PATTERSON
REAL ESTATE ADVISORY GROUP

CAPITAL VIEWS

PATTERSON PERSPECTIVE
AND WE MARCH FORWARD

LANCE PATTERSON, ***Chief Executive Officer***
lpatterson@pattersonreag.com

I assume that if you're reading this newsletter, you're either my mom, my mother-in-law, or you work in the commercial real estate industry. At least for the latter group, I don't need to tell you about the challenges we're facing in our industry. We're all experiencing it – bankers, big institutional equity investors, individual investors, debt funds, life insurance company lenders, brokers, architects, etc. And while I've personally felt embattled this year as we try to make our way through the environment, I've also been pretty encouraged not only by what our company has been able to accomplish, but also by where I think we have opportunities in our industry.

I want to spend some time on those opportunities, but I also think it's important to be realistic about the challenges. Laying them out, here's where I think our industry sits and will be for the balance of this year:

- Construction debt from all sources is scarce, but especially so among banks. For reasons specific to banks (funding source is deposits, heavily regulated) and for reasons endemic to all lenders (not getting loans paid off), the vast majority are on the sidelines for construction debt. I don't see this changing for the rest of this year.
- For non-bank construction lenders, there has been some talk about trying to "fill the void," but to date, this has been very limited, with the few new entries generally being lower-levered and still pretty expensive.
- Interest rates have remained high, and it doesn't feel like they'll decline to any great extent this year and even well into next year. This will continue to make transactions difficult to underwrite and will chill activity in our industry.
- I have written about the difficulties of office as a product type now for well over a year. My belief is on an <u>overall</u> basis (with exceptions for specific buildings) office has gotten worse this year and still has a ways to go to hit its nadir. We will be struggling and dealing with what this means for our industry for many, many years.

With that addressed, what are the positives?

- Property level performance (other than office) overall is good. I know there are some specific properties, maybe certain sub-markets for various product types, that are soft, but overall properties are finding tenants/ users, rents are holding up or continuing to increase and most capital stacks remain in pretty good shape. For those older readers, you'll remember this was not the case during the GFC 15 years ago.
- We've seen some reductions in construction costs. These are still limited and largely focused on stick-built product, but it's happening. I personally don't believe

we'll see substantial reductions in construction costs, but even a leveling of the growth is a positive outcome.

- Despite my concerns about office as a product type, we've done a good bit of research on the impact the decline in office values might have on our industry. My conclusion is that it won't have the substantially dire effect that we're reading about in the press. I am well aware of numerous specific problem office loans/valuations. I know there is a lot more to come and also that many people will suffer large losses. But overall, the banking industry is very well capitalized, and even severely negative declines in office values can be handled. Most losses on office loans/investments will happen within CMBS and/or the debt funds, meaning losses will be borne by larger, institutional investors vs. retail investors/FDIC insurance.

- Most equity investors have been on the sidelines for the past year, and most will likely stay on the sidelines for the balance of this year. It doesn't mean they aren't willing to invest. It's just that no one feels compelled to invest, In order to get this type of capital interested in doing a deal, the "bar" for what qualifies is usually too high for most situations. My belief is that this is changing now as the angst of not doing anything new since summer of 2022 will cause this bar to lower.

- The "other side" of the higher interest rate environment that we're experiencing is the general sense from most of us that the rapid increase in rates is likely over. I personally believe we'll see one more increase in the Fed Funds rate, but thereafter, even without significant reductions, this stabilizing of rates will be a positive both for new development and for acquisitions/sales of existing product. And while it's still early, given that we'll have a presidential election next year, this will provide further pressure on keeping rate increases from happening.

- While actual property sales are modest compared to the recent past, they are occurring – and are doing so at cap rates that are pretty good for the sellers. We expect this trend to accelerate given the stabilizing interest rate environment.

- For those of us in the Southeast or Southwest, we continue to benefit from strongly positive demographic trends. This is not going to change in the future.

- Rickie won!

And Now, The End

There has been lots of action in our company this year! It's amazing to think that only a few years ago our annual Christmas party was about 12 people – and that included spouses, significant others and half of the service staff. Now, with 26 of us in the company, it's hard to keep up with everything going on with our people. But here's a sample: Katie Busch, who joined our firm three years ago then left one year ago to pursue her dream of living in Colorado, chose to come back to us early this summer – welcome back Katie! Walker Saint, our summer intern in 2022, graduated from Wake Forest this May and has recently joined our firm full-time. Welcome Walker! To our two summer interns in 2023 – Pfifer Blackman and Jack Tucker – thanks for being with us! Cameron Peterson, our spring intern, will intern for us again this fall – look forward to having you back, Cameron! We also have lots of upcoming marriages – newly engaged Austin Smith (to Lauren), Emily Harte (to Hudson) and Jordan Johnson (to Kendall). Congratulations to the three of you! And lots of babies – congratulations Laura Friddell (Mac) and Javi Morales (Matias) on the births of your first children, and Margaret Wells on baby #2 (George). And a nod to Ken Grimes and everything he's done in Charleston; we've even picked up our first Chief Art Officer – that being his young daughter Stella.

