Real estate industry outlook

2022 research report

WIPFLI

Executive summary

Real estate firms are at a crossroads. Market conditions are changing. Sale prices are up, and inventory at the price point you're looking for is scarce.

Meanwhile, evolving expectations from investors, tenants and local governments are putting pressure on your business to adapt. And investing in new technology is increasingly a requirement in ensuring your continued profitability.

There's no better time than now to start looking at new opportunities and business strategies to create greater value for your organization.

What are these opportunities, and what are other real estate firms doing to ensure long-term success? Wipfli surveyed 198 real estate firm leaders to learn just how they're reacting to change. Their responses show that real estate is prioritizing differentiators like ESG (environmental, social and corporate governance) and technology, as well as business strategies like tax incentives and the ability to easily repurpose spaces.

This report will dive into the results of the survey, as well share key perspectives of Wipfli real estate consultants.

198
real estate firms surveyed

Across **39** states

The majority with assets under management of

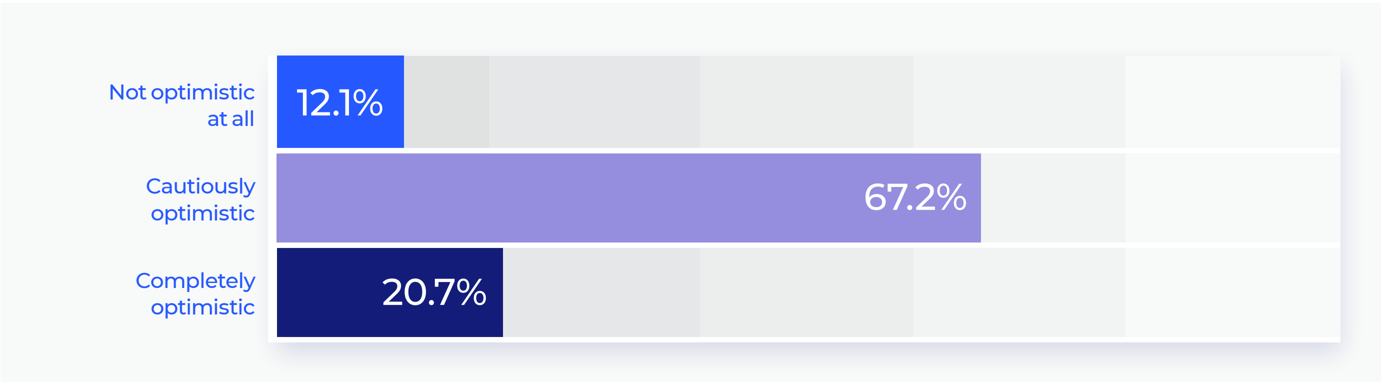
$10-50
million

Key findings

88% of respondents are optimistic about current real estate market conditions	**66%** have not changed their investing strategies in the past 12 months
77% said that ESG has impacted their investor pool or real estate projects	**38%** are moving forward on digital transformation with very clear objectives

Business strategies

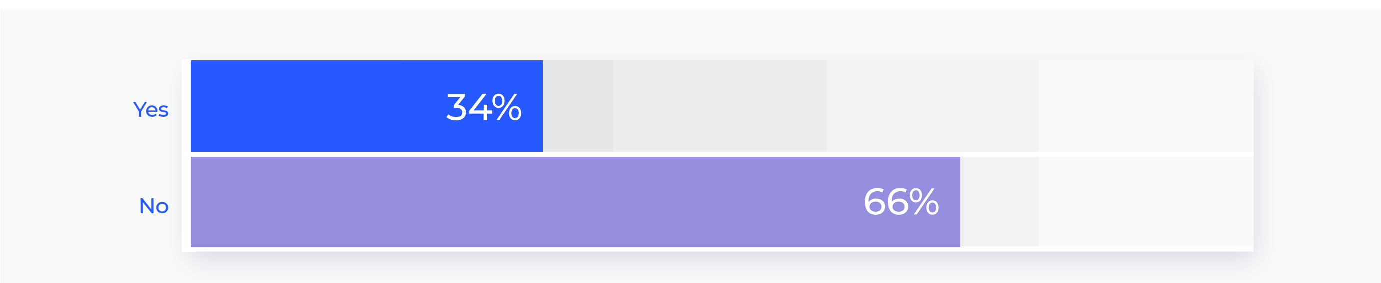
Current market conditions have created a closer relationship between the users, operators and owners of real estate. Whether it involves objective considerations such as finance or subjective considerations like ESG, these factors are playing a significant role in the decisions real estate firms make.



