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RETAIL & COMMERCIAL DEVELOPMENT GROUP
2021 FORECAST

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As we have done for the past twelve years, the Retail and Commercial Development Group of Cox, Castle & Nicholson LLP has, once again, taken on the challenging task of forecasting what to expect in the forthcoming year in four critical segments that affect the retail and office industries. In doing so, we analyzed the global health, social, political and economic events of 2020, reviewed various economic data and projections and have come to certain opinions relating to the retail and office industries and where they are heading in 2021. Included here is the product of our thinking, in the form of four articles of interest addressing such topics as capital markets, retailing, retail development, and office leasing.

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Gary specializes in shopping center development and retail, office and industrial leasing, generally representing shopping center, office, and industrial developers, as well as major retailers. He is nationally recognized as one of the premier retail transactional attorneys by his clients and peers. He has also been extremely involved in the International Council of Shopping Centers (ICSC), the retail industry's most prominent trade group.

GOOD RIDDANCE 2020! WHAT WILL HAPPEN TO THE CAPITAL MARKETS FOR RETAIL IN 2021?

by Gary Glick

The introduction of COVID-19 into the U.S. at the beginning of 2020 sent shock waves through the entire economy. Every person in the U.S. has been affected by the pandemic. The suffering caused by the pandemic has been enormous. Through late December of 2020, the U.S. infected population was close to 19 million with a death count exceeding 335 thousand. However, there is cause for optimism with two highly effective vaccines currently being deployed throughout the U.S., albeit at a pace that is not fast enough for many.

COVID-19 has severely impacted the U.S. economy. The U.S. lost more than the 22.4 million jobs that were added in the 11 years since the Great Recession, and most of these losses occurred in a five-week period spanning March and April. In addition, during the second quarter of 2020, the coronavirus caused the biggest quarterly drop in GDP in U.S. history, led by a 24 percent decline in consumer spending.

Washington responded to the economic devastation caused by the coronavirus by enacting the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided over $2 trillion for workers, businesses, and local governments. The CARES Act provided an additional $600 per week to those receiving state unemployment benefits and facilitated loans and grants to businesses that kept employees on the payrolls. Up to $2.3 trillion was allocated by the Federal Reserve to support financial markets and state and local governments through direct lending, securities

purchases, and numerous other actions. Following this initial response, the Federal Reserve has continued to pump massive liquidity into the system, and has pledged to keep the federal funds rate near zero through 2023. In late December of 2020, Congress passed a close to $1 trillion additional coronavirus relief package which extended many of the benefits contained in the CARES Act for an additional approximately three-month period.

The shopping center industry has been severely impacted by COVID-19, with a rash of retailer bankruptcies and small retail operator failures, in addition to industry-wide disruption caused by acceleration of the shift by consumers toward on-line retail purchasing. Thousands of retailers were forced to abruptly close their doors when the pandemic proliferated in March. Many have yet to reopen or reopened only briefly (or with limited capacity), even where they are allowed to operate. As of the end of 2020, public health orders remain in effect for many types of stores and services in much of the U.S., particularly for businesses that require close personal contact, such as restaurants, salons, bars, gyms, and most forms of indoor entertainment. These restrictions have devastated the finances of retailers and restaurateurs, as well as their landlords. For the shopping center industry, widespread vaccination cannot arrive fast enough.

Many economists believe that, as the vaccines for COVID-19 are more widely deployed, shopping center investment sales will start to normalize based on abundant liquidity, low cost of capital and attractive returns.

As one would expect, the coronavirus has weighed heavily on shopping center investment activity. In general, commercial real estate investment volume in the first three quarters of 2020 fell by 44% from the same period in 2019. However, despite the significant increase in COVID-19 infections and deaths in the fourth quarter of 2020, investor sentiment for retail has begun to recover due to the optimism over the efficacy of the two COVID-19 vaccines currently being deployed in the U.S. Despite this recovery, capital markets remain soft relative to the pre-COVID-19 normal, moving to a stage of price discovery and risk aversion. A disconnect on pricing has occurred between shopping center buyers and sellers. Based on CBRE's latest Cap Rate Survey, 61% of commercial real estate buyers are seeking discounts while only 9% of sellers are willing to offer them. Additionally, with retail being disproportionately impacted by COVID-19, investment activity for retail continues to lag well behind that for multi-family and industrial.