All the best to everyone for the balance of 2023 - I'm sure there's more to come!

2023 SELECT TRANSACTIONS

CLIENT	**THE MATHEWS COMPANY**
PROJECT	**615 3RD AVENUE**
MARKET	Nashville, TN
TYPE	Office
ASSIGNMENT	Equity

CLIENT	**NEWSTAR ASSET MANAGEMENT**
PROJECT	**VILLAGE PARK CENTER**
MARKET	The Villages, FL
TYPE	Build-to-Rent Community
ASSIGNMENT	Construction Debt

CLIENT	**LOUDERMILK COMPANIES**
	REGENT PARTNERS
PROJECT	**THOMPSON BUCKHEAD**
MARKET	Atlanta, GA
TYPE	Hotel
ASSIGNMENT	Bridge Debt

CLIENT	**VENTURES DEVELOPMENT GROUP**
PROJECT	**THE SOUTHERLY AT HERON CREEK**
MARKET	North Port, FL
TYPE	Multifamily Development
ASSIGNMENT	Construction Debt

CLIENT	**TRITEN REAL ESTATE PARTNERS**
	ANGELO GORDON
PROJECT	**PORT OF SAVANNAH IOS PORTFOLIO**
MARKET	Savannah, GA
TYPE	IOS
ASSIGNMENT	Acquisition Debt

CLIENT	**CARTER**
PROJECT	**STORY UNIVERSITY NORTH**
MARKET	Charlotte, NC
TYPE	Multifamily Development
ASSIGNMENT	Construction Debt

CLIENT	**HIGH STREET LOGISTICS PROPERTIES**
PROJECT	**PERIMETER PARK WEST PHASE II**
MARKET	Orlando, FL
TYPE	Industrial
ASSIGNMENT	Construction Loan

CLIENT	**ANIMAL GROUP HOLDINGS**
PROJECT	**410 MINT STREET**
MARKET	Charlotte, NC
TYPE	Parking
ASSIGNMENT	Bridge Debt

CLIENT	**ANIMAL GROUP HOLDINGS**
PROJECT	**IMAGE AVENUE ASSEMBLY**
MARKET	Atlanta, GA
TYPE	Land
ASSIGNMENT	Land Loan

CLIENT	**ANIMAL GROUP HOLDINGS**
PROJECT	**11TH STREET**
MARKET	Atlanta, GA
TYPE	Land
ASSIGNMENT	Land Loan

CLIENT	**NEWSTAR ASSET MANAGEMENT**
PROJECT	**HADLEY CROSSING**
MARKET	Charlotte, NC
TYPE	Build-to-Rent Community
ASSIGNMENT	Construction Debt & Equity

CLIENT	**CORE5 INDUSTRIAL PARTNERS**
PROJECT	**C5 ENCORE LOGISTICS CENTER**
MARKET	Cincinnati, OH
TYPE	Industrial Facility
ASSIGNMENT	Construction Debt

CLIENT	**IVEY GROUP**
PROJECT	**WEST PARK**
MARKET	Augusta, GA
TYPE	Build-to-Rent Community
ASSIGNMENT	Construction Equity

CLIENT	**NAI EARLE FURMAN**
PROJECT	**HUNTER INDUSTRIAL**
MARKET	Greenville, SC
TYPE	Industrial Development
ASSIGNMENT	Construction Debt & Equity

CLIENT	**S.J. COLLINS**
PROJECT	**THE KELLY**
MARKET	Panama City, FL
TYPE	Multifamily Development
ASSIGNMENT	Construction Equity

CLIENT	**TRUX**
PROJECT	**TRUX PARKING SITES**
MARKET	Various
TYPE	Parking and IOS
ASSIGNMENT	Acquisition Debt & Equity

CLIENT	**HIGH STREET LOGISITICS PROPERTIES**
PROJECT	**KENNESAW INDUSTRIAL PORTFOLIO**
MARKET	Kennesaw, GA
TYPE	Industrial
ASSIGNMENT	Acquisition Debt

CHARLESTON AND PATTERSON – GROWING UP TOGETHER!