The majority of real estate leaders say they are either completely or cautiously optimistic about current market conditions, with only 12% saying they aren't optimistic at all.

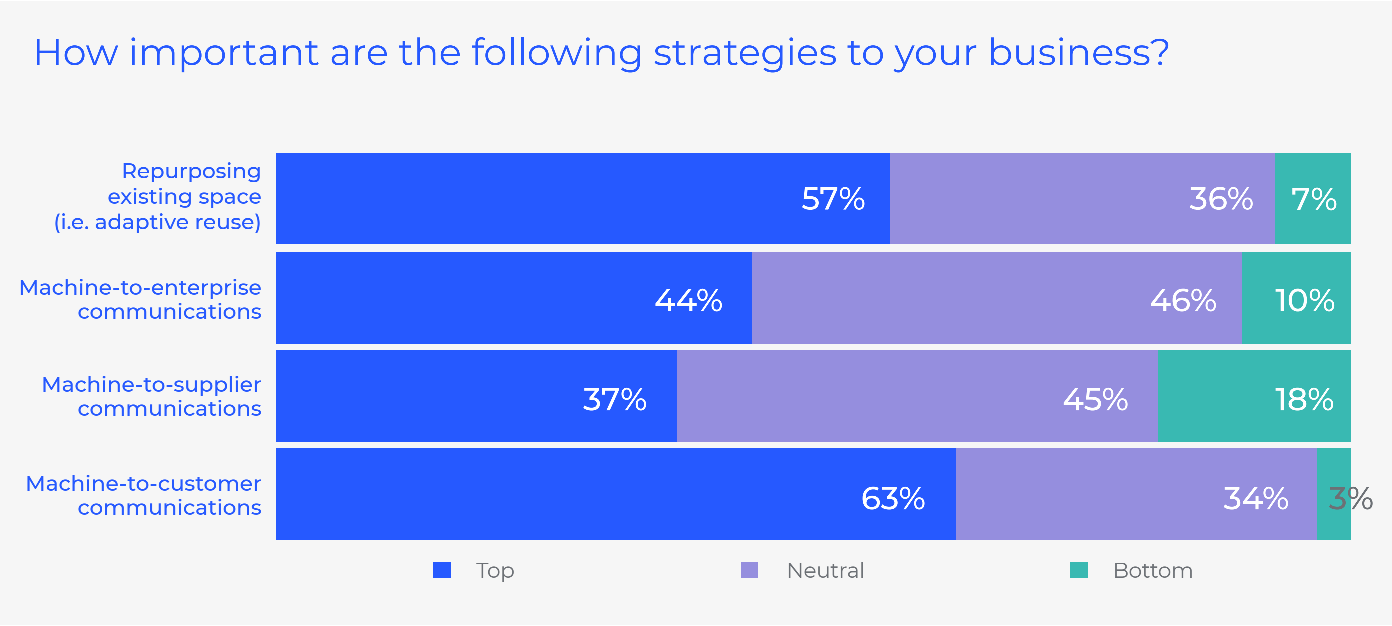
So while the level of optimism is already pretty high, 100% would likely be completely optimistic if they had the ability to find the dollars they've been leaving on the table. Many investors look at anything that doesn't directly create financial value as being cost-prohibitive. It isn't always easy to quantify how investing $5 in ESG or new technology, for example, will return $10. Yet these types of investments create greater value and allow real estate firms to be much nimbler in a changing environment.

Despite all the changes real estate has had to navigate the past three years, 66% of survey respondents haven't changed their investment strategy in the past 12 months.