Many economists believe that, as the vaccines for COVID-19 are more widely deployed, shopping center investment sales will start to normalize based on abundant liquidity, low cost of capital and attractive returns. Available capital for real estate investment remains more than $300 billion globally, the majority of which is targeting North America. This wall of capital is a major contributor to the constrained expansion of cap rates. Additionally, with the Fed plans to keep interest rates near zero until 2023, real estate cap rates should remain relatively stable. This financial environment rewards investors with a potentially wider yield spread and potential additional gains from asset value appreciation. Additionally, the ultra-low cost of borrowing will help offset the likely slow growth of rental income.

Surprisingly, shopping center regional malls and distressed shopping centers could become a favored investment sector in 2021 due to large discounts in value, the receding pandemic, and a growing economy. Because commercial real estate investment firms are having a difficult time acquiring industrial, manufactured housing, suburban office

and apartments, and fully leased food store/drugstore shopping centers at acceptable cap rates, it is anticipated that an infusion of new private equity capital and institutional capital will be utilized to acquire malls and distressed shopping centers.

While COVID-19 has affected nearly every aspect of commercial real estate in one way or another, one of the most fundamental consequences has been in lending, where strategies are being adjusted for a post-pandemic environment. Many lenders are facing substantial headwinds and, as a result, underwriting criteria has become more conservative. In the second quarter of 2020, commercial real estate loan closings declined nearly 21% year-over-year, driven by the pandemic-related temporary freeze in lending and transaction markets between mid-March and early April, according to an index published by CBRE.

This recession is more akin to the economic damage wreaked by a natural disaster, like a hurricane or earthquake, which typically interrupts the supply of goods and services. When a disaster of this sort ends, a V-shaped recovery typically ensues.

This conservative lending environment has resulted in fewer options for shopping center borrowers. Although liquidity has remained ample, loan terms have changed as a result of the pandemic. While interest rates remain low, in the 3.50 to 4.25 percent range, loan-to-value (LTV) underwriting requirements have decreased by about 10 percent, depending on the lender. For example, before the pandemic, LTVs offered by life insurers averaged about 65 percent. Now that figure is at 55 percent. LTVs offered by CMBS lenders averaged 75 percent before pandemic, but are now in the 60 to 65 percent range. Debt service coverage ratio underwriting requirements have also shifted, rising to the 1.6 to 1.9% range. For the best-of-the-best retail properties, long-term, fixed-rate financing at moderate leverage levels will price between 2.75 and 3.25 percent. More transitional, higher leverage and weaker shopping centers will price in the higher rate range.

While there is still sufficient debt capital today for new shopping center acquisitions and refinancings, the pricing and leverage referenced above will be highly dependent on the sponsor, location, quality of the asset, stability of cash flow and business plan, with terms varying significantly depending on the combination of those factors. Surprisingly, there is a significant amount of liquidity in today's market from all groups of lenders, including banks, life companies, specialty finance groups and investment banks. Interest rates are also anticipated to remain at historic lows well into next year, which bodes well for investors and the capital markets.

Most recessions begin when rising interest rates or stressed financial markets undercut demand for goods and services, driving up unemployment, which further crimps demand. The COVID-19 recession is different. This recession is more akin to the economic damage wreaked by a natural disaster, like a hurricane or earthquake, which typically interrupts the supply of goods and services. When a disaster of this sort ends, a V-shaped recovery typically ensues. With effective vaccines, most of the population could be vaccinated by midyear, allowing social-distancing restrictions to loosen or even end. Once restrictions are lifted, the ensuing recovery could turbocharge asset prices and consumer and capital spending. Combining this with historically low interest rates, it seems more likely than not that shopping centers will begin to recover or even flourish by the end of 2021, so long as new or existing restaurant and retail operators are able to fill the void left by COVID-19-related vacancies.

