HIGH REAL ESTATE GROUP LLC

Winter 2023

RealEstateMatters

In This Issue

For our latest thinking on what matters to you in real estate, please visit **www.highassociates.com.**

The Strength of Brick-and-Mortar Retail

By: Powell W. Arms – Senior Vice President & Managing Director – Retail Division, High Real Estate Group LLC

One real estate surprise coming out of the pandemic has been the strength of brick-and-mortar retail. Despite years of predictions of a retail apocalypse, it seems the stress of the pandemic actually strengthened those retailers that survived.

In this article, we will look at the measures of strength and a few possible reasons behind the return to brick-and-mortar retail.

Physical retail remains the dominant channel for retail sales and plays an expanded role in the post-pandemic consumer landscape. [Note that for this article, we are excluding retail in the central business districts of America, where the foot traffic and daytime population are dependent on a return to office movement that has not yet occurred.]

Physical retail had its challenges long before the start of the pandemic. E-commerce emerged as a viable retail option, smartphones allowed us to shop anywhere, shipping costs were reduced or eliminated, and consumers were using physical retailers as showrooms before buying online. The response of retailers to the threat of e-commerce and its ubiquitous availability put retailers in a mode where they were forced to listen to the customer and focus on quickly responding – through enhanced services, adding online presences, or other means. As a result, retailers put tools in place to allow physical retail to adapt, survive, and thrive before the pandemic even began.

"Physical retail remains the dominant channel for retail sales and plays an expanded role in the post-pandemic consumer landscape."

Demonstrating the strength of physical retail

While the pandemic clearly changed the way people shop, customers still voiced a desire to return to in-person shopping, ultimately leading to a decline in online sales in 2022. By the fourth quarter of 2021, physical sales volume had returned to the pre-pandemic level; and in the first and second quarters of 2022, online sales, as a percentage of overall retail sales, declined for the first time since 2013.

continued on page 3

President's Message

Greenfield, which opened nearly 60 years ago, has grown to include more than 600 acres of park-like beauty and a variety of amenities and services. Greenfield is currently home to 250 businesses, 4,000 employees, 2,000 students across four colleges, and 3,000 residents – with further growth on the horizon.

A mixed-use development on the largest open tract left in East Lampeter Township's Greenfield complex – Greenfield North – will include a pair of 200,000-plus-square-foot Class A industrial buildings as well as more than 600 apartments in four five-story elevatored buildings and 28 townhomes. The industrial warehouses will be built with the flexibility to accommodate a wide variety of uses. Commencement of site work for all three projects is scheduled for spring 2023.

Greenfield also recently added three more miles of walking trails, for a total of approximately 10 miles throughout the campus. Those will tie into the 1.2-mile-paved Greater Lancaster Heritage Pathway trail for pedestrians and bicyclists that is part of the Walnut Street project. That project, which began in August 2022, is expected to be completed in November 2023, will add a 1.2-mile, two-lane roadway linking Greenfield to U.S. Route 30, one of Lancaster County's busiest thoroughfares.

As you can see, there is a lot happening in the Greenfield community, and we're looking forward to all the growth 2023 will bring.

Mark

Mark Fitzgerald
President and Chief Operating Officer
High Real Estate Group LLC
717.293.4466
mfitzgerald@high.net

Starbucks Coming to Greenfield

High Real Estate Group recently signed a lease for a new 2,500-square-foot Starbucks to be built at 525 Greenfield Road.

"We're thrilled for this new addition to the Greenfield community," said Mike Lorelli, Sr. Vice President of Commercial Asset Management, High Associates Ltd. "A high-quality coffee shop is the most frequently requested amenity by all stakeholders in Greenfield, and we're happy we are bringing it to fruition."

Greenfield Architects completed the design drawings for the one-story Starbucks building shell. Highlights of the new building include a drive-thru lane with space for up to 16 cars, an outdoor dining patio with a pergola and outdoor furniture, a bike rack, and large storefront windows to let natural light into the retail space – with canvas canopies for summer shade.

High Construction Company was selected as the general contractor for the project. Construction is already underway and expected to be completed in the summer of 2023.