Those who have changed business strategies did so in a variety of ways. They changed their portfolio mix (with a heavier tilt toward residential), shifted away from volatile markets to more stable ones, focused on ESG and sustainability, adjusted sales and construction processes to be more efficient, gave employees better training and even looked at cryptocurrencies.

But certain business strategies were more important than others. Survey respondents by far named tax incentives as their #1 business strategy compared with repurposing existing space, changing their portfolio mix or focusing on shorter leases.



Why are tax incentives so important?

To get deals done, real estate firms are looking for a bonus that helps them make the numbers work, and tax incentives are numerous. Tax credits, increment financing, government grants, specialty financing — the opportunities are out there, and real estate firms are looking for a way to add them into their current portfolio mix if they have not already.

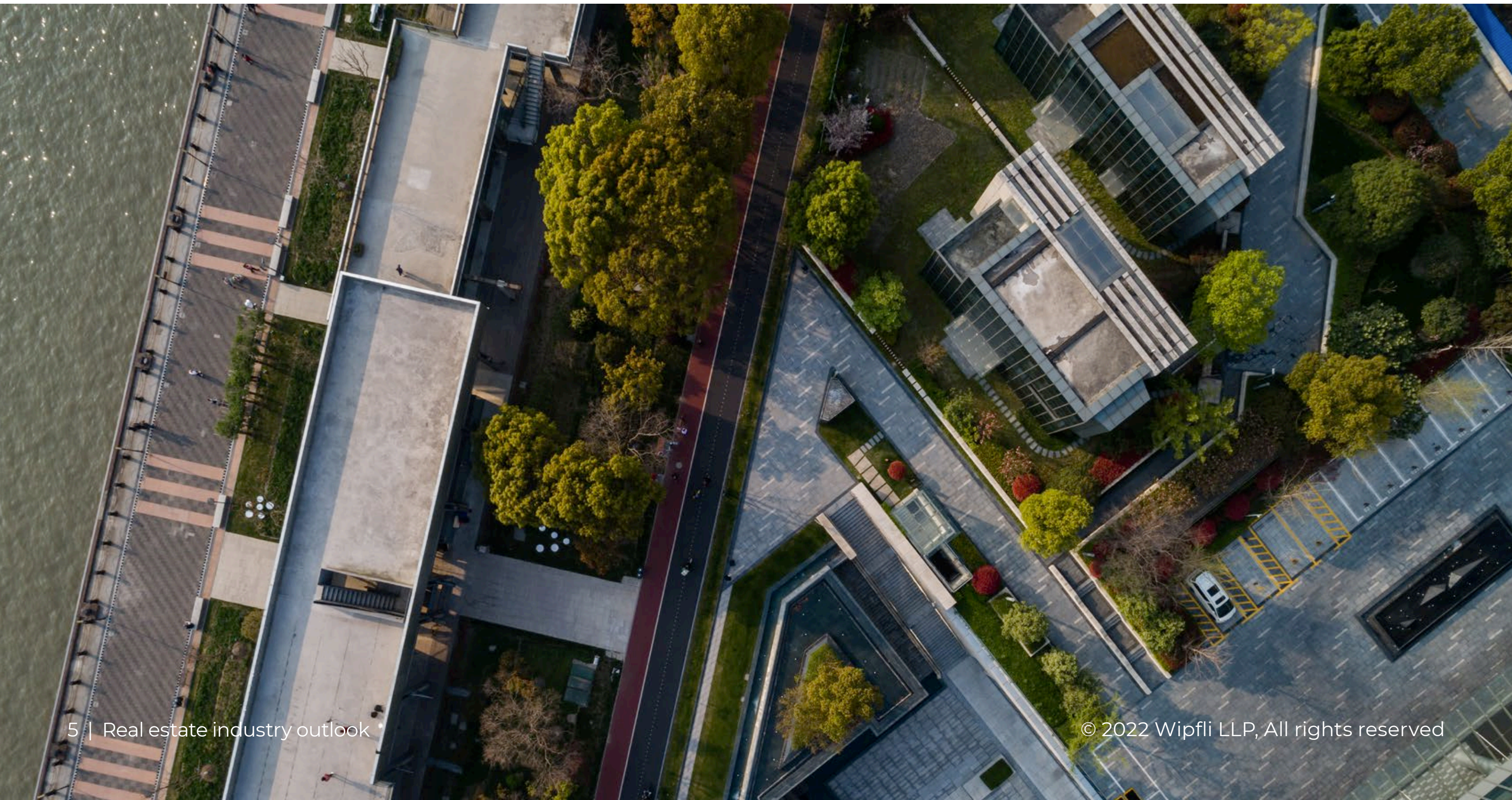
These days, counties and municipalities with approval authority are more likely to seek quid pro quo. Want to build a commercial space? Now you have to build a parking structure alongside it. Want to build an industrial complex? You're going to have to resurface an aging road nearby. The more the local government wants a specific type of real estate (such as multi-family housing), the less stickiness there will be in greenlighting projects, but if they need convincing to give you dollars, be prepared to deliver on some type of ask.