WILL THE RETAIL ROLLER COASTER LEVEL-OFF IN 2021?

by Scott Grossfeld

Scott's practice focuses on shopping center and other commercial development and leasing. He has comprehensive experience representing developers and property owners in all aspects of retail, office, mixed-use and industrial development, including the negotiation and drafting of leases, purchase and sale agreements, development and management agreements, reciprocal easement agreements, listing agreements and all other agreements related to the acquisition, construction, development and repositioning of commercial projects.

Last year (2020) witnessed unprecedented swings in the retail sector of the U.S. economy.

The 2020 Roller Coaster

The year started on sound footing. Core fundamentals were strong. Heading into 2020, the stock markets were at all-time highs. Unemployment was at record lows. Wages were generally increasing. Interest rates were low and capital was plentiful. In addition, early in the year, the Federal Reserve Board announced that it would not increase the Federal rate for borrowing funds and that it was not likely to increase the rate for the immediate future. Consumer confidence was at reasonably high levels, and the Trump administration was on track to settle, or at least ease, its trade war with China. In addition, retail sales and performance were up (year over year) coming out of the 2019 holiday period.

Although there were still certain reasons to be concerned and mildly apprehensive of retail going into 2020, most commentators were optimistic about the sector for the foreseeable future.

Of course, what happened next was not foreseeable. What started in late 2019/ early 2020 as a health emergency in Wuhan, China, quickly grew and spread into a regional epidemic and then into a global pandemic. COVID-19 quickly spread from China to other countries in Asia and then to Europe, North America and throughout

the rest of the world. By February of 2020, cases began to appear in the United States. In March and April, the cases (and related deaths) in the U.S. began to grow exponentially.

In response to the quick spread of the COVID-19 virus in the early part of 2020, many local governmental authorities issued "stay at home" and similar orders in an effort to stave off the spread of the disease. This resulted in the temporary closures of most businesses within jurisdictions covered by these orders, except for so-called "essential" businesses (such as supermarkets, drug stores, banks and certain other businesses). Most restaurants were closed, except for delivery and take-out service. Health clubs and movie theaters were closed. Basically, for many parts of the country, the retail sector shut down, except for essential services and e-commerce.

Although broad "stay at home" orders ultimately lapsed or were modified to re-open the economy in a limited capacity, especially after COVID numbers began to improve for the better, as COVID surges began to re-occur throughout the United States, states and cities began to re-implement partial closures of select portions of their business communities. To this day, many cities still do not permit indoor dining at restaurants, some do not allow outdoor dining, many retail establishments are limited to certain percentages of permitted occupancy (i.e., 25% of maximum occupancy) and, in many places, health clubs are not permitted to provide indoor services and movie theaters cannot operate. The extent of the impacts on retail in particular communities have continued to depend upon the amount of COVID cases in the relevant communities.

Needless to say, forced governmental closures and the scaling down of businesses have had a significant impact on retail in 2020. Many retailers have been unable to survive and have been forced to close their businesses – some through bankruptcy. Many retailers have been forced to layoff or furlough employees, and many tenants are unable to meet their lease obligations. Unemployment has risen greatly on a national level and physical retail is almost unrecognizable.

Better Than Expected Retail Performance

Notwithstanding this bleak-sounding assessment, the retail sector managed to perform better than many experts expected in 2020 (largely due to major increases in e-commerce sales and physical retail pick-up and delivery services), and the outlook for 2021 appears to be better.

In 2020 retail was, and going into 2021 retail will be, resilient, flexible and resourceful. As many commentators agree, and as stated in the recent pwc/ULI Emerging Trends in Real Estate 2021, "[s]tores still matter…. Even with the many challenges that COVID-19 poses for consumers and retailers, we still purchase the overwhelming share of our retail goods and services in stores, and that share is bound to rise again once it is safe for people to resume their normal routines. The vast majority of stores and shopping centers will not only survive but thrive – after some painful times and tough adjustments."

Citing National Retail Federation data, a recent GlobeSt. article reported that, despite the ongoing struggles of many retailers, "retail sales in the aggregate have seen a V-shaped recovery, growing both month-over-month and year-over-year each month since June [2020]. Sales were up 10.6 percent in October versus October 2019…. For the first 10 months of this year [2020], retail sales were up 6.4 percent versus the first 10 months of 2019."