The Strength of Brick-and-Mortar Retail continued from page 1

Below are some statistics that highlight the strength of brick-and-mortar retail:

- Retail vacancy nationwide was at 6.1% in the second quarter of 2022, the lowest level in 15 years (Cushman & Wakefield)
- More retailers opened than closed in 2021, the first time that has occurred since 1995 (Morgan Stanley)
- Vacancy and positive openings/closings are reflected in a positive absorption in 2021 in excess of 25 million square feet (CoStar)

All of these indicators positively impacted investor interest, with the transaction volume of retail centers increasing by 24% in 2021 as compared to the full year of 2019.

Causes and opportunities

Despite an extended period where many people shopped predominantly online, that higher level of online sales was not sustainable, and we returned to a mix of online and in-person shopping.

Omnichannel retail strength reinforces our continued belief in the strength of physical retail. Store environments matter more than ever, needing to serve as stores, showrooms, fulfillment centers, return locations, and customer service centers. And consumer experience matters most of all. Much to the dismay of operationally focused retailers such as The Home Depot, Wall Street is beginning to reward retailers such as Lowe's, Best Buy, and Target that are considered by many to be more consumer-centric.

Driving physical sales and positive absorption, digital retailers are also coming to appreciate the halo effect of physical locations, as well as the functional benefits. Physical presence drives awareness and impression at a level that cannot be matched online. Physical stores also allow for service and expertise to enter the buying decision, changing it from a commodity transaction. Digitally native retailers that create a physical presence see a 37% increase in web traffic from the trade area. On the flip side, retailers that close physical locations in a trade area see web traffic decline by 77%.

> **"Omnichannel retail strength reinforces our continued belief in the strength of physical retail."**

The future of brick-and-mortar retail

As we move forward, the factors that make up a successful retail site, such as location, visibility, accessibility, parking, environment, and favorable demographics, will become even more important as they all play a role in determining whether a project will be sustainable.

This evolution of physical retail and its strength raises some interesting questions about the relationship between retailers and landlords, which we plan to address in future issues of Real Estate Matters.

Powell Arms
Senior Vice President and
Managing Director - Retail Division
High Real Estate Group LLC
717.209.4069
parms@high.net

Good Things are Happening in Hospitality

Hospitality Rebounds and Projections Strengthening

By: David Aungst – President, High Hotels Ltd.

The hospitality industry was drastically affected by the COVID-19 pandemic – faced with dramatic reductions in demand, various state and federal restrictions, the rising cost of goods, and more. Despite these challenges, this sector has proven itself resilient and is not only surviving but thriving.

For the hotel industry specifically, the leading benchmark for recovery is a metric called Revenue per Available Room, also known as RevPAR. It is calculated by taking a hotel's room revenue and dividing it by the number of available rooms. For example, if a 100-room hotel generates $8,000 in room revenue, its RevPAR for the day is $80. From the onset of the pandemic, the industry focused on returning to 2019 RevPAR numbers.

In previous hospitality industry downturns, such as post-9/11 (2001-2002) and the Great Recession (2008-09), the hospitality industry in the United States took years to simply recover to prior trailing 12-month (TTM) RevPAR levels. Specifically, post-9/11 TTM RevPAR required 52 months to achieve pre-9/11 peak levels. In a similar study, post-Great Recession TTM RevPAR required 59 months to return to pre-Great Recession peak levels.

At the onset of COVID in 2020, many prognosticators felt that recovery to 2019 RevPAR levels would not occur until 2024 or 2025. Fortunately, that did not end up being the case. In April 2022, just 25 months after the pandemic began, the hospitality industry reached peak pre-COVID TTM RevPAR results. By the end of 2022, US RevPAR achieved 108% of year-end 2019 RevPAR results.

However, not all hotel types and not all markets recovered equally. Hotel type, access to the market, and availability of leisure activities all played a role in recovery speed. Markets that had outdoor recreation and that were drivable exploded in popularity. Markets that were heavily dependent on large group events or business travel recovered more slowly. For example, markets like Virginia Beach and Tampa were amongst the highest RevPAR markets in the entirety of the United States at different points in 2020 and 2021. With restaurant closures and availability impacting many markets, guests also craved hotels that had kitchens, ovens, and refrigerators. These hotels have suites and are typically called extended-stay hotels. These types of hotels had a rapid recovery to 2019 results.