How easily can your space be repurposed?

With all the disruption created by the COVID-19 pandemic, the ability to easily repurpose space has never been more attractive. Tenants are breaking leases and paying early-exit penalties, or they're looking to renegotiate leases. Having a plan B for your space is critical because if you're making a significant investment to build out this space only to have a tenant leave in three years, how much will it cost to repurpose it for a new tenant? It's not surprising that repurposing existing space was the #2 business strategy leaders are leveraging.

Are you diversified?

Real estate investors with 100% office space have fared the worst during the pandemic. Those with more industrial real estate or family housing have been much better off. Diversification lowers risk. And it's not just industrial or housing projects you should be looking at. Other asset classes to explore include student housing, senior living and even retail and dark stores. Brands are moving toward having smaller brick-and-mortar stores, rather than being anchor tenants, in key locations (e.g., Las Vegas, Chicago, New York, Los Angeles) because data has shown that these stores actually help drive more online sales.

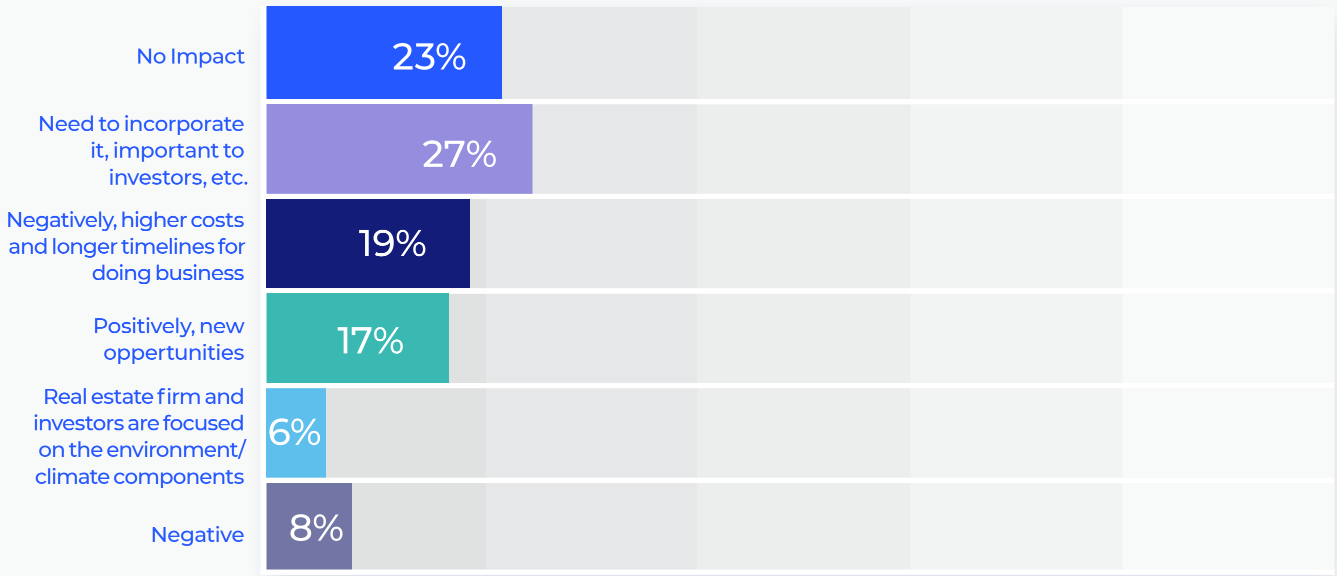


Top three barriers affecting successful deals

- Lack of inventory
- Financing limitations
- Government regulations

ESG

How has ESG (environmental, social and corporate governance) impacted your investor pool and/or real estate projects?