KEN GRIMES, *Senior Managing Director and Partner*
kgrimes@pattersonreag.com

While Charleston dates its roots to 1670 and Patterson to 2009, we share a common bond in truly growing up together over the past 13 years. Both experienced growth and changes resulting in an altered landscape, both physically and psychologically. In 2009, Charleston was an award-winning, internationally acclaimed tourist destination, but there was little in terms of employment opportunity that wasn't in some way reliant on the tourism industry. Today, Charleston boasts a broadly diversified economy thanks to an influx of technology, state-of the art manufacturing and its world-class port. Similarly, in 2009, Patterson was a two-man, Atlanta-based shop just getting its start. Today the firm employs 26 full-time people with offices in Atlanta, Charleston, Charlotte, Dallas, Nashville and Tampa.

While you can speculate as to correlation or causation, once we "opened" the Patterson office in 2010, the expansion and diversification of the Charleston economy was lit by jet fuel, literally. With the announcement of Boeing in 2010, Volvo and Mercedes in 2015, and most recently, Redwood Materials (EV batteries) in 2022, Charleston has found itself in a hotbed of high-tech manufacturing supported by one of the nation's top container ports. These manufacturers provide high paying engineering jobs, and the multiplier effect within the community is now visible in technology, housing, port and other service-related industries.

So, in thinking about how to highlight the Charleston market in this newsletter, we thought it would be helpful to take a look at the past decade or so of change as a way to give a bit of a road map for the region's future growth. In the paragraph above, I used air quotes around "opened" since our introduction to Charleston was strategic luck, as we've found is often the case with Charleston transplants. When Lance Patterson started the company

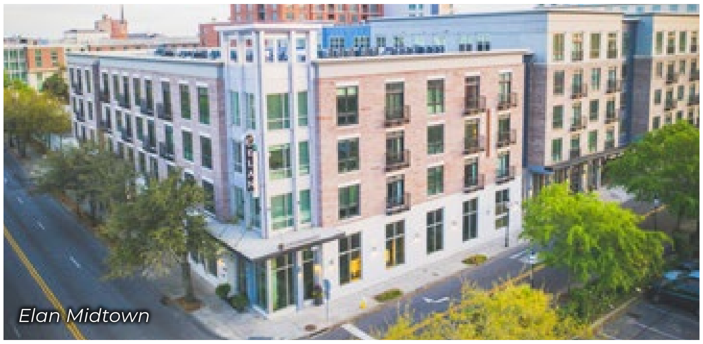
CHARLESTON GROWTH

	2010	2023
POPULATION (MSA)	668,000	836,000
MULTIFAMILY		
TOTAL UNITS	35,000	65,000
AVG RENT	$1,000	$2,000
MEDIAN HOME PRICE	$254,000	$615,000
OFFICE		
TOTAL SF	27M	34M
PEAK RENT PSF	$20.00	$50.00
INDUSTRIAL		
TOTAL SF	32M	63.3M
AVG RENT PSF	$4.00	$8.00
HOTEL		
TOTAL ROOMS	17,700	23,000
AVG ROOM RATE	$200	$350

and we were talking about working together, I was trying to convince my now wife to move from San Francisco. Atlanta just wasn't going to be in the cards. We visited Charleston once and decided quickly it was the place for us. Thanks to Lance's well-known flexibility, I became an early-stage remote worker.

In meetings, we would reference under our breath that I was in Charleston. The rest of the conversation would then shift to the topic of Charleston as a growing market with increasing interest from institutional capital. After about the tenth time that happened, we decided that we had a Charleston office and pretended we had done that on purpose. Better to be lucky than good. Thanks to our friends at Regent Partners, an early assignment of Patterson was a mixed-used project called Midtown Charleston, which eventually became development of the dual branded Hyatt Place / Hyatt House and Greystar's Elan Midtown on the upper (now core) part of the peninsula.

Hyatt House



Elan Midtown

In hindsight, the Midtown transaction represented a catalyst for Charleston by planting a significant flag up the peninsula and expanding its core, but also by proving the viability of residential development in downtown Charleston. Prior to Elan Midtown, the most expensive sale in the Charleston MSA was Beach Company's Watermark development in Mount Pleasant at approximately $160k per door. Charleston did not have a structured parking multifamily development in the entire area. But, relying on their hometown knowledge, Greystar forged ahead with Elan Midtown at a cost of $200k per door – with rents and an exit sale price that were totally unsupportable by existing data. At stabilization, Elan Midtown sold for $320k per door, and the realization that Charleston was a rising star quickly settled in with the development community.