Overall, secondary/tertiary markets according to JLL, such as Lancaster and York, achieved 114% recovery compared to 2019, while those in the Top 25 markets, such as Philadelphia and San Francisco, had a much slower recovery. Likewise, select-service hotels, like Hampton Inn and Courtyard by Marriott, achieved 110% recovery compared to full-service hotels, such as Sheraton, Westin, and DoubleTree, which only achieved 104% recovery.

High Hotels Ltd. is a prime example of overcoming this challenging time. Our portfolio of drivable, select-service hotels located near an abundance of leisure activities helped us achieve a robust recovery. We also could not have achieved this level of recovery without our resilient coworkers, innovative ideas, strategic vision, and collaboration.

"We were hit hard by the pandemic, but we came back stronger than ever," stated David Aungst, President, High Hotels Ltd. "Within the hospitality industry, the return of Revenue per Available Room (RevPAR) to 2019 levels was the key recovery metric that the industry monitored. As of year-end 2022, High Hotels Ltd. not only recovered but exceeded 2019 RevPAR results. None of these revenue results could have been achieved without our dedicated coworkers."

As we begin settling into our "new normal" and returning to in-person meetings, events, and travel – both business and personal – one thing is becoming clear. The hospitality industry is not only bouncing back to the pre-pandemic levels, but it is also well-positioned for continued growth into the future.

David Aungst
President
High Hotels Ltd.
717.293.4558
daungst@high.net

Two New Hotels Added to Portfolio

High Hotels Ltd. further extended its reach into the York, PA hospitality market by acquiring Home2 Suites by Hilton and Hampton Inn & Suites South on October 27, 2022. High Hotels has a rich hospitality history in York – having operated York Hampton Inn located beside the York Galleria Mall since 1992. The two newest hotels in High Hotels' portfolio are located off the Queen Street exit of I-83.

These acquisitions reflect the patient growth process of identifying acquisition targets that satisfy our age, market, and return expectations. The hotels have recovered admirably following the COVID-19 pandemic, both financially and with respect to guest satisfaction, as evidenced by both hotels being ranked in the top 25% of their respective brand families. In 2023, both hotels will have their exteriors and interiors renovated and refreshed.

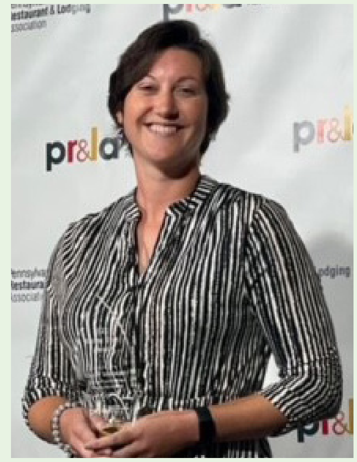
The Hampton Inn & Suites, which opened in 2014, includes 100 guest rooms and suites, a meeting room, a fitness center, an indoor swimming pool, and Hampton Inn's iconic waffles for breakfast. It is part of the iconic Hampton Inn by Hilton brand, which consists of 2,839 properties in 35 countries. High Hotels opened its first Hampton Inn in Lancaster in 1989 and has operated multiple Hampton Inns continuously since that date.

The Home2 Suites by Hilton, which opened in 2016, includes 107 suites, a fitness center, and an indoor swimming pool. It offers longer-stay options with expanded suites that include refrigerators, dishwashers, and cooktops. Home2 is a newer brand to Hilton, but it has been readily embraced by customers and developers and currently consists of 560 properties in three countries.

Two Hotel Coworkers Honored with Industry Recognitions

Jason Schultz, Area Director of Sales & Marketing – West Region, High Hotels Ltd., was recently recognized in Central Penn Business Journal's Forty Under 40 rankings. Selected by the editors/publisher of Central Penn Business Journal, honorees are selected based on professional accomplishments, community service, and commitment to inspiring change.