GlobeSt. also reported the National Retail Federation's prediction for the 2020 holiday season, which is often a good indicator of upcoming retail industry performance for the ensuing year. In its forecast, the National Retail Federation predicted "that holiday sales during November and December will increase between 3.6% and 5.2% over 2019…."

As mentioned above, it is generally believed that much of the success of retail in 2020 was due to the rise of e-commerce and its ability to produce where brick and mortar was unable to produce due to governmental shut-downs. In addition, operators with good omni-channel programs have been able to perform better than retailers with only brick and mortar (or limited e-commerce) platforms.

So-called “essential” services also have driven retail performance through these trying times. Sales from these businesses have remained strong throughout the COVID-19 crisis, in large part because they have been exempted from government shut down orders. Therefore, despite the pandemic, supermarkets and stores such as Costco and Target that sell a significant amount of food and household essentials have performed exceedingly well, as they provide the most important goods and services needed by house-bound consumers.

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Looking Forward

As we enter 2021, two vaccines have been approved for use in the U.S. Additional vaccines are anticipated to be approved for use following the beginning of the year. There is hope that, by mid-year, a good percentage of the population will be vaccinated and life in the U.S. could start to return to something approaching normal.

Notwithstanding the decent retail statistics from 2020, brick and mortar retailers are banking on retail buying habits returning to pre-pandemic norms. These retailers hope that consumers who have shifted to significantly purchasing goods via e-commerce as a result of pandemic fears, will progressively return to physical stores to buy their goods. As a greater portion of the population is vaccinated and COVID numbers start to significantly decrease, we expect that more retail establishments will be permitted to re-open with or without occupancy limits and that more consumers will feel comfortable once again shopping, eating, exercising and otherwise being out in public. When this happens (and it should happen when more people are vaccinated and less people are getting sick), retail should start to return to normal, or at least improve.

Many commentators have also noted that consumers have a pent-up demand to personally shop, and they have accumulated savings. The pandemic has resulted in many consumers and households significantly saving by not traveling during the past year and not being able to make other anticipated or discretionary purchases. When stores open, many consumers will be ready to buy and will have the funds with which to do so.

Finally, although unemployment may continue to be an issue due to many business closures even after significant vaccinations, other key economic factors could facilitate a relatively quick recovery for the retail sector. 2021 is still expected to see some of the lowest interest rates in our country’s history, plentiful capital, record-high stock markets and a trade program structured to incentivize business.

* * *

COVID-19 impacted the retail sector in a major, negative way. However, retail managed to adapt, in large part due to heavy investment in on-line resources. As soon as it is safe to once again venture out in public, this resilient sector should quickly rebound.

COX CASTLE NICHOLSON

RETAIL DEVELOPMENT – BLINDSIDED BUT ADAPTING

by Daniel Villalpando

For more than 25 years, Dan has specialized in commercial development and leasing. Developers and property owners look to Dan for his counsel on all aspects of shopping center development, including the acquisition and disposition of commercial real estate and the negotiation and drafting of development agreements, reciprocal easement agreements and leases with almost every national and regional retailer.

As 2019 came to an end and we flipped the calendars to 2020, many in the retail development industry felt a sense of tempered confidence. However, at the time, nobody was predicting that 2020 would bring devastating wildfires, numerous instances of civil unrest and, not to be outdone, a crippling global pandemic, just to name a few tragedies. The COVID-19 pandemic has accelerated the failure of some retailers, many of whom were struggling prior to the start of 2020, and all retailers – even the most successful ones – have been forced to adapt. The resulting vacancies will likely create opportunities for new types of retail uses and concepts. Despite it all, many in the retail development industry remain cautiously optimistic about the coming year, and, for most, 2021 cannot come soon enough. After all, ever since Sears delivered its first catalog in the 1890s, retail development has been forced to adapt to stay relevant, and all signs point to the need for further adaptation in 2021.