Nowhere more than real estate is ESG (environmental, social and corporate governance) growing to be so critical. Only 23% of survey respondents said ESG hasn't impacted their investor pool or projects. The other 77% revealed just how many ways ESG is impacting them. Some respondents noted that ESG has decreased their investor pool and made it tougher to bring in new investors. Others said it's actually increased their projects. And still others said their focus on ESG has helped them attract and retain employees. [There are plenty of benefits to ESG.]

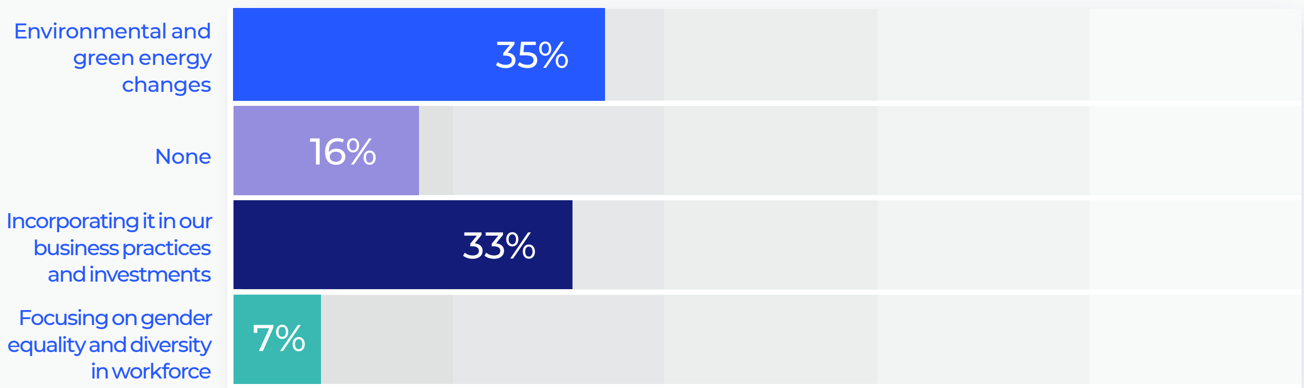
What real estate is saying about ESG

- "It's hard now to find any kind of fund that doesn't consider climate risks in some way."
- "Investors want investments to reflect social values."
- "Investors care more about what happens in the next decade than in the next quarter, and they are more likely to stay invested."
- "ESG has gained a greater importance among investors, policymakers and other key stakeholders because it is seen as a way to safeguard businesses from future risk."
- "Investor portfolios with ESG perform better than those without."

At the end of the day, it's very clear that for many real estate firms, investors are putting large sums of money into companies with strong ESG programs. The biggest question right now is how exactly you measure ESG, who should be responsible for measuring it and how you can validate your data to attest to its accuracy. But once ESG reporting becomes standardized by regulatory bodies, ESG will be vital for building a robust portfolio that attracts investment. That regulatory process is already well on its way, led by a proposal from the SEC in May 2022.

Because ESG impacts the decisions of investors, consumers, tenants and buyers, it will be critical for your real estate firm to be mindful of the financial relationships you have and whether they align with your own ESG metrics and/or goals. ESG needs to be an essential part of your decisions around new acquisitions, lease renewals, investor relations and even what other business strategies you pursue. After all, ESG incorporates social values such as DEI alongside environmental ones, which makes the work opportunity tax credit just as valuable an opportunity as green credits like the Section 179D energy-efficient tax deduction and the §45L credit.

What steps have you taken to address ESG?



It's not surprising that the majority of respondents have addressed ESG on the environmental side. Most of the leading ESG frameworks right now focus heavily on sustainability reporting, carbon disclosure and other climate change-related measures. Until a universal framework that includes the social and governance aspects of ESG emerges, this will likely continue to be the case.