Casey Spadaro, Assistant General Manager, High Hotels Ltd., was recently honored with the Spirit of Hospitality Rising Star Award from the Pennsylvania Restaurant & Lodging Association (PRLA). Each year, the PRLA honors exceptional members of the hospitality industry for their leadership, commitment, and service to the industry and community.



Congratulations to Jason and Casey on their awards and accomplishments.

Continued Evolution of Office Spaces

By: Mike Lorelli – Sr. Vice President of Commercial Asset Management, High Associates Ltd.

Over the past year, there has been a lot of speculation about the future of office spaces. Second only to hospitality, office space has been most impacted by the pandemic over the past three years. This impact is only now being felt due to the expirations of long and short-term leases.

One of the first trends we have seen is a flight to higher quality buildings – increasing vacancies and sublease opportunities in "B" quality properties. In addition to building quality, employees are looking at office locations. Over the past three years, there has been a notable shift from urban centers and mass transit to suburban locations with access to amenities. Finally, employers are being forced to decide how their company will operate in a post-pandemic environment, defining what the workplace will look like going forward.

Pre-pandemic, work-from-home employment accounted for less than 5% of the office employment landscape. Today, approximately 70% of companies have adopted a hybrid work arrangement where some portion of the work week/workday can be conducted from home. What was originally an outcome of health concerns for employees is now a requirement to retain employees in an extremely tight national labor market. The impact of this hybrid model is expected to result in a reduction of square footage by approximately 10 – 15%. The impact is relatively minor, as employees are still demanding a specific workspace when working in the office.

Due to the organic growth of employment in the sectors that utilize office space, occupancy should be back to pre-pandemic levels by 2024 or 2025. Despite the contraction in office occupancy, rents have increased slightly here in central Pennsylvania and increased by roughly 4% nationwide.

In addition to the amount of space being occupied, the purpose of office space has changed. Historically, it was viewed as a place to house employees and conduct all

continued on page 7

Continued Evolution of Office Spaces continued from page 6

functions of business such as accounting, sales, and administration activities. To a degree, success was measured by time spent in the office and dollars produced. The function of the office is now realized as a way of communicating corporate culture and values. Success is now being measured by employees' sense of inclusion and collaboration.

Recently, many employers, office managers, and developers have begun putting greater focus on the physical aspects of the workspace. Early into the pandemic, investments were safety-driven such as touchless technologies, increased janitorial cleaning, and improvements to air quality with HVAC modifications. Now, emphasis is being placed on features you might experience in a restaurant or hotel lobby, including bright and engaging wall graphics; greater incorporation of glass in wall systems; inviting colors, textures, and patterns for walls and flooring; and increased plant-scaping.

The final way that the concept of office utilization has changed is the focus that time within the office should be meaningful, not simply completing a task. With the recent "Great Resignation," the importance of collaboration and training has been identified as one of the meaningful benefits of being in an office environment. With so much workforce turnover experienced over the past three years, as well as new employees entering the workforce, time spent in meaningful, personal contact has never been more important. A tremendous amount of practical business learning and culture is communicated through day-to-day personal contact among team members. To facilitate this, office design trends are using more collaboration areas, casual seating, coffee bars, and meeting spaces to encourage that interpersonal connection. Flexible office utilization will take on greater importance allowing individuals and work teams to create their own workspace that combines personal satisfaction and organizational outcomes. Without any substantive change in the current low employment environment, the importance of location, building quality, design, and utilization will remain relevant.

Mike Lorelli
Senior Vice President -
Commercial Asset Management
High Real Estate Group LLC
717.293.4410
mlorelli@high.net

PA Gets with the "1031" Program

By: Rebecca Hodson, CPA, MST – Tax Director, High Company LLC

After decades of non-conformity, Pennsylvania will finally allow tax deferral on like-kind ("1031") exchanges, effective January 1, 2023. Until this date, Pennsylvania was the only state in the nation that did not recognize 1031 exchanges. Previously, real estate investors could complete 1031 exchanges to defer capital gains taxes at the federal level but could not defer taxes on gains at the state level in Pennsylvania.