RESIDENTIAL

As evidence of the above, the Charleston MSA had approximately 35,000 multifamily units in 2010, and currently has more than 65,000 with 5,900 more units in the active development pipeline. With more than 30 people a day moving to the area, the demand for residential of all types remains high. Despite increased supply, average rents have almost doubled in the last decade – from $1,000 to near $2,000 per month. The highest rent levels have gone from $1.50 PSF to the upper $3.00s PSF and are now charting north of $4.00 PSF. Additionally, the median price of a single-family home has increased from $254,000 to $615,000 since 2010 – an increase of nearly 150%. And, with the average days on the market hovering around 40, the Charleston MSA continues to illustrate its appeal. In 2010, 668,000 people called the tri-county area home. Today that number is approximately 836,000 and is estimated to crest at one million people by the end of the decade.

JOBS

Perhaps the most dramatic shift in the landscape of Charleston has been the significant evolution of its economy away from just its appeal as a tourist destination. This evolution is what is primarily driving Charleston's robust development pipeline across all asset types. Since 2010, there has been more than $6 billion dollars in private corporate investment into the region, creating almost 10,000 direct jobs. With the average multiplier effect, this results in almost 50,000 new jobs in the region. While the headlines of Boeing, Volvo and Mercedes lead the charge in high-tech manufacturing, the Charleston MSA is working to the earn the nickname of "Silicon Harbor" by participating in the EV revolution with battery plants and associated technology.

With an annual economic impact of approximately $63 billion to the state of South Carolina, the Port of Charleston is the engine that drives a wide variety of industries. While the economic slowdown has reduced volume this year, the Port of Charleston handled nearly 2.8 million twenty-foot equivalents in 2022 which represents the most containers in its history.

SC Ports of Charleston

One of the oldest and most impactful economic contributors to the Charleston MSA is the Medical University of South Carolina (MUSC). Since its founding in 1824, MUSC has been a leading employer in the region and has a total annual economic impact of more than $4.6 billion corresponding to more than 30,000 jobs.

The core drivers above lead to a wider diversity of jobs as the healthcare, financial, restaurant, education, legal and other service industries expand to meet the needs of companies doing business in the low country. Additionally, proactive groups like the Charleston Digital Corridor, South Carolina Research Authority (SCRA), Harbor Entrepreneur Center and the Charleston Regional Development Alliance are working daily to ensure the creative, entrepreneurial nature of Charleston is nurtured to allow for organic expansion of home-grown companies in technology and other industries.

OFFICE

As a smaller market, Charleston's office inventory has long consisted of charming (small), inefficient (cramped), historical (old) buildings that were converted to suit a need along with a limited number of purpose-built office buildings downtown, near the airport and scattered about the suburbs. Neither office rents nor demand justified large scale office development, so buildings were added slowly, and the market remained tight, but uninspired. In the current environment, one might think the prospect for office development would be further constrained, but Charleston is one to buck the trend. Starting with 22 WestEdge in the medical district, Portside Ferry Wharf in Mount Pleasant and followed by Charleston Tech Center, The Morris and Morrison Yard Office (Patterson's current office location), the core of Charleston has seen a boom in Class-A office construction. And despite the headlines – it's working!

Morrison Yard

Since 2010, peak office rents have gone from the mid $20s to almost $50.00 PSF plus parking. Total office inventory has increased more than 25% to exceed 34 million square feet, with vacancy rates in the single digits, resulting in a robust and growing market. This growth attests to the strong impact of Charleston's population growth and job migration on demand, particularly in light of the trending hybrid workplace.

INDUSTRIAL

The industrial boom in East Coast port cities continues in Charleston, evidenced by the sustained growth in its industrial activity since the Panama Canal expansion which was further accelerated by West Coast supply chain issues during COVID. With a vacancy rate of less than 1% over the past six quarters, industrial demand is outstripping supply. But developers are working hard to fix that! The total market today sits at 63.3 million square feet, and there is more than 13 million square feet under construction. Comparatively, total market inventory was 32 million square feet in 2010 with a vacancy factor of 11% and little under construction. Average rental rates in 2010 were approximately $4.00 PSF, while today's peak rental rates are north of $8.00 PSF. With developable land running scarce, the industrial market continues to move out from I-26 with activity past I-95 and on the way to Columbia.