Learn more.

Technology

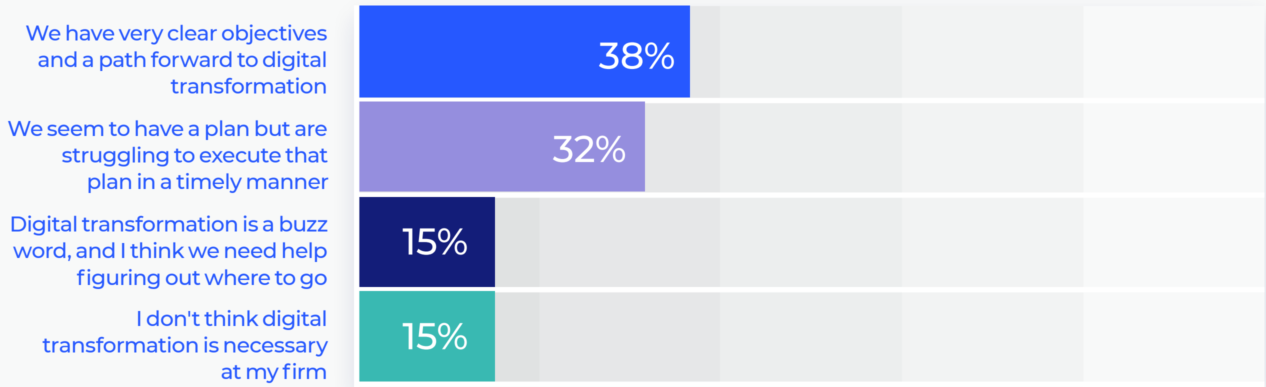
Compared with other industries, real estate lags behind in adopting new technology. There aren't government regulations driving some of the new tech you see in healthcare or financial services. And the high-volume needs seen in construction and manufacturing just don't carry over into real estate.

For years, technology adoption in real estate has depended on how big the organization is and what service lines it pursues.

The more services you perform — property management, investor relations, development — the more it makes sense to leverage technology, especially if that technology can integrate to feed into one centralized database.

Some firms believe they don't need the sophistication and connectivity offered by technologies more complex than Excel and QuickBooks. But others are recognizing just how important their digital transformation is to their future success and longevity.