What is a 1031 exchange?

When it comes to selling a real estate property, capital gains taxes can be pretty significant. A 1031 exchange allows tax deferral on capital gains on the real property component of a real estate transaction. Note that tax deferral is not available on personal property components of a real estate transaction, which was a change contained in the Tax Cuts and Jobs Act of 2017.

"A 1031 exchange allows tax deferral on capital gains on the real property component of a real estate transaction."

Simply put, a 1031 exchange involves a swap of one property for another between two individuals. However, the odds of finding someone with the exact property that you want who wants the exact property that you have are slim. Therefore, it is common for a qualified intermediary ("QI") to be involved in a 1031 exchange. The purpose of the QI is to facilitate the exchange and hold cash after a taxpayer's property is sold. When a replacement property is identified, the QI uses the cash to purchase the replacement property for the taxpayer.

continued on page 8

PA Gets with the "1031" Program continued from page 7

There are two key timing rules that must be observed in like-kind exchanges. First is the "45-Day Rule." Within 45 days of selling their relinquished property, the taxpayer must identify in writing to the QI, a specific property they wish to acquire. The IRS allows the taxpayer to designate three properties as long as they eventually close on one of the identified properties. A taxpayer can even designate more than three properties if they fall within certain valuation tests. The "180-Day Rule" says that the replacement property must be acquired within 180 days of settlement on the relinquished property.

It is important to note that any cash remaining with the QI after the replacement property is acquired is taxable. Also, the impact of mortgages or other debt on property relinquished and debt on replacement property should be considered.

> **"The IRS allows the taxpayer to designate three properties as long as they eventually close on one of the identified properties."**

There's no limit on how frequently a taxpayer can do a 1031 exchange. A taxpayer may roll over the gains from one piece of real estate to another and another and another.

Why is the change in PA state law significant?

The state law change is seen as a major victory for taxpayers and the 1031 industry. Depending on the size of the real estate transaction, hundreds of thousands or even millions of dollars of state taxes that weren't previously eligible for tax deferral in the state of Pennsylvania can now be deferred in a 1031 exchange.

> **"The ability to defer PA state tax in a 1031 exchange could be a deciding factor for small companies or individuals looking to buy or sell real estate in PA."**

The ability to defer PA state tax in a 1031 exchange could be a deciding factor for small companies or individuals looking to buy or sell real estate in PA.

It is important to note that Pennsylvania tax will be due on exchanges initiated in 2022; in other words, to qualify for state tax deferral in PA on 1031 exchanges, the exchange process must begin in 2023.

*Disclaimer: The information contained in this article does not constitute **tax advice** that may be used or relied upon by the recipient or any other person to avoid the imposition of any penalty by the Internal Revenue Service. Please consult your tax advisor.*

Rebecca Hodson, CPA, MST
Tax Director
High Company LLC
717.293.4559
rhodson@high.net

RealEstateMatters

High Real Estate Group LLC
1853 William Penn Way
P.O. Box 10008
Lancaster, PA 17605-0008
Tel: 800.638.4414
www.highrealestategroup.com

WINNER 2021 APEX AWARDS FOR PUBLICATION EXCELLENCE

Real Estate Matters: Recognized for Excellence Since 2001

HIGH REAL ESTATE GROUP LLC
Your Full Service Real Estate Resource

Services:

- Industrial / commercial brokerage, leasing, and development
- Asset and property management
- Strategic planning and consultation
- Corporate real estate services
- Appraisal services
- Construction services
- Architectural design
- Hotels
- Real estate investments

naiop National Association of Industrial and Office Parks · ULI · ACCREDITED MANAGEMENT ORGANIZATION® · SIOR · ICSC · CCIM

Affiliates:

High Associates Ltd.
www.highassociates.com

High Construction Company
www.highconstruction.com

Greenfield Architects Ltd.
www.greenfieldarchitects.net

High Environmental Health & Safety Consulting Ltd.
www.highehs.com

High Hotels Ltd.
www.highhotels.com