 2021, the SEC launched an ESG Enforcement Task Force to

identify material omissions or inaccuracies in issuers’ disclosure of climate risks and in April issued a risk warning to caution investment advisers, registered investment companies, and private funds that their ESG statements will be more heavily scrutinized.

The SEC proposed sweeping requirements in March 2022 that would require public U.S. companies to begin disclosing greenhouse gas (GHG) emissions and climate-related risks as early as 2024 for calendar year 2023 operations. If adopted, public companies would need to disclose both physical climate-related risks, such as sea level rise, and transition risks, such as increased insurance costs or decreased asset values. For example, if determined to be material real estate investors would be required to provide a list of any properties by zip code with identified physical risks and the percentage of buildings or properties located in flood hazard areas. All affected companies would be required to report Scope 1 and Scope 2 GHG emissions from owned operations and purchased electricity. One of the most controversial proposed requirements include larger portfolios to report material Scope 3 emissions, such as tenant electricity consumption. If not satisfied with the disclosures, investors and the SEC would be able to challenge what a company deems material.

More extensive requirements are in place and being expanded in Europe and the UK. The UK government's Green Finance Strategy set an expectation that all listed issuers and asset managers will begin reporting emissions and climate risks in alignment with the Task Force on Climate-Related Financial Disclosures (TCFD) by 2022. On the continent, European Climate Law has codified the EU's commitment to reaching climate neutrality by 2050 and the intermediate target of reducing net greenhouse gas emissions at least 55% by 2030 compared to 1990 levels. Two of the largest regulatory bodies governing ESG initiatives and reporting in Europe are the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy. SFDR introduced new ESG transparency and disclosure requirements for European financial market participants, mandating that all Financial Market Participants (FMPs) evaluate and disclose ESG data at entity, service, and product level. Likewise, the EU Taxonomy requires financial participants in scope for SFDR to back up claims on environmental characteristics associated with their products, and report the percentage of their turnover, capital expenditures, and operational expenditures aligned with the EU Taxonomy.

In addition, cities and municipalities around the world are implementing local ordinances requiring the benchmarking and reporting of commercial buildings' energy use, including over 30 cities and four states in the U.S. Several cities have also passed laws mandating GHG emissions reductions from large commercial buildings within their borders, such as New York City's Local Law 97 and similar laws in Denver, Boston, and Washington D.C. Building owners who do not comply face significant fines in the coming years.

While the "E" in ESG gets the most attention, we must remember that ESG stands for environmental, social, and governance. Increased stakeholder recognition of the importance of social factors like diversity, as well as health and wellness, in commercial real estate are setting new expectations from investors, employees, and the communities in which real estate operates. Both the SFDR and the SEC have expressed interest in disclosures on social topics, and they may be added to ESG disclosure regulations within the next few years.

The "G," Governance, comes into play by holding companies accountable for their actions. ESG is hardly a new concept, and it may be number Ten in this survey, but one could say that it is embedded in or greatly impacts each of the other issues. Like all the Top Ten Issues, it is very present and will continue to make its mark on the real estate industry.

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