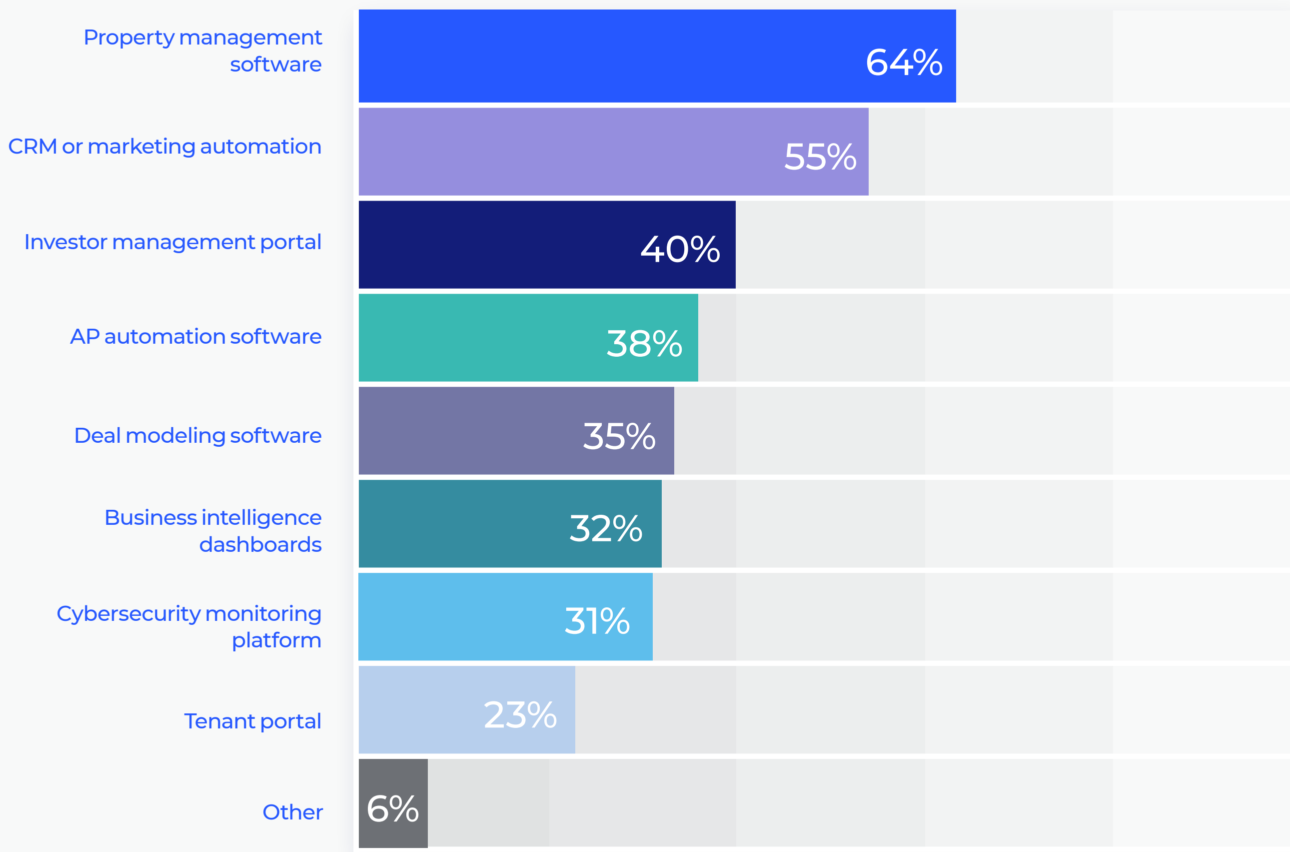
What steps have you taken to address ESG?



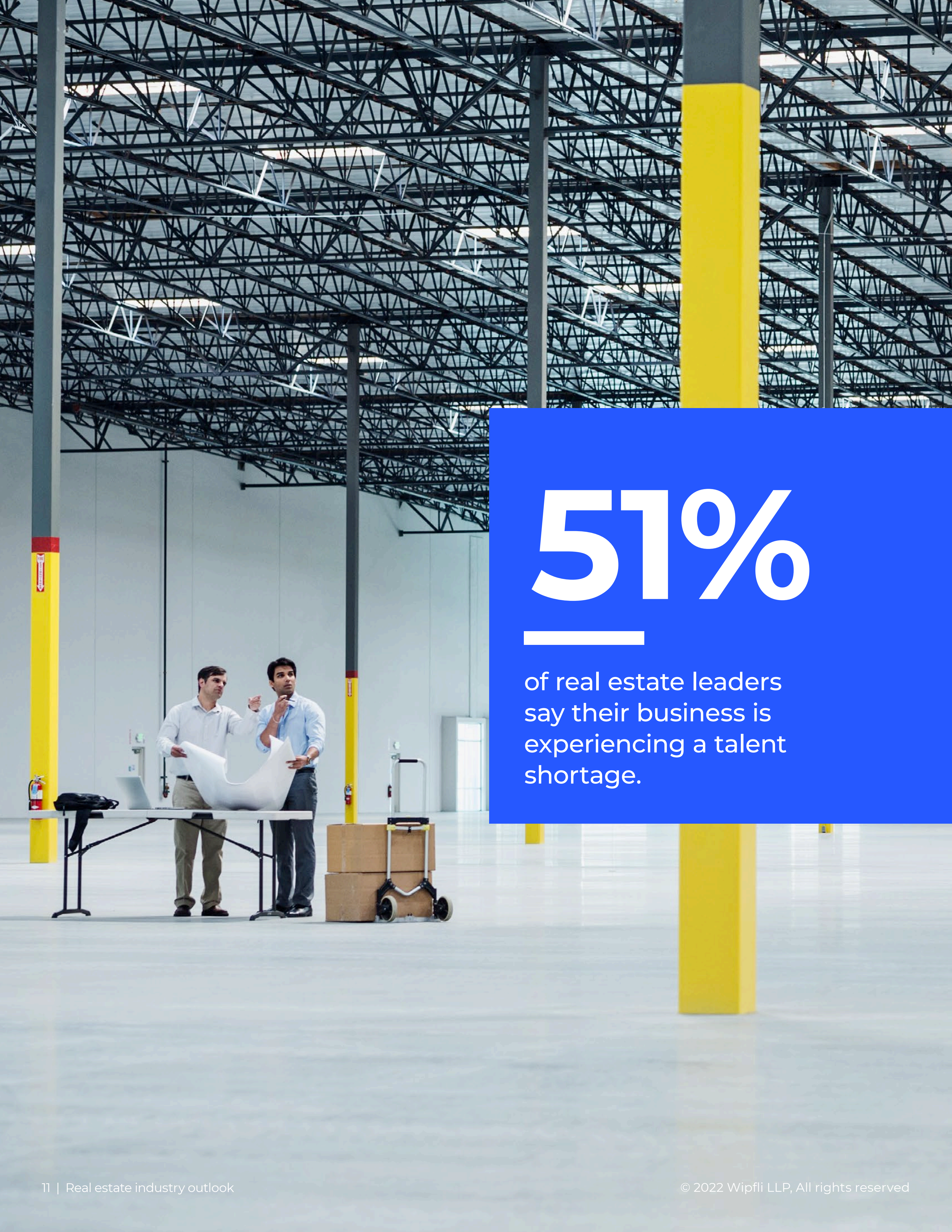
The majority of survey respondents are on their digital transformation journey, with 38% having very clear objectives to meet and 32% on the journey but [facing struggles in executing their plan](). Only 15% [don't think digital transformation is necessary at all]().