HOTEL

For decades, Charleston has been in the headlines as a world-class tourist destination – winning awards every year. This has resulted in a robust hospitality industry reinforced by the lack of developable land (it is a peninsula after all) as well as extremely difficult design (Board of Architectural Review) and zoning regulations. Together, these factors create a rate and occupancy dynamic that makes the extreme investment a worthwhile one. Despite regulations limiting many sites to only 50 rooms, the Charleston hotel market grew more than 30% from 2010 to 2023, now totaling more 23,000 rooms. On the Peninsula, the average room rate in 2010 hovered around $200 per night compared to more than $350 today – which is also reflective of the year-round demand. With several hotels under construction for more than $1 million per key, the expectation is those rates will continue to climb. Charleston's historic limitation on development combined with an aggressive limitation of short-term rentals results in a hospitality market on par with New York or the Florida Keys.

CAPITAL

Always follow the money! For a market of its size, Charleston has always had more than its fair share of institutional capital interest. However, due to deal size and long-term ownership, there has historically been a lack of opportunity to place capital. That said, a few groups like Prudential were early adopters of the Charleston MSA and have now been joined by their peers. Platforms like PIMCO, JP Morgan, MetLife, State Street, PacLife, Hartford, Stockbridge, Blackstone, Morgan Stanly, KKR and Brookfield are all making their investment mark on the region and looking for more. While the expanded market has resulted in greater deal size and more opportunities, there is still a lack of transactions due to the long-term hold mentality, which results in a pricing premium when quality assets come to market.

SUMMARY

While our industry is cyclical by its very nature, and our current climate is one of confusion, there are markets that break the cycle and spend decades on a positive trajectory. Austin is a proven example, and Nashville is a work-in-progress. Both are markets that have played through difficult cycles without missing a beat. While it may be too early to call this one, it seems that since 2010, Charleston has been on a run that is setting the foundation for similar long-term success. Charleston's broad diversification of industry, colonial city charm and access to world-class restaurants and entertainment results in an unmatched quality of life for visitors and those now participating in its primary economy.

A fun note to end this article – earlier this month, Charleston won Travel + Leisure Readers' No. 1 Favorite City in the United States designation, marking the 11th time since Patterson's office opened here in 2010!

If you're contemplating a project or investment in the Charleston area, don't hesitate to give us a call to talk through – we enjoy talking shop and never have a shortage of opinions!

Data Sourced From: Charleston Regional Data Center, CoStar, showingtime.com, Charleston County Economic Development, South Carolina Ports Authority, Medical University of South Carolina

CONNECT WITH US

LANCE PATTERSON
Chief Executive Officer
lpatterson@pattersonreag.com
404.504.6683 | Atlanta, GA

KEN GRIMES
Senior Managing Director
kgrimes@pattersonreag.com
404.504.6685 | Charleston, SC

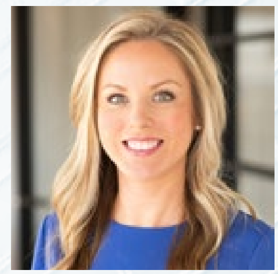
BILL MEALOR
Senior Managing Director
bmealor@pattersonreag.com
404.504.6687 | Atlanta, GA

TODD FLAMAN
Senior Managing Director
tflaman@pattersonreag.com
404.504.6677 | Atlanta, GA

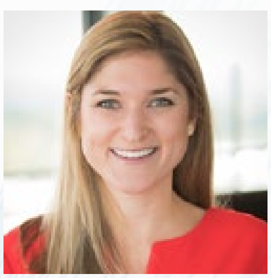
BARRY OLSON
Senior Managing Director
bolson@pattersonreag.com
214.347.4094 | Dallas, TX

DREW BARNETTE
Managing Director
dbarnette@pattersonreag.com
704.280.8705 | Charlotte, NC

LAURA CLOUD
Managing Director
lcloud@pattersonreag.com
615.410.9815 | Nashville, TN

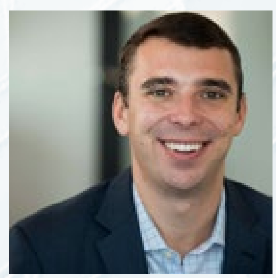


LAUREN HANLEY
Market Director
lhanley@pattersonreag.com
813.658.3230 | Tampa, FL



MARGARET WELLS
Director
mwells@pattersonreag.com
404.504.6688 | Nashville, TN

LAURA FRIDDELL
Director
lfriddell@pattersonreag.com
404.504.6693 | Atlanta, GA



AUSTIN SMITH
Director
asmith@pattersonreag.com
404.504.6676 | Tampa, FL

PATTERSON
REAL ESTATE ADVISORY GROUP

ATLANTA | CHARLESTON | CHARLOTTE | DALLAS | NASHVILLE | TAMPA

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