Any consideration of what might occur in 2021 requires us to address the proverbial "pandemic elephant" in the room. As COVID-19 started to rage in March, millions of retailers were forced to close their businesses, and some of the smaller retailers (especially "mom-and-pop" restaurants and sundry shops) were unable to re-open and turned their keys back over to their landlords. Others reopened briefly, only to close again. As a result, despite the efforts of many retail developers (and the federal government) to provide financial assistance, the pandemic has resulted in the shuttering of millions of square feet of retail space.

However, some might argue that COVID-19 only accelerated the inevitable for some retailers, and recent data backs up that argument. In general, experts believe that the United States is significantly over-retailed, with much more retail space per capita than any other country. In addition, consumers are devoting more of their hard-earned money to health care, housing and recreation than ever before, which results in less cash being spent at retail establishments. Even before the pandemic, aging baby boomers, who feel that they have accumulated most of the material items they need, are spending more money on experiences and travel, and less on buying goods in stores. And, perhaps most significantly, for several years, physical retailers have been losing market share to online sellers. Each of these factors was only exacerbated by the pandemic.

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Many retail developers spent much of 2020 trying to support their tenants, either through negotiating rent relief amendments to help keep struggling tenants afloat, or by spending money to attempt to entice leery customers to return to their projects. Some retail developers have helped organize curbside pickup programs at their properties to assist smaller retailers who lack the resources to establish their own programs. In addition, retail developers have installed hand-sanitizing stations in the commons area, as well as six-feet-apart reminders and floor decals, to help create a sense of safety in their projects. Others have transformed common areas and sidewalks for tenant use as dining space or space for outdoor exercise and workouts. In addition, some developers are being forced to get creative with their parking lots to provide their tenants with the ability to offer buy-online-pick-up-in-store (BOPIS) capabilities, which appears to be a growing trend. Since statistics show that over 80% of BOPIS consumers will shop for additional items while picking up their orders, it is no surprise that retailers are interested in offering this service, which will likely become more popular when the pandemic subsides. The common thread is landlords working with tenants to keep businesses open (and somewhat profitable) and making retail establishments as safe as possible for consumers in order to lure them back.

Other retail developers are being more proactive in dealing with existing space by negotiating early lease terminations with struggling tenants who do not see things turning around anytime soon. These developers are seeking to strategically take back certain spaces prior to the natural expiration of the applicable leases in order to remerchandise with better tenants and higher rents. Some “mid-box” or “junior anchor” tenants like PetSmart and Staples, who are looking to downsize their footprints, may be willing to give space back early, allowing landlords to aggregate enough square footage to attract certain “hot” retailers in an effort to revitalize their shopping centers. For example, discount and dollar stores such as Dollar General, Family Dollar, Dollar Tree and Five Below are in the market for residual space, often in the 5,000- to 10,000-square-foot range. Dollar General, alone, recently announced plans to open 1,000 new stores in 2021, while Dollar Tree is hoping to open 500 new stores. In addition, automotive retailers like O’Reilly and Jiffy Lube are actively growing and scooping up second generation space. Other new concepts that might be positioned to absorb excess space in 2021 include health and wellness, pet services, automobile showrooms and salon suites.

The pandemic has also highlighted the difference between “essential” and “non-essential” retail and, not surprisingly, the product type that emphasizes “essential” retail has fared much better. Businesses believed to be essential to daily life, such as grocers, home improvement stores, pharmacies, banks and gas stations, have generally been

allowed to remain open, which is obviously the most critical component to turning a profit. On the other hand, "non-essential" retail, such as apparel, salons, gyms and movie theaters have been forced to close for much of the year, and projects where those types of tenants serve as "anchors" have suffered the most.