So, with a full 85% of real estate leaders recognizing the importance of digital transformation, it appears the industry is turning a corner on tech. And there are good reasons : Better products are being developed, costs are decreasing, platforms are being standardized and, perhaps most importantly, data analytics are becoming more sophisticated. Real-time reporting — the kind that pulls in data from all areas of the business and visualizes it into digestible dashboards — is directly responsible for leadership being able to make faster, better decisions.

What technology do you use for yourself/properties?



These days, technology is less about creating efficiency and convenience and [more about creating value](). If you aren't looking at how you can leverage technology to create greater value, your profitability will suffer. Technology products are already helping organizations make decisions faster, close deals faster, improve the structure of those deals and communicate better with everyone from employees to investors. Like ESG, technology is a need-to-have investment going forward if your organization is going to continue growing and competing.



51%

of real estate leaders say their business is experiencing a talent shortage.

Tackling continued disruption

Real estate is facing a wide range of challenges. The biggest appear to be inventory, financing limitations and government regulations, but survey respondents offered up plenty more. Take a look at what else showed up on the survey as being important to the industry: rising interest rates, inflation and rising prices in general, the growing labor shortage, changing workplace habits and preferences and even the length of due diligence periods and lack of reviewable information.

The survey also showed that while respondents believe the volume of deals currently being done is higher, they're also seeing significantly higher sale prices but only around the same amount of new development activity. This is putting the pressure on them to adapt quickly, but not every firm can see a clear path forward.

This report sheds light not only on big trends but also on big opportunities. Real estate firms need to look at their current business strategies, reevaluate them based on changing market conditions and leverage new or different strategies that create greater value for them. From diversifying their portfolio to leveraging the right data analytics technology, they can take steps now to set themselves up to tackle future disruption.

Looking for ways to get started? Discover how Wipfli can help you overcome your biggest challenges. And for additional resources, visit our real estate thought leadership hub.

Real estate trends

- Volume of deals are: Moderately higher (35%)
- New development activity is: About the same (36%)
- Investor expectations are: About the same (35%)
- Sale prices are: Significantly higher (41%)
- Tenant expectations are: Moderately higher (39%)


Wipfli helps real estate firms navigate an increasingly complex landscape with clarity and confidence. Others see problems. We see possibilities.
Visit wipfli.com/real-estate.
Perspective changes everything.
WIPFLI