In terms of what is occurring with different types of retail projects, grocery-anchored neighborhood centers appear to have weathered the storm and generally continue to provide a good return for their owners. During the pandemic, consumer priorities have shifted to focus on basic needs, such as food, and grocery stores have generally benefited. Indeed, traditional grocers Albertsons, Kroger and Publix have all had a strong 2020 despite the circumstances. As in 2019, one of the larger growth sectors in retail is specialty grocers, such as Whole Foods, Trader Joe's and Sprouts; another is discount grocers like Walmart Neighborhood Market. However, the pandemic has accelerated the growth of online grocery shopping, largely out of necessity due to customer safety concerns. In addition, the acquisition of Whole Foods by Amazon continues to spark change in the grocery sector, and some experts predict that consumers may get even more comfortable ordering groceries online in 2021. Such comfort in online ordering and delivery may result in fewer trips to the local grocery store and, therefore, less foot traffic in the neighborhood center.

Not surprisingly, traditional enclosed regional malls have struggled, likely because shoppers have been unwilling, or unable, to brave the enclosed spaces that make up most indoor malls. Overall, owners of regional malls in non-affluent areas (mainly Class B and C malls) have had to adapt to stay relevant. According to data from ICSC, of the "roughly 1,500 enclosed malls built across the U.S. since 1956, about 1,000 continue to be used for their original purposes and about 500 have been changed to different uses." Such uses include offices (ranging from call centers to high-tech spaces), distribution and industrial centers, sports facilities, movie stages and data centers. A prime example of such transformation is the former Westside Pavilion mall in West Los Angeles, which is being converted into a 584,000 square foot headquarters space, to be anchored by a Google campus, and is on pace for first-quarter 2022 completion. Whether such projects will still fall in the "retail" category after conversion remains to be seen, but there does seem to be an appetite for developers to repurpose underperforming enclosed malls.

Meanwhile, many retail developers continue to be affected by the closures of department stores, such as Sears, Macy's and JC Penney. Even before COVID-19, the deconstruction of the department stores, or "right-sizing," was seen by some as the natural progression of retail; those department stores that have elected to stay open have generally reduced product offerings to three primary product categories—apparel, housewares and cosmetics/fragrances. To combat closures, "specialty leasing" had been on the rise prior to the pandemic, with retail developers looking to re-lease large vacant space to concepts not traditionally associated with shopping centers, such as e-sports facilities, escape rooms, laser tag venues, day care centers, painting studios and cooking schools. Of course, the ability to add such non-traditional tenants needs to be balanced against the rights of other existing tenants that may have the ability to keep certain uses out of a given project. A non-traditional use may allow a retail developer to temporarily re-lease space and get some rent in return. But adding such uses may upset major or anchor tenants at a project, who may decide to aggressively fight the new uses or to leave the project when their current term expires, rather than renew or exercise available options.

When it comes to the world of retail development, the pandemic has certainly highlighted the difference between "essential" and "non-essential" retail, and the different types of retail developments have been affected accordingly. The good news is that many in the industry expect consumers to return with a vengeance once the pandemic is under control and to resume spending money on "non-essential" items. Until then, retail developers will continue to be forced to adapt, by working with their tenants to keep them open and improving their projects to deal with whatever the future brings. After all, none of us could have predicted what happened in 2020. Isn't it safe to say the same thing about 2021?

OFFICE LEASING IN 2021: SOME LIGHT AT THE END OF THE TUNNEL

by Andrew Ouvrier

Andy's practice focuses on the leasing and development of office, retail, medical office and mixed-use properties. He has a proven track record of structuring, negotiating and executing complicated deal transactions for a wide variety of clients, including institutional investors, entrepreneurial individuals and entities, and institutional tenants. He also regularly represents landlords in the ongoing management of office projects and retail shopping centers.

2020 will be remembered as a year of great tragedy and upheaval for many reasons, but first and foremost for the ravages wrought by the COVID-19 pandemic. The pandemic affected everyone and changed everyday lives and habits. People avoided close contact with family and friends, faced shortages of basic necessities, and were forced to learn and interact in a virtual environment. The pandemic even turned some of our most routine tasks, such as going to the grocery store, into new and potentially risky adventures.

The COVID-19 pandemic also profoundly affected the economy and the U.S. real estate markets. While the COVID-19 pandemic has been particularly devastating on the retail sector, principally due to mandatory closures of a variety of retail operations such as restaurants, health clubs and the like, the office leasing market was not spared from the impacts of the pandemic. With many smaller tenants unable to pay rent, some landlords worked to provide rent abatement or other forms of rent relief to help keep these tenants in business. In many areas where office tenants were unable to make rental payments, vacancy rates have gone up while rental rates have gone down. Fortunately, unlike most retail industries where employees need to be on-site to perform their tasks, the nature of office work makes it far easier for employees to be able to work remotely from home, and in 2020 many office employees shifted to working from home for the first time in their working careers. As a direct result, the actual utilization of leased office space dropped significantly in 2020, resulting in a precipitous drop in the volume of office leasing activity, especially in denser office environments such as central business districts.

With the recent surge in COVID-19 cases across the country, it is clear that the pandemic's effect on all aspects of our economy, including office leasing, will continue to be with us far longer than most people had hoped. However, while no one can predict what 2021 will look like, we do think the outlook is far brighter than in 2020 because the COVID-19 pandemic will eventually subside. Some experts predict that, even with the (hopefully soon) wide-spread availability of vaccines, "normal" life will not return to the United States before the third quarter of 2021, with the real estate industry lagging somewhat behind. We think it is safe to say that only when life returns to some semblance of normalcy will we see an increase in office space use and a corresponding increase in office leasing activity.

So, while there is some uncertainly as to when the "return to the office" will occur, there are some factors that will have large scale effects on office leasing activities in 2021.

> While the COVID-19 pandemic has been particularly devastating on the retail sector, principally due to mandatory closures of a variety of retail operations such as restaurants, health clubs and the like, the office leasing market was not spared from the impacts of the pandemic.

The first factor is that the return of employees to the office environment will not happen all at once, but will instead occur gradually as employers and employees alike assess their office environments and the effectiveness of improvements and policies intended to support social distancing. Companies may also seek additional protections from their office building landlords in the form of touchless technologies before allowing their employees to return in person. This gradual return will limit office leasing activities in the immediate future as companies wait to enact long term leasing plans while they evaluate their space requirements and weigh their leasing options.

The next factor is the effectiveness of remote working. As cities went into lockdown, many companies were left with no choice other than to switch to working remotely. One study suggests that up to 88% of office-based companies encouraged or mandated working from home in response to the pandemic. Even though many companies allowed employees to work remotely before the COVID-19 pandemic, working from home has now become the new standard for many office employees. Working from home has been, in broad terms, far more effective than most had expected due to the many new video and teleconferencing tools available on the market. Remote working also saved workers a considerable amount of time by eliminating commutes. One study indicated that workers saved an average of 227 hours per year (or the equivalent of 28 eight-hour work days) that can be used for either work or play. Remote working also saves many companies money that would have been spent on other costs, such as parking, meals and travel expenses. For these reasons, companies may need to continue offering employees the ability to work from home even after there is a return to the office. Companies may find it necessary to offer remote working as an amenity in the ongoing effort to attract new talent and retain existing employees who have grown accustomed to the freedoms and flexibility that working from home offers, even after the abatement of office density control measures imposed in response to social distancing requirements. It is important to note, however, that remote working may not be for everyone. For example, remote working is less likely to be an effective alternative

to the office in situations where employees lack adequate space and/or privacy to work from home, or where high-speed internet is unavailable or unaffordable.

We anticipate that the trend of remote working will continue in the foreseeable future. Remote working doesn't always mean working from home, and can just as easily be done in smaller satellite offices. This trend favors those companies with less centralized offices, as opposed to centralized offices often found in higher density central business districts, and with more satellite offices in suburban areas closers to employees' homes.

While we expect increased leasing activity in all office leasing sectors, we anticipate seeing the greatest rebound in leasing activity in Class A and medical office properties, and with technology users.

The last factor is the need to increase the amount of office space available per employee in order to meet social distancing requirements. Once the pandemic struck, many office building landlords implemented operational and physical upgrades at their buildings in order to comply with governmental requirements and public health and safety recommendations. When employees begin returning to the office environment in significant numbers, we will see this extend to the interior of office spaces, resulting in tenants likely requiring more space on a per-employee basis than before COVID-19.

The trend toward remote working, with less employees in an office on any given day, will likely translate into a push towards smaller office size and a corresponding decrease in office rental rates. The need for additional space per worker, however, will have the opposite effect and will likely translate into a push towards larger office spaces and a corresponding increase in office rental rates. While the full effect of both of these trends is impossible to predict, we anticipate that these two trends will, at least in the short term through 2021, tend to offset one another.

While we expect increased leasing activity in all office leasing sectors, given the factors mentioned above, we anticipate seeing the greatest rebound in leasing activity in Class A and medical office properties, and with technology users.

Studies have shown that Class A properties typically experience a greater rebound in leasing activity and rental rates after a recession than Class B properties, and we expect that trend to continue as part of the post COVID-19 office leasing recovery. It wasn't that long ago that touchless technologies in office buildings, such as app-based or facial recognition at building entrances and elevators, would have been considered an amenity, but tenants who are now returning to the work place will expect touchless technologies or other high-level social distancing/ safety measures to have been implemented by their landlords. The availability of such technologies will also be a differentiator for tenants in evaluating new spaces for leasing. Since Class A properties are in the best position to provide these often-costly technologies, we anticipate they will see the greatest rebound in office leasing activity. Additionally, many companies who reduced the amount of space they leased during the COVID-19 pandemic may need to lease Class A flex space and other short-term spaces in order to solve short term space needs as their employees return to the office, or to serve as satellite offices in suburban areas close to employees' homes. Additionally, as we move forward in a post COVID-19 world, we will likely see new Class A office product designed with touchless technologies and other social distancing requirements in mind.

The COVID-19 pandemic has made the need for readily available medical care all the more evident. In addition to COVID-19, a confluence of factors, such as the aging U.S. population and increasing lifespans, rising medical costs, new medical technologies/outpatient procedures, and insurance companies' push for outpatient care in an effort to reduce costs, has caused an increase in demand for medical services at medical offices, rather than at more traditional hospital or surgery center settings. As a result, we expect to see steady growth in medical office demand in 2021.

The COVID-19 pandemic also has posed unique office development challenges for the tech industry. Before the pandemic, many "tech" companies invested heavily in promoting a robust corporate culture. For these companies, the office environment is not only a work environment, but also a social environment, and tech companies worked to offer their employees a live/work/play type of balance in their office spaces. Larger tech companies have provided amenities such as cafeterias, fitness centers, access to health professionals, private work spaces for focused work and open environments for communal work and engagement. Tech companies have been willing to provide these amenities in an effort to make an office environment more of a community and to attract and retain "talent". Remote working is at odds with this type of culture, and while tech companies currently offer the ability to work from home, they will push to have their employees back in their offices as soon as it is safe to do so. The tech sector was the largest single source of demand for office space in the U.S. in both 2019 and 2020, and we expect that this trend will continue in 2021 as tech companies continue to seek office space to physically accommodate their employees. We also expect that developers and landlords with office space positioned to provide the types of amenities stated above will have advantages in their leasing activities.

Only when there has been a substantial containment of the COVID-19 pandemic, and a significant number of employees return to the office environment, will the full impact on office leasing activity be known.

In summary, so long as the COVID-19 pandemic continues to rage through the United States, office leasing activity will continue to be slow. Only when there has been a substantial containment of the COVID-19 pandemic, and a significant number of employees return to the office environment, will the full impact on office leasing activity be known. Several factors, including working from home, which will tend to push down occupancy and rental rates, will be offset by the need to lease additional space so that employees can maintain social distance standards, which will tend to increase occupancy and rental rates. It is expected that some office leasing sectors, such as Class A properties, medical office properties, and technology users, will lead the rebound in office leasing activity in 2021.

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The Retail and Commercial Development Group of Cox, Castle & Nicholson LLP has extensive experience in acquiring, developing, constructing, leasing, financing, and disposing of all types of retail projects, including regional enclosed malls, lifestyle community centers, neighborhood centers, as well as office and mixed-use projects. Members of the Retail and Commercial Development Group include attorneys who are experts in sales and acquisitions, reciprocal easement agreements, development and management agreements, and leasing, and generally represent shopping center, office, and industrial developers, as well as major retailers